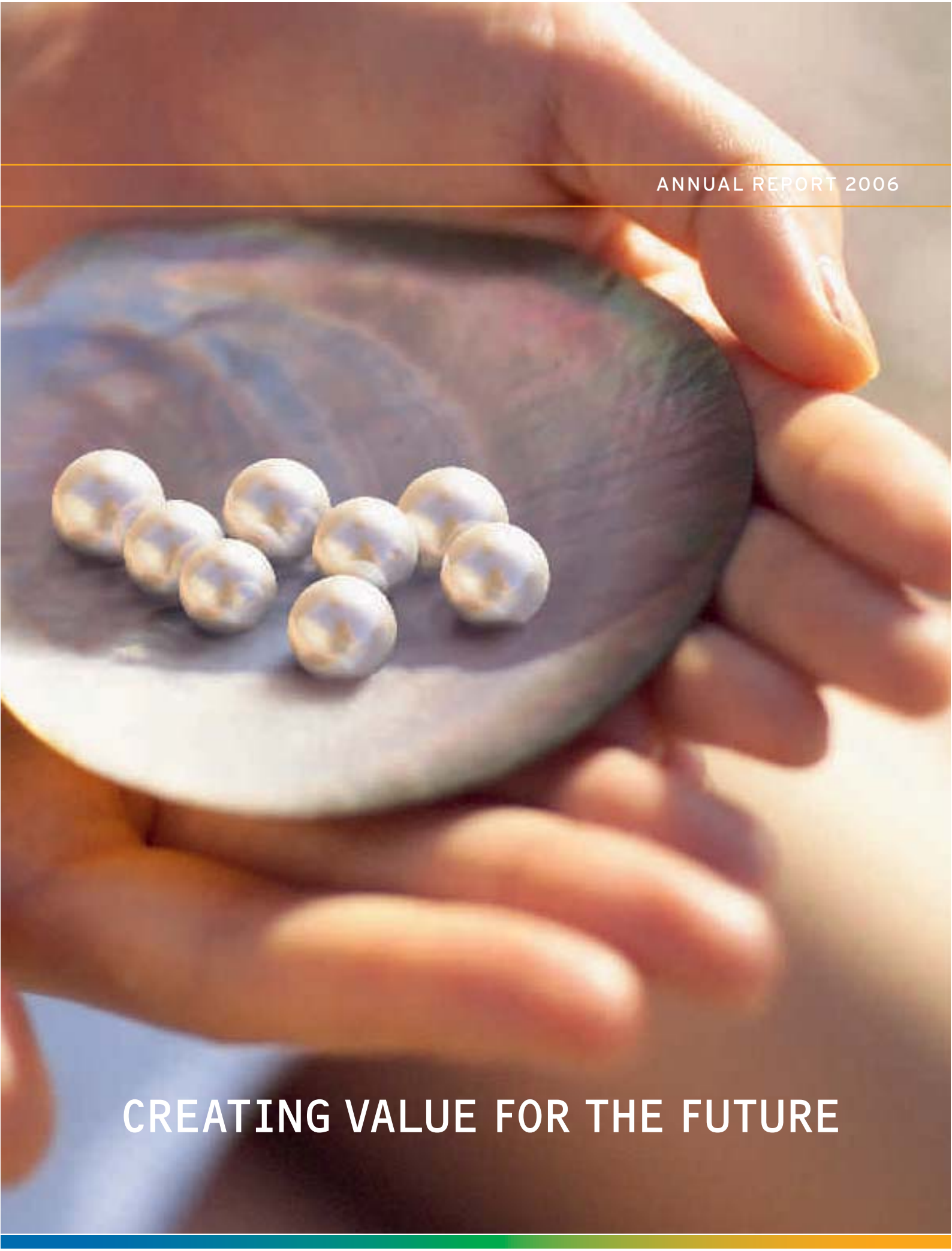


ANNUAL REPORT 2006

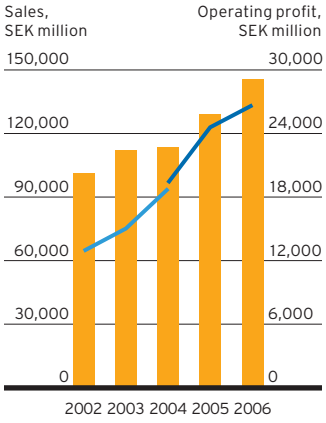
CREATING VALUE FOR THE FUTURE

VATTENFALL

VATTENFALL AT A GLANCE

Vattenfall is Europe's fourth largest generator of electricity and the largest producer of heat. Consolidated sales in 2006 amounted to SEK 145,815 million. Vattenfall's vision is to be a leading European energy company. Operations today are conducted in Sweden, Denmark, Finland, Germany and Poland. Vattenfall works in all parts of the electricity value chain: generation, transmission, distribution and sales. Vattenfall also conducts energy trading and lignite mining, and produces, distributes and sells heat. The Group has slightly more than 32,000 employees, and the Parent Company, Vattenfall AB, is 100%-owned by the Swedish state.

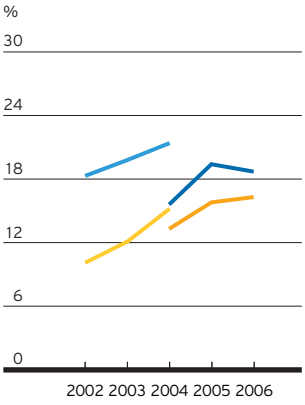
Sales and operating profit



Sales (IFRS)
Operating profit[1] (Sw. GAAP)
Operating profit[1] (IFRS)

1) Excl. items affecting comparability.

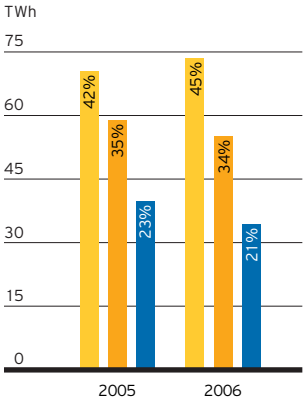
Profitability



Return on equity[1] (Sw. GAAP)
Return on equity[1] (IFRS)
Return on net assets[1] (Sw. GAAP)
Return on net assets[1] (IFRS)

1) Excl. items affecting comparability.

Total electricity generation[1]



Fossil-based power
Nuclear power
Hydro power

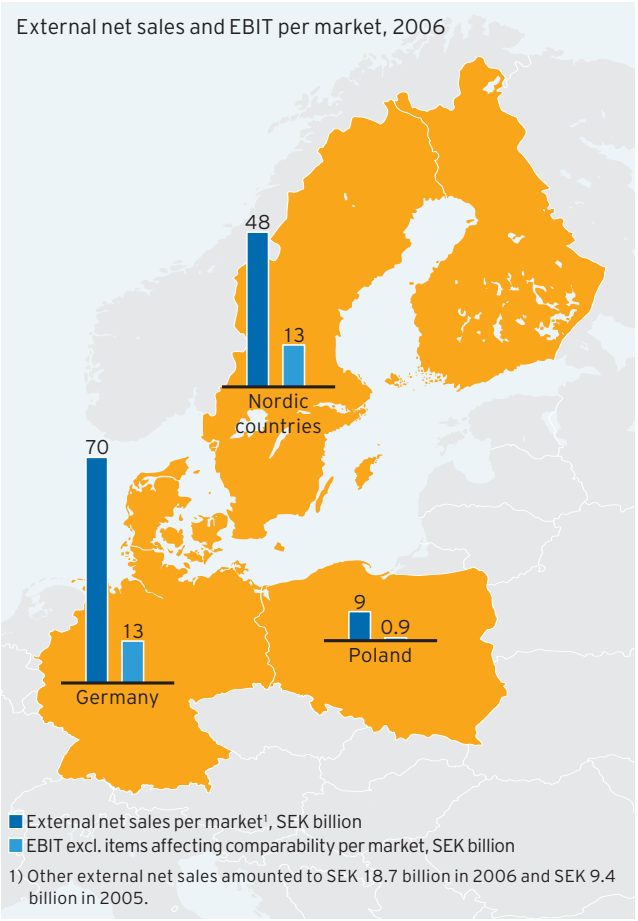
1) Wind power, biofuel and waste are included in these volumes at a total of 1.3 TWh for 2006 and 0.5 TWh for 2005.

Key data

		2006	2005	Change, %	2006 (EUR)[1]
Net sales, SEK million	▲	145,815	129,158	12.9	16,112
Operating profit, SEK million	▼	27,049	27,571	–1.9	2,989
Operating profit (EBIT) excl. items affecting comparability, SEK million	▲	26,676	24,585	8.5	2,948
Profit before tax, SEK million	▼	25,525	26,160	–2.4	2,820
Profit for the year, SEK million	▼	19,858	20,518	–3.2	2,194
Earnings per share, SEK	▼	142.21	146.05	–2.6	15.71
Return on equity excl. items affecting comparability, %	▼	18.7	19.4		
Return on net assets excl. items affecting comparability, %	▲	16.3	15.8		
Total assets, SEK million	▼	323,166	325,068	–0.6	35,709
Equity/assets ratio, %	▲	33.3	28.0		
Funds from operations (FFO), SEK million	▲	35,673	31,386	13.7	3,942
Investments, SEK million	▼	17,220	24,497	–29.7	1,903
Electricity generation, TWh	▼	164.5	169.1	–2.7	
Heat production, TWh	▲	35.2	34.1	3.2	
Average number of employees in the Group (full time equivalents)	▲	32,308	32,231	0.2	

1) Exchange rate SEK 9.05=EUR 1.

External net sales and EBIT per market, 2006



External net sales per market[1], SEK billion
EBIT excl. items affecting comparability per market, SEK billion

1) Other external net sales amounted to SEK 18.7 billion in 2006 and SEK 9.4 billion in 2005.

Vattenfall's markets

Nordic countries

Vattenfall generates slightly more than 20% of the electricity that is used in the Nordic countries. Electricity generation consists primarily of nuclear and hydro power. Electricity is sold to approximately 950,000 customers in the Nordic countries. Vattenfall is also a major producer of heat, mainly based on biofuels, and sells district heating and thermal heat. The Distribution unit owns and operates electricity networks and distributes electricity to some 1.3 million network customers. Vattenfall also conducts consulting, contracting and R&D activities, mainly in the energy sector.

Germany

Vattenfall generates nearly 14% of the electricity that is used in Germany and is thereby the country's third largest electricity generator. Approximately 87% of generation is based on fossil fuels, mainly from Vattenfall's own lignite mines. Vattenfall's coal-fired plants are among the most modern in the world. Vattenfall also produces heat and has substantial district heating sales, primarily in Berlin and Hamburg. In electricity networks, Vattenfall owns and operates high-voltage as well as regional and local networks. Vattenfall has a total of approximately 3.3 million network customers and approximately 2.9 million electricity customers.

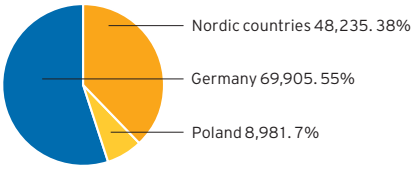
Poland

Heat production and sales make up the majority of operations, and Vattenfall has a market share of approximately 27%. Electricity is also generated on a small scale. The Distribution unit owns and operates electricity networks and distributes electricity to 1.1 million network customers, mainly in the south-west part of the country. Vattenfall has approximately 1.1 million electricity customers in Poland.

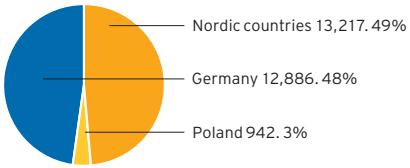
Joint-Group operations

Vattenfall Trading Services, Vattenfall Treasury, Vattenfall Insurance and Vattenfall Research and Development are central support functions which manage the Group's risks, funding, provide market access and work with research and development.

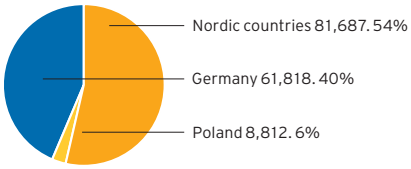
External net sales[1] per market, SEK million



EBIT excl. items affecting comparability per market, SEK million



Net assets per market, SEK million



1) Other net sales amounted to SEK 18,694 million (9,352). The Other segment includes Energy Trading, Finance and Other Group functions.

CONTENTS

Financial calendar 2007

8 February	Year-end report
19 March	Annual Report 2006
26 April	Interim report January–March
26 April	Annual General Meeting
26 July	Interim report January–June
31 October	Interim report January–September

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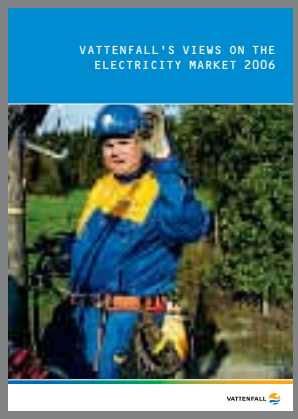
Other publications

Vattenfall's CSR report describes Vattenfall's operations from a sustainability perspective.



Vattenfall describes its views on the electricity market in a yearly report.

All reports can be ordered from
Vattenfall AB, SE-162 87 Stockholm, Sweden
Tel. +46 8 739 50 00, e-mail info@vattenfall.com

Further information about Vattenfall can be found on Vattenfall's websites:

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

VALUE CREATION IS A PREREQUISITE FOR ACHIEVING OUR VISION TO BE A LEADING EUROPEAN ENERGY COMPANY

To achieve our vision, we have embraced five strategic ambitions: Profitable Growth, Number One for the Customer, Number One for the Environment, Benchmark for the Industry and Employer of Choice.

Achieving this vision requires that we continuously create economic value in our operations. These five strategic ambitions make up the core of Vattenfall's work on realising this value. At the same time, value creation is essential for Vattenfall's long-term ability to invest in new, sustainable energy production.

In 2006 we continued to improve our earnings and are now focusing even more clearly on achieving our vision: to be a leading European energy company.

FINANCIAL TARGETS AND OUTCOMES

Vattenfall's aspiration to be a leading European energy company has involved an emphasis on economic value creation and profitable growth. This overarching ambition forms the platform for Vattenfall's four financial targets, which have been set by the owner at the Annual General Meeting. These targets are long-term and thus are evaluated as averages over a business cycle (approx. 5–7 years).

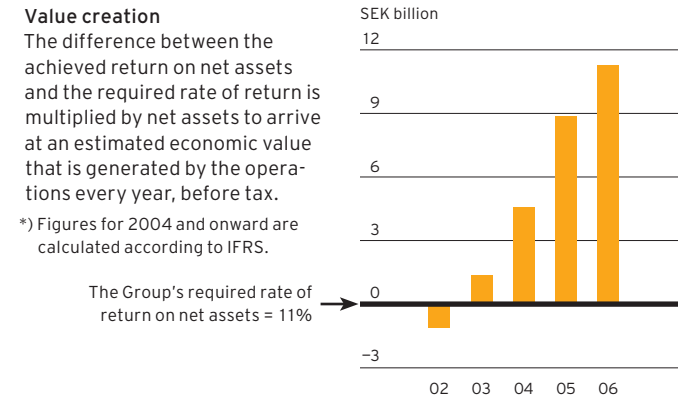
Main target: value creation/profitable growth

Vattenfall measures value creation over time by measuring the achieved return on net assets against the cost of capital, which is based on the owner's required rate of return (15% return on average equity). The difference between the achieved and target returns is then multiplied by net assets to arrive at an estimated economic value that is generated by the operations every year, before tax. The business units that create economic value can seek opportunities for profitable growth, either organically or through acquisitions. Definitive investment decisions are made at the Group level.

Value creation

The difference between the achieved return on net assets and the required rate of return is multiplied by net assets to arrive at an estimated economic value that is generated by the operations every year, before tax.

*) Figures for 2004 and onward are calculated according to IFRS.



Financial targets	Outcome

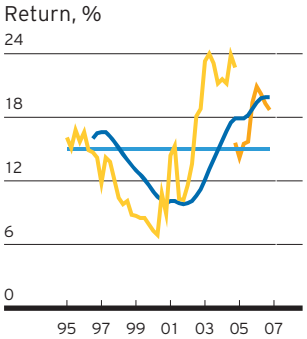
Profitability

The owner's long-term profitability target is that profit after tax should amount to 15% of average equity. Recalculated to the Group's long-term profitability requirement, expressed as the return on net assets, this corresponds to a return of approximately 11% before tax.

- Return on equity[1] after tax was 18.7% (19.4%) in 2006.
- Return on net assets[1] was 16.3% (15.8%).

Return on equity after tax[1], last 12 months (Sw. GAAP)
Return on equity after tax[1], last 12 months (IFRS)
Return on equity after tax[1], last 4 years (Sw. GAAP through Q3 2004)
Return target, 15%

1) Excl. items affecting comparability.

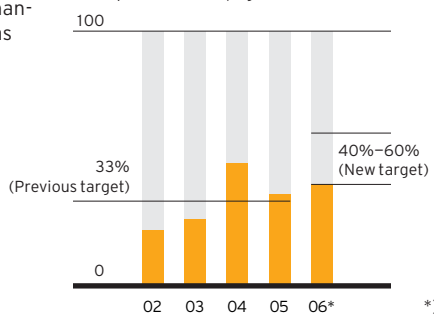


Dividend policy

The aim is that the dividend over the long term should amount to 40%–60% of profit after tax. However, in yearly dividend decisions the Company's strategy implementation, financial position and other financial targets shall be taken into consideration. The dividend target was changed in April 2006. The previous target was 33%.

Long-term dividend target, %

Per cent of profit for the year. Exact dividend amounts are shown in the Nine-year review on page 112.



*) Proposed dividend.

Return targets

Vattenfall's owner believes that the return on average equity is the most relevant measure of profitability from an ownership perspective. The target is that profit after tax should amount to 15% of average equity. Compared with many of Vattenfall's Nordic competitors, this is an ambitious goal. Direct comparisons are difficult, however, especially in view of the fact that the companies differ with respect to the age of their assets and depreciation. Vattenfall has considerable hidden assets on its balance sheet, especially concerning hydro power assets.

Dividend policy

In view of Vattenfall's strong balance sheet and the conservative dividend policy the company has had in comparison with several competitors in recent years, the dividend goal has been changed so that the dividend should amount to 40%–60% of profit for the year. A more generous dividend policy is viewed to be compatible with Vattenfall's growth strategy.

Financial risk level

The goal for Vattenfall's risk level consists of an ambition to maintain a credit rating in the single A category and a "cash flow interest coverage ratio after maintenance investments" of 3.5–4.5. A credit rating takes into account a number of quantitative and qualitative variables which together make up an estimate of a company's ability to meet its credit obligations. The current ratings assigned by Moody's and Standard & Poor's take into account the extra risk component inherent in Vattenfall's acquisition strategy.

As an accounting concept, the traditional key ratio of interest coverage based on operating profit has the disadvantage that it does not take actual cash flows into account. For this reason, Vattenfall has changed over to measuring the cash flow interest coverage ratio, which shows how much of cash flow generated by operations during the year is available for new investment and the dividend, in relation to interest expenses. The highest returns in a capital-intensive industry such as Vattenfall's are often generated through reinvestment in existing facilities. Due to the relatively low operating risk associated with this type of investment, the interval has been narrowed slightly to 3.5–4.5. Previously the interval was 3.5–5.0.

Vattenfall's current four financial targets and target achievement are summarised below.

Financial targets | **Outcome**

Ratings

Vattenfall's aim is to maintain a credit rating in the single A category from both Moody's and Standard & Poor's.

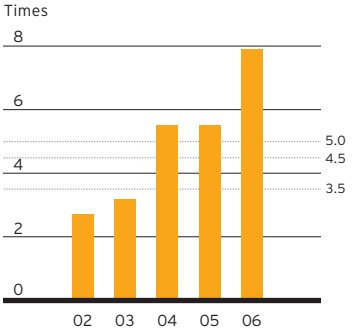
	Long-term Moody's	Long-term S&P	Short-term Moody's	Short-term S&P
2006	A2	A–	P–1	A–2
2005	A2	A–	P–1	A–2
2004	A3	A–	P–2	A–2
2003	A3	A–	P–2	A–2
2002	A3	A–	P–2	A–2
2001	A3	A–	P–2	A–2
2000	A1	A+	P–1	A–1

Vattenfall currently has ratings of A–/A–2 from Standard & Poor's and A2/P–1 from Moody's. Both Moody's and Standard & Poor's changed their outlook from positive to stable during the third quarter of 2006. Among other things, the agencies cited Vattenfall's ambitious investment plans, more stringent requirements from network regulators and greater political risk. During the year, the rating agency Fitch published its own rating for Vattenfall. This was not initiated by Vattenfall and is thus based only on openly available public information about Vattenfall.

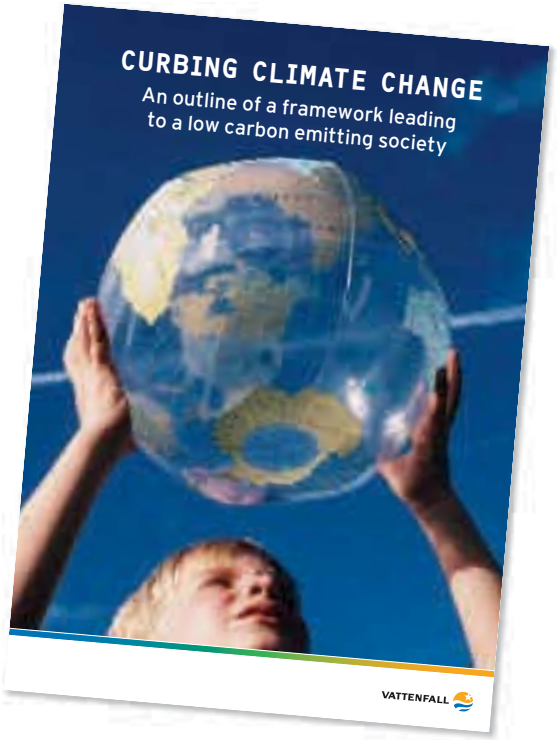
Cash flow interest coverage ratio

This target was redefined in April 2006. The owner's previous requirement that the interest coverage ratio based on operating profit should amount to a multiple of 3.5–5.0 was replaced by a target that the "cash flow interest coverage ratio" should amount to 3.5–4.5. For a complete definition, see page 111.

Cash flow interest coverage ratio after maintenance investments



IMPORTANT EVENTS IN 2006



MAJOR INITIATIVES TO CURB CLIMATE CHANGE

Since a large part of Vattenfall's electricity and heat generation is based on fossil fuels, it is important that we invest in technologies that reduce emissions of carbon dioxide. In early 2006 Vattenfall published a report entitled "Curbing Climate Change", which presents proposals for a model on how to reduce CO_2 emissions globally and at the same time maintain favourable conditions for investment in cost-effective and environmentally friendly technologies.

In May, Vattenfall presented a plan for greater investment in renewable electricity generation in the Nordic countries. The goal is to increase annual generation of renewable energy by 10TWh by 2016.

Also in May, construction was begun on Vattenfall's pilot CO_2 emission-free lignite power plant. The plant is based on oxyfuel technology[1] and is the first of its kind in the world. The facility, which is being built adjacent to the Schwarze Pumpe power station in eastern Germany, represents a milestone in the development of new technology for developing lignite-based electricity generation without carbon dioxide emissions. Vattenfall is investing EUR 65–70 million (approx. SEK 588–633 million) in the pilot plant, which will be commissioned in 2008. Through this new technology, Vattenfall aims over the long term to safeguard lignite-based electricity generation in Germany and at the same time make a strong contribution to a global solution to the climate issue.

1) The carbon dioxide emitted from combustion is separated and liquefied for subsequent storage in bedrock.

REDUCED NETWORK TARIFFS FOLLOWING DECISION BY GERMANY'S NETWORK REGULATOR

In June Vattenfall was handed a decision by Bundesnetzagentur, the German network regulator, demanding sharp reductions in tariffs for the transmission operations. After Vattenfall appealed the decision, a German court overruled the regulator's demands for retroactive tariff reductions. In September and October, Bundesnetzagentur announced its decision regarding Vattenfall's distribution networks in Berlin and Hamburg, and for the subsidiary Wemag's network in northern Germany. As a result of the new rules for electricity network operations and Bundesnetzagentur's decision to lower Vattenfall's tariffs, following an impairment test, Vattenfall's distribution network assets were written down by SEK 1,019 million (EUR 110 million).

COMPLETION OF DEAL BETWEEN VATTENFALL AND DONG IN DENMARK

Following intensive work, the asset swap between Vattenfall and the Danish energy company DONG was completed on 1 July, when approximately 24% of the combined production capacity of the Danish companies Elsam A/S and Energi E2 A/S was transferred to Vattenfall in exchange for Vattenfall's 35.3% shareholding in Elsam A/S and participation in I/S Avedöre 2. The assets taken over consist primarily of combined heat and power plants and wind power plants. The takeover increases Vattenfall's annual production volume by approximately 6 TWh of electricity and 6 TWh of heat.

POSITIVE CUSTOMER RESPONSE TO VATTENFALL'S "TRYGGHETSAVTAL"

In June Vattenfall launched a three-year fixed-price contract with an accompanying renewal right in Sweden. The contract shelters customers against rising electricity prices for three years at the same time that it gives them the right to sign a new three-year contract at a lower price if the price of electricity falls. Demand for the new product has been very high.

SUBSTANTIAL PROBLEMS IN NUCLEAR POWER GENERATION

On 25 July a short circuit in a switchyard outside of the Forsmark 1 nuclear power plant caused an emergency shutdown of the plant (a "scram").

The reactor was shut down automatically, at which time two of the four diesel-powered reserve systems were started and maintained adequate cooling of the fuel. The incident was classified as a 2 on the 7-degree INES scale, where 1–3 represent incidents without off-site risk, and 4 or higher signifies a discharge with impact on the environment and people. In September the Swedish Nuclear Power Inspectorate (SKI) issued a statement clarifying that the incident did not cause any damage to the reactor. According to SKI, the control room personnel acted according to instructions. Cooling of the reactor was present at all times and there was never any risk of radioactive discharge.

Before allowing a restart, SKI demanded that a number of safety measures be performed at Forsmark 1 and also at Forsmark 2, which was closed for an annual overhaul when the incident occurred. On 28 September, SKI gave its clearance for the restart of both reactors. However, at the same time, SKI stated its assessment that "Forsmarks Kraftgrupp AB has shown defects in its safety management and control of operations." The restart of the Forsmark 2 reactor was delayed by a leakage in the reactor containment and shortcomings in control

documentation. Following repairs and a review of the documentation of the repair work, SKI granted clearance for a restart on 24 October. As a principal owner of Forsmark, Vattenfall has taken the events at Forsmark with the utmost gravity. As a result of these events, a thorough review has been conducted at all of Vattenfall's nuclear power plants and safety routines are being strengthened. The incident caused a 2.3 TWh loss in generation, and the total loss of income amounted to approximately SEK 1.4 billion, of which Vattenfall's share (66%) was approximately SEK 0.9 billion.

CEO's message

A SUSTAINABLE ENERGY COMPANY FOR A SUSTAINABLE SOCIETY

Looking back at Vattenfall's development in recent years, we can view it from two entirely different perspectives.

On the one hand, Vattenfall can look back at a number of years filled with major successes. Year after year we have presented record earnings, we have expanded into new markets, and we have successfully integrated acquired companies. Profitable growth has been our guiding principle – to focus on value creation as a platform on which to meet the challenges presented by a deregulated, common European energy market.

Parallel with this, Vattenfall has carried out a number of aggressive moves. Major investments have been made in the electricity network to ensure improved security of supply delivery reliability for our customers. Investments in new technology in our existing power plants have resulted in improved efficiency, at the same time that emissions of carbon dioxide and other harmful compounds have been reduced.

On the other hand, success is a subjective experience. For many in our operating environment – society, customers and other interest organisations – Vattenfall's development has not been equated with success in all respects.

On the contrary, many people still regard Vattenfall as part of an ineffective energy market in which the market mechanisms are not creating efficiency and competitive prices. Instead, say the critics, energy trading is taking place in an oligopolistic market in which a handful of large energy companies are maintaining price levels that are too high and detrimental for energy consumers.

This criticism must not be brushed aside as off-target and mistaken. We cannot let ourselves be satisfied with the tangible successes that we have achieved in terms of delivered terawatt hours, or in dollars and cents. We must acknowledge that these reactions are real and worth taking seriously. Therefore, one of our absolute most important tasks is to continue the work on showing that we are a company that stands by a well-functioning market and constantly strives to deliver competitive energy solutions to society and to the customers we work for. It is not until our customers are satisfied that we can be satisfied ourselves with the services and products that we deliver.

Building up this trust is a duty fitting for a company that has a long-term horizon such as Vattenfall's. We must take advantage of every opportunity to show that our company, our products and our knowledge truly support sustainable development and correspond to our customers' needs and preferences. We do this by offering modern technological solutions of the highest calibre as well as products and advice at prices that meet the high demands made by our customers.

Customers' success is Vattenfall's success

Sustained profitable growth is the centrepiece for meeting the demands that are placed on Vattenfall. Being a strong partner to our customers and to the society that we work for requires a profitable Vattenfall. A strong balance sheet and strong cash flow are prerequisites for the major investments and risk-taking that are required to manage our part of the necessary changeover to a sustainable energy system that does not contribute to climate change.

On a platform of this financial strength, we are constantly taking new strides to offer an even better partnership for our customers. At Vattenfall we regard the society in which we work as our principal. A successful society is one in which investment is made; accordingly, success for our customers also means success for Vattenfall.

2006 was a year of high electricity prices throughout Europe and especially in the Nordic countries. Representatives of Sweden's basic industry have expressed their concerns and have also questioned the energy companies' ability to offer competitive terms. For large companies in the forest industry, steel industry and other energy-intensive industries, for example, it is critical for long-term investment to be able to foresee electricity costs in production for several years into the future. This is why Vattenfall's relationships with basic industries are based on long-term partnership.

During the past year, Vattenfall has also been able to offer a long-term partnership to our private customers in Sweden. Last summer we introduced "Trygghetsavtalet", which briefly entails a fixed electricity price for three years, but with the right to renegotiate the agreement if wholesale electricity prices should fall during the term of the agreement.

"Trygghetsavtalet" has met a positive reception from both "old" and new customers. The response was so high at times that our customer service unit had problems taking care of all the new customers who contacted us. The warm reception given to "Trygghetsavtalet" shows the confidence with which retail customers in Sweden regard Vattenfall. The introduction of this price model is an important step in our work on further strengthening our relationships with our customers.

Major initiative in curbing CO_2 emissions

Another way of measuring Vattenfall's success is to see how well we succeed in combining financial success and increased energy generation with our simultaneous effort to reduce environmental impact. It is now entirely clear that major emissions of carbon dioxide and other greenhouse

gases are posing a major threat that risks irreparably changing the climate on our entire planet.

The climate issue is a challenge of such huge dimensions that everyone – nations, states, organisations and individuals – must take an involvement. At the same time, we know that all of the energy sources that we use today will continue to be needed in the foreseeable future. Consequently, we are forced to make long-term choices and use the energy sources that are available in an efficient and responsible manner.

Vattenfall approaches its climate work on contributing to sustainable development through technological development and suggests solutions and contributes to opinion-shaping. In the important work on finding new technological solutions to the environmental problem, Vattenfall is far advanced. We have a long record of experience in both increasing the efficiency of our electricity and heat generation plants and in minimising emissions of harmful greenhouse gases. Especially with respect to the integration of the Polish power plants, these are undergoing a technical upgrading that is bringing them up to an environmental level that is well in line with the rest of the Group's facilities. In Sweden and Finland, a number of thermal energy plants have been rebuilt in order to be able to change over from fossil fuels to biofuels.

In spring 2006 Vattenfall presented a plan to further increase investment in renewable energy sources in the Nordic countries. Our ambition is to increase our generation of renewable energy by 10 TWh per year in Sweden by 2016. A key part of this initiative involves a massive expansion in wind power, which will be conducted at Lillgrund in the Oresund Strait and at the Kriegers Flak site in the southern Baltic Sea, among other places.

However, our most pioneering and progressive investment involves the construction of the world's first coal-fired power plant that does not emit any CO_2 gas. In May 2006 the planning work began on the pilot plant at Schwarze Pumpe in eastern Germany. Through this investment we are leading the global development in a technology area that will be absolutely necessary in the efforts to solve the climate issue.

Leading role in opinion-shaping

Vattenfall has taken a leading role in the opinion-shaping work surrounding our shared responsibility for the future. In our "Curbing Climate Change" report, which we published in January 2006, Vattenfall outlined a proposal for handling

climate change on the global level. Vattenfall has set forth a global model that is based on the principle that all countries should participate in relation to their share of global GDP, without slowing economic development or allowing the changeover in energy sources to present a threat to prosperity. Vattenfall's proposal combines trade mechanisms with measures for accelerating technological development.

Vattenfall's responsible approach and constructive attitude toward handling this important and difficult issue has been met with interest and respect around the world, and I have personally presented our proposal at several international environmental conferences and discussed it with several of the world's political leaders. Since December 2006 I have had the honour to serve as German Chancellor Angela Merkel's adviser on climate issues. During the current year, Germany is serving as chair in both the EU and G8 and sees this as a key opportunity to further direct focus to the climate issue.

In early 2007 Vattenfall took two more steps in its work on reducing greenhouse gas emissions. Together with the leaders of a number of international corporations, we launched the global 3C initiative – Combating Climate Change. Detailed information on this initiative can be found at the 3C website: www.combatclimatechange.org.

In our extensive Global Climate Impact Abatement Map, Vattenfall has compiled the measures that are needed and possibly can be done around the world to curb climate change. If these measures are realised it will be possible to stabilise emissions of greenhouse gases at a level making it possible to limit the long-term temperature rise to 2°C. For more information on this, visit our website: www.vattenfall.com/climate.

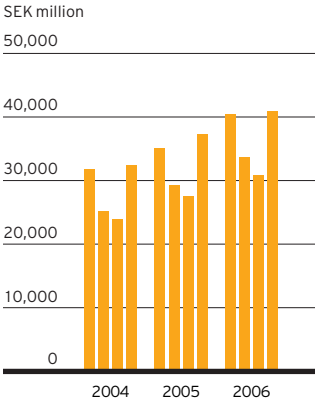
A central part of Vattenfall's proposal involves developing a global system for trading in emission allowances. Vattenfall therefore supports the system for trading in emission allowances for greenhouse gases that has been used in the European Union during the past two years.

Record earnings also in 2006

Vattenfall is thus facing a number of major challenges – ranging from the decisive climate issues to issues involving customer confidence and price levels. Allow me therefore to once again stress that continued profitable growth is a

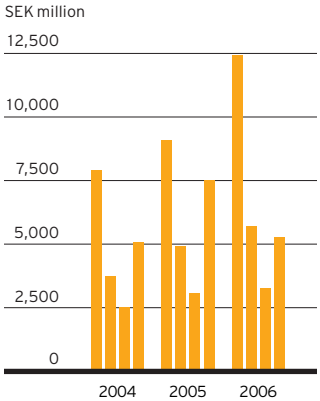
Sales rose 12.9% to SEK 145,815 million (129,158)

Net sales, quarterly



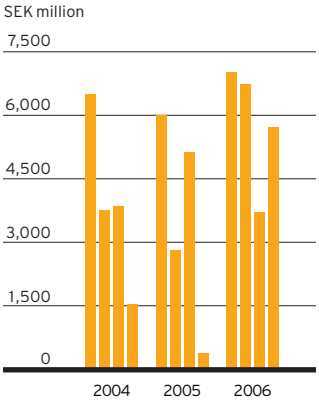
Operating profit excluding items affecting comparability rose 8.5% to SEK 26,676 million (24,585)

Operating profit, quarterly



Free cash flow totalled SEK 23,178 million (14,341)

Free cash flow[1], quarterly



1) Cash flow from operating activities less maintenance investments.

prerequisite for our success in handling future issues. Stable long-term earnings are a necessity if Vattenfall is to be a stable and long-term player that can guarantee energy supply in the future.

I am pleased to note that the Group's earnings for 2006 were strong, despite a weak fourth quarter. Operating profit excluding items affecting comparability rose 8.5% to SEK 26,676 million, and net sales rose 12.9% to SEK 145,815 million. The improvement can be credited primarily to stronger earnings from our German operations as a result of higher wholesale electricity prices and slightly higher generation volumes. In the Nordic countries, however, sales as well as earnings were down from the preceding year due to a significant drop in generation. This decline is mainly attributable to a weak hydrological balance – water levels in reservoirs hit their lowest levels since 1996 – and to problems at the Forsmark nuclear power plant during the second half of the year. These problems, which were caused by a short circuit in a switchyard outside the Forsmark facility in late July, resulted in a standstill for both reactors for a couple of months. The disruption resulted in a loss of approximately SEK 900 million in income. The Nordic operations were also burdened by higher generation taxes of approximately SEK 1.7 billion.

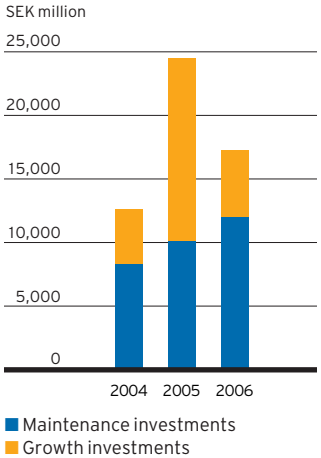
To meet tomorrow's challenges, Vattenfall must also succeed in attracting the competence needed to be a leading energy company in Europe. To our pleasure, we can see that the energy industry is regarded as a future segment by many young people, and vacant positions in our organisation attract many applicants.

It is with the knowledge of strong contributions from all of our employees during the past year and knowing that we are well equipped for the future that I look forward with confidence to the many major challenges that await us – in 2007 and the years that follow.

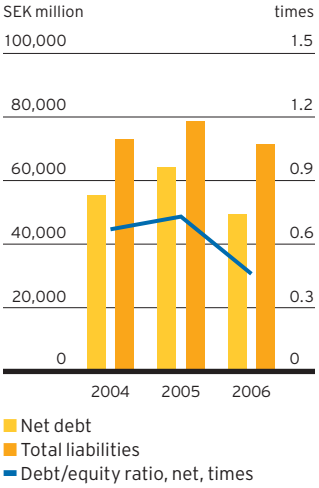
Lars G. Josefsson
President and CEO

Net debt decreased by SEK 14.9 billion, to SEK 49.4 billion

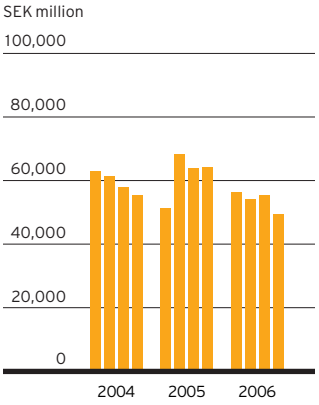
Investments



Debt/equity ratio



Net debt, quarterly



REVIEW OF OPERATING ENVIRONMENT, STRATEGIES AND ACTIVITIES

Operating environment

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

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

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

Increased focus on safety and environment

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

Mounting competition

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

Greater regulation

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

Strategies

Profitable Growth

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

Benchmark for the Industry

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

Number One for the Customer

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

Number One for the Environment

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

Employer of Choice

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

Activities

Achieved 2006

Activities	Achieved 2006
• Continuously evaluate acquisition candidates and investments in expanded capacity and delivery ability. Geographic expansion will primarily take place in or around regions in which Vattenfall is already established. Growth will take place with a continued emphasis on being a vertically integrated energy company with focus on electricity production and heat. Natural gas has potential as an acquisition area, partly as a source of heat and electricity generation, and partly due to the growing convergence between the electricity and gas markets. • Prepare and implement an extensive investment programme. By 2011 Vattenfall plans to invest SEK 134 billion, of which roughly SEK 102 billion in generation capacity. • Reduce costs per customer ("cost to serve").	• Consolidated Danish generation assets, increasing Vattenfall's annual heat and electricity generation by approximately 6 TWh each (read more on page 4). • Acquired the Vanaja combined heat and electricity power plant in Tavastehus, Finland (150 MW heat and 60 MW electricity).
• Expand efficiency-improvement work to cover the entire organisation; identify and implement best practice in as many areas as possible. • Continuously improve follow-up systems. • Execute strategies for achieving economies of scale in IT investments and purchasing. • Continue to improve and centrally co-ordinate investment planning.	• Adopted a number of Key Performance Indicators (KPI) for following up the various business units at the Group level. • Established a joint service unit in Germany by combining the service units in Berlin, Hamburg and Cottbus. • Implemented the joint "Vattenfall Business Services Nordic" unit for the Nordic countries. • Established the new "Capacity Management" staff function (see also page 68 under Investment risk), in order to achieve stronger management of the focus and priorities of investment projects within the Group. • Began work on a Group-wide IT platform and continued work on harmonising all of the Group's websites in a measure aimed at supporting a cohesive brand for Vattenfall.
• Ensure competitive pricing while providing the best possible service. Projects are under way to improve and simplify customer service. Customer satisfaction is being continuously measured in order to be able to take improvement actions. • Offer long-term contracts to industrial customers. • Improve co-ordination of customer service between the various business units. • Adapt the product portfolio in order to meet changed customer needs, such as through electricity and gas offers ("dual fuel") in Germany. • Create a cohesive brand for all parts of Vattenfall in an effort to serve customers better and more clearly, with one face to the customer.	• Launched "Trygghetsavtalet", a three-year fixed-price contract in Sweden with a favourable renewal option (see page 5). • Carried out an energy efficiency-improvement campaign, introduced 24-hour customer service and a price guarantee programme in Germany. • Streamlined and improved customer service in Poland (see case on pages 44–45). • Continued to improve delivery quality to customers by isolating the medium-voltage grid in the Nordic countries. • Successfully migrated the Vattenfall brand to our German and Polish subsidiaries, which now operate under the Vattenfall name, enabling us to act as One Vattenfall toward customers.
• Invest in energy production that generates low or no carbon dioxide emissions (such as nuclear power) and in technology for reducing emissions from fossil fuel-fired power plants. Increase capacity of existing facilities that generate low carbon dioxide emissions. • Invest in wind power and biofuel-based electricity and heat generation, assuming attractive commercial conditions. • Invest in new turbine wheels when refurbishing hydro power plants with better environmental qualities and higher generation. • Increase efficiency in the generation and transmission of electricity. • Create better systems and processes for directing and following up environmental work.	• Commissioned a new biofuel-fired combined heat and electricity plant (17 MW heat and 3.5 MW electricity) in Motala, Sweden, with a lower CO_2 footprint. • Started construction of Vattenfall's pilot CO_2 emission-free power plant in Germany (read more on page 4). • Restoration of natural landscape and flora on a 200 hectare site alongside the Spree River in Germany. • Complete sulphur cleansing at the Prusków power plant in Poland, one of Europe's largest combined heat and electricity plants, and decision to stop depositing ashes at the Żéràn combined heat and electricity plant in Warsaw. • Presented a model for reducing global CO_2 emissions in a report entitled "Curbing Climate Change". • Established four competence centres to optimise knowledge-sharing between various units and countries in an effort to take effective action at an early stage.
• Strengthen leadership through a first rate leadership succession process and Group-wide management development programmes. • Implement long-term strategic competency planning throughout the Group. • Continuous development of employees' competence, with commercial needs as a starting point. • Conduct the "My Opinion" employee survey once a year to gain documentation for improvements and strengthen employee commitment. • Offer all employees a safe, healthy and stimulating work environment. • Continue developing flexible pay models and incentive programmes that support the Group's long-term objectives.	• Vattenfall ranked as Sweden's best employer among young professionals who evaluated their own employers in Universum Communications' Young Professionals survey. • Annual employee survey points to major advances made in several important areas, such as goals and feedback, work/life balance and leadership. • Collective agreement reached for the core business in Germany. • Completed evaluation and performance reviews of 1,458 managers and potential managers. • Participation of some 300 employees in Group-wide leadership development programmes. • Establishment of Vattenfall Business Institute, which offers Group-wide programmes in business control, purchasing, HR and specialist areas.

SECURING THE FUTURE THROUGH FOCUS ON ECONOMIC VALUE CREATION

Economic value creation and profitable growth are the most central of Vattenfall's strategic ambitions. They are a fundamental prerequisite for our ability to achieve the company's other objectives – not least regarding sustainability – and for realising Vattenfall's vision to be a leading European energy company.

Following a period of consolidation and integration of acquired operations, Vattenfall shifted its strategic focus in 2005 towards realising its vision of being a leading European energy company. This work rests on a platform of Vattenfall's five strategic ambitions. However, a fundamental precondition for being able to achieve this vision is to constantly grow the economic value that is generated by the operations. Consequently, value creation and profitable growth have obtained further importance as key pillars in Vattenfall's strategy work and business planning, and thereby also in the setting of the Group's financial targets. The Board of Directors discusses the proposed targets and makes decisions to recommend them to the Annual General Meeting, where the owner then makes a formal decision. For more information on Vattenfall's current financial targets, see pages 2 and 3.

Process for goal-steered value creation

Overarching financial targets are set by the owner in dialogue with Vattenfall's Executive Group Management. Value creation and profitable growth are the overarching goals.

Four Group-wide financial targets
- Minimum 15% return on average equity.
- Cash flow interest coverage ratio after maintenance investments of 3.5–4.5.
- Dividend 40%–60% of profit for the year.
- Single A credit ratings.

Profitability requirement
Based on these financial targets, a required rate of return is set, expressed as the return on net assets (operating profit as a percentage of average net assets). This required rate of return is currently 11%.

Value creation

Operating margin

Capital efficiency

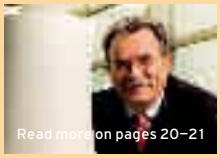
Return on Net Assets (RoNA)

– (less)

Required rate of return 11%

Value creation
Vattenfall creates economic value when it exceeds the requred rate of return.

Units that exceed the required rate of return can seek profitable growth opportunities.



Read more on pages 20–21

Read more on pages 34–35

Organic growth

Growth through acquisitions

Profitable growth

How does Vattenfall measure economic value creation in its various operations?

Since Vattenfall works in an exceptionally plant-intensive industry, management has opted to set a Group-wide return target that is expressed as a return on net assets (operating profit as a percentage of average net assets). The operating profit that is generated by operations is always assessed in relation to Vattenfall's asset base, on which the owners and lenders expect a reasonable return. The return target is currently 11% and is based on a balanced consideration of the financial targets that were adopted by the owner at the Annual General Meeting. This target, in turn, is translated into individually defined targets for each business unit, according to which operations are managed. The main reason for this reformulation to individual targets for each business unit is that Vattenfall's operations have widely varying conditions – mainly different asset bases in terms of size and age. Moreover, the company's equity and net financial income and expense are not distributed over the business units. The basic principle for this target formulation is that asset-intensive operations are assessed according to their return on the asset base, while service operations are assessed according to their operating margin.

Since Vattenfall's nuclear electricity generation and distribution facilities are asset-intensive, cash flow and capital allocation are central components in decision-making, such as when investments are evaluated. To maximise the impact of internal communication surrounding economic value creation and establish a common understanding of these targets within the organisation, Vattenfall has chosen to emphasise operating profit before tax rather than cash flow as a first step. The main reason for this is that operating profit is a key ratio that is clearer and easier to understand than cash flow. Moreover, cash flow requirements tend to punish investment, which is negative in an extremely plant-intensive industry such as electricity generation. In our internal communication, major emphasis has also been put on cost-effectiveness and efficiency-improvements at the business unit level.

Goals for the business units

Since equity is not distributed over the various operating units and since Vattenfall's operations are so different from each other, the Group-wide required rate of return is translated to individual targets for each business unit. If a business unit's performance exceeds this required rate of return, the unit can seek profitable expansion opportunities. If its performance is below the requirement, then profitability must be improved, assets must be reduced and growth must be restrained.

Financial targets at the business unit level

Since the book value of Vattenfall's electricity generation assets in many cases does not give a representative picture of the actual value, operating profit is instead measured against an indexed cost, i.e., an inflation-indexed value.

In Heat Generation, the same targets are used as at the Group-level, i.e., return on net assets.

Electricity generation
- Return on indexed cost

Heat
- Return on net assets

The primary financial target for Vattenfall Trading Services is return on trading mandate. This unit is expected to generate a return on its trading via the foreign cables – SwePol Link and Kontek – that the unit is responsible for.

Trading
- Return on trading mandate
- Return on net assets (SwePol Link and Kontek)

In Sales, the primary financial target is net return on a set value per customer.

Sales
- Net return on a set value per customer

Like in Electricity Generation, Electricity Distribution has a substantial asset base. Consequently, the return on replacement value is measured instead of on the book value, which would underestimate the value of the assets.

Electricity networks (Transmission and Distribution)
- Return on replacement value (Nordic countries and Germany)
- Return on net assets (Poland)

DRIVING FORCES, RISKS AND STRATEGIES FOR VALUE CREATION

Vattenfall's earnings are affected by certain fundamental driving forces and risks, such as electricity prices, fuel prices and political decisions. Vattenfall has adopted strategies, activities and risk management policies for all of its business units.

Generation

Driving forces

Electricity prices

Electricity prices are the single most important value-creation factor at Vattenfall. Losses can arise due to changes in the wholesale prices for the electricity that Vattenfall conducts physical and financial trading in. The price of electricity is affected by fundamental factors such as water supply, fuel prices, CO_2 emission allowances and electricity consumption. To manage price risk, Vattenfall sells and buys electricity through forward contracts. Business in the various electricity markets is handled by Vattenfall Trading Services' market access function.

Plant availability and efficiency/ available generation capacity

Production stops caused by ageing plants or operative problems can cause losses of income. Such losses can be compensated to some degree through insurance. About half of Vattenfall's electricity generation in the Nordic countries is derived from hydro power from Swedish hydro power plants. An increase in the hydrological balance, i.e., water levels in dams, can push down electricity prices, with lower income as a result. The earnings impact of such a drop in prices can be mitigated if electricity has been sold in advance in the forward market. Increased generation can also be sold on the spot market. This risk can be lowered through greater integration between the Nordic region and other markets.

Fuel prices

The Group is dependent on the price of coal and uranium, which are fuel for the power plants. However, most of Vattenfall's coal-fired plants use lignite from the Group's own mines. If the market price of hard coal and uranium rise more than what has been assumed in the Group's hedging strategy, it can entail higher costs and – if electricity and heating prices do not follow suit – lower margins. The cost of uranium accounts for a very small part of the total production cost for nuclear power, however.

Energy and environmental policies

National targets for the share of electricity generation based on renewable resources are rising in all of Vattenfall's markets, which affects our investment plans. The return on such investment projects depends in large part on the subsidy systems.

Starting in 2005, most countries in the EU have been allocated quotas for CO_2 emission allowances in accordance with the EU burden-sharing agreement. Allocations of emission allowances will be gradually reduced, and quotas will be lowered up until 2012. Higher prices of emission allowances would increase the price of Vattenfall's fossil-based generation, but at the same time, higher income is generated if electricity prices also rise.

Strategies/actions

- Optimisation of spot sales/hedging and production planning/control.
- Hedge future electricity prices through forward contracts.
- Raise capacity utilisation at existing generation facilities and implement efficiency improvement programmes.
- Growth through profitable investments in new capacity with focus on renewable energy.
- Hedge CO_2 emission allowance needs.
- Hedge future fuel costs.

Key risks

- Electricity price risk
- Plant risk
- Fuel price risk
- Environmental risks and environmental liabilities

For a more detailed discussion of risks, see page 67.

Trading

Driving forces

Vattenfall Trading Services has been set up to minimise costs and to benefit from the advantages of having a large and central trading unit. The main purpose of this unit is to help the various business units hedge the risks that arise in their business activities and in such way create value-added. The unit serves as a sort of internal bank and is a central function for the Group's transactions on the raw material exchanges. At the same time, a consolidated risk profile can be created at the Group level, and risks in various portfolios and raw materials can be netted against each other.

Vattenfall Trading Services also has its own limited mandate to use its market expertise and take advantage of business opportunities in the raw material markets. The chief risks in this operation consist of volatile electricity and raw material prices, risks that can arise when a counterparty in a transaction fails to meet its obligations, and some currency risk in euros and Norwegian kronor in connection with price hedging of electricity primarily on Nord Pool.

Strategies/actions

- Be an active market player and a driver of market development.
- Develop infrastructure to cover the entire Group.
- Gather all tradable raw material flows and be even more active in developing hedging strategies in these markets.

Key risks

- Price area risk
- Electricity price risk
- Credit risk
- Currency risk

For a more detailed discussion of risks, see page 67.

Sales

Driving forces

Number of customers/economies of scale
Increasing the number of customers and lowering cost-to-serve are central for economic value creation in Sales.

Cost effectiveness
Greater competition is putting pressure on margins in all of Vattenfall's markets, which is why it is very important to achieve a high level of cost effectiveness.

Long-term contracts
Major customers often require long-term, complicated contracts that are specially adapted for their respective operations. The Vattenfall Group tries to the extent possible in the market to hedge the risks that can be associated with these types of contracts.

Counterparties
If a customer fails to meet its payment obligation, this can lead to a loss of income. Vattenfall uses external rating information when such is available. If the company does not have an external credit rating, internal models are used to determine the counterparty's creditworthiness. Limitations in trading volume are continuously evaluated for each counterparty.

Volume
Changes in temperature and in the economy can result in customers using more or less electricity than expected. This gives rise to a risk that delivered volume will differ from what was planned. Vattenfall manages this volume risk by improving and developing processes for electricity consumption and, as a rule, taking it into consideration when setting the terms and conditions of contracts with customers.

Strategies/actions

- Improve customer handling, such as through new IT systems.
- Offer competitive prices and contract forms.
- Develop new, individualised products.
- Provide advice on contract forms, energy savings and the environment.
- Implement Web-based self-service for the private market.

Key risks

- Price area risk
- Electricity price risk
- Credit risk
- Volume risk

For a more detailed discussion of risks, see page 67.

Electricity network

Driving forces

Regulation of network activities
In Germany, Finland and Sweden, new models have been introduced for regulating network tariffs. These models have been formulated to encourage network operators to increase the efficiency of their respective systems and at the same time allow for a reasonable return on invested capital. In Germany, demands are being made to expand the distribution network to allow it to accommodate a higher percentage of wind power. The new regulations are putting downward pressure on network tariffs, with the risk that the costs associated with the expansion will not be fully covered.

Network losses
Variations arise in network loads over the short and long term. It can be very difficult to predict how large these variations will be. This risk is managed through careful follow-up of outcomes in relation to hedged volumes. For deviations that are judged to be enduring, the volume target is changed for hedges for future periods.

Strategies/actions

- Cut costs in Transmission and Distribution.
- Increase pace of investment and quality in the electricity network.
- Increase security of supply through maintenance programmes.
- Invest in reducing bottlenecks.
- Strengthen preparedness organisation.
- Streamline and simplify handling of customer matters.
- Improve customer handling, such as through the installation of meters for remote reading in Sweden and Finland, and new IT systems.

Key risks

- Network loss risk
- Plant risk
- Political risk
- Environmental risks and environmental liabilities
- Credit risk

For a more detailed discussion of risks, see page 67.

VATTENFALL IS INVESTING IN GROWTH

Vattenfall's growth in the coming years will be based primarily on investments in new energy generation. Investment decisions are based on fundamental analyses of supply and demand.

Vattenfall's long-term goal is to attain a sizeable market share in a future, integrated European energy market. In a slightly shorter time perspective, the ambition is to be one of the three largest players in the regional and local markets in which Vattenfall chooses to be active. The expansion strategy covers both investments in Vattenfall's current market and establishment in priority markets in Europe in which Vattenfall is currently not active. A key precondition when evaluating establishment in new markets is that a leading market share can be achieved in the foreseeable future. Vattenfall will continue to be an integrated energy company, but its growth strategy will primarily be pursued through capacity increases in electricity and heat generation, both organically and through company acquisitions. As a result of convergence between electricity, coal and natural gas, many growth-oriented utilities are taking strategic positions in natural gas. Vattenfall is no exception – opportunities to grow in the area of natural gas are being evaluated continuously.

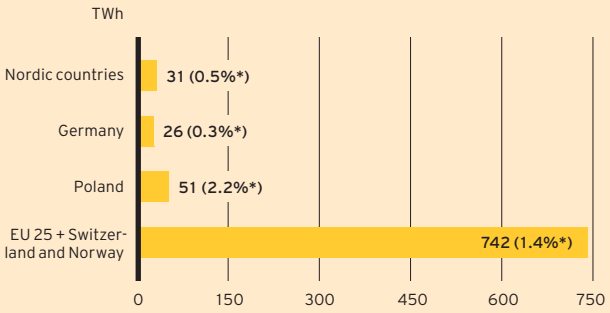
Opportunities to make major acquisitions have decreased in pace with a declining number of possible takeover candidates in relevant markets in Europe, which is driving up prices. Although Vattenfall is constantly analysing potential takeover candidates, its growth strategy is primarily focused on achieving organic growth. Investments in new electricity generation are steered by fundamental factors: either a projected growth in consumption, or an identified need to replace ageing facilities. Based on these fundamental factors, Vattenfall makes a long-term price forecast, which is the primary factor in an investment decision. Price stability

Conditions for investment in new electricity generation

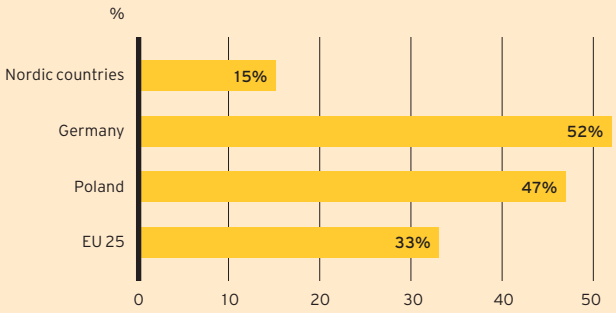
As a rule, investments in new electricity generation have a very long payback time, while there are many uncertainty factors during a facility's economic life. A deep understanding of market forces is therefore crucial when evaluating investment projects.

The most fundamental preconditions for investing in a new power plant are anticipated growth in demand or a need to replace old capacity.

Increase in annual electricity consumption, 2020 compared with 2005



Share of installed capacity that needs to be replaced before 2020



Source: EURELECTRIC, EURPROG 2005

*) Annual growth in consumption, 2005–2020

is also a key component that affects the risk of an investment. Electricity prices in the Nordic countries fluctuate substantially compared with other European countries, since hydro power accounts for such a large share of electricity generation. Reservoir levels have a direct impact on the price of electricity. These differences will be smoothened out in the future if improvements can be made in transmission capacity between different price areas. Expansion plans are currently very restrained, so these differences will most likely remain in the foreseeable future.

Extensive investment programme

A number of other factors also affect the attractiveness of individual markets, such as the extent of political regulation and subsidies, liquidity in the electricity market, and the structure of the supply curve. Vattenfall is continuously developing its model for assessing market attractiveness, which complements its fundamental analyses of supply and demand.

The profitability of a new plant is dependent on its capacity utilisation and on a price for generated electricity that covers the plant's total cost over the long term, including the cost of capital. This explains why investments in wind power, for example, are dependent on subsidies in order to be profitable.

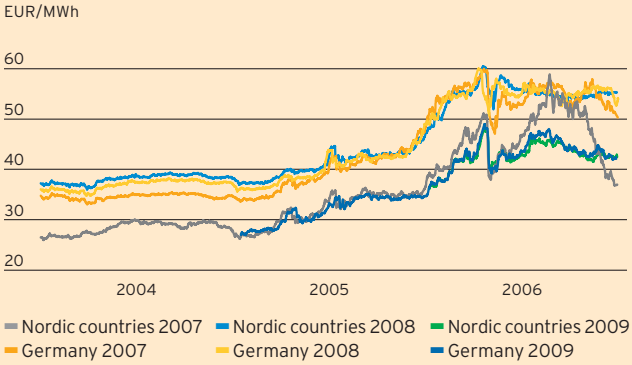
Vattenfall has adopted a very extensive investment programme for the period 2007–2011. A total of SEK 134 billion will be invested, of which SEK 102 billion will be in electricity and heat generation, SEK 31 billion in network activities, and the remaining SEK 1 billion in other operations.

Vattenfall's ambition is to increase renewable electricity generation by approximately 10 TWh by 2016 – primarily in wind power.

Company acquisitions are outside the scope of this investment programme.

A long-term price forecast based on fundamental parameters is the most important factor underlying an investment decision.

German and Nordic electricity forward prices. Forward prices express the market's aggregate expectation of future electricity prices. A liquid forward market currently exists only for terms of up to 3–4 years. On top of this, Vattenfall makes its own long-term price forecasts based on extensive analyses of fundamental factors.



Sources: Nord Pool och European Energy Exchange (EEX).

An investment can be considered if the long-term average price covers the entire cost of the new facility (variable and fixed, including cost of capital).

What does new electricity generation cost? See next page

Investment decisions are influenced by many other uncertain factors:

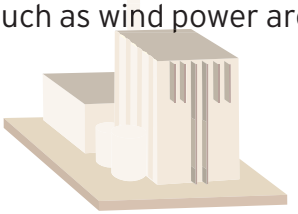
Commercial conditions
- Balance between supply and demand
- Margin cost for existing capacity
- Competitive structure
- Business climate/economic growth

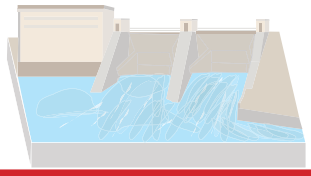
Market structure
- Liquidity
- Degree of integration with neighbouring markets (transit capacity)

Regulatory/political conditions
- Subsidies
- Political orientation

WHAT DOES NEW ELECTRICITY GENERATION COST?

In order for an investment in new electricity generation to be profitable, the price of electricity must be at such a level that covers all costs, including the cost of capital. Currently a price of at least € 4–5 cents/kWh is needed. Cost structures differ for various types of energy and depend on a variety of factors, such as fuel prices. In many countries, such as in Sweden and Germany, renewable energy such as wind power are subsidised in order to be competitive.





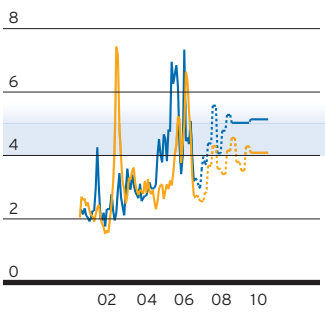
Total cost per KWh*	**€ cents 3.7–4.4**	**€ cents 4.4–6.6**	**€ cents 4.9–5.6**
	Nuclear power	**Hydro power**	**Coal condensing (hard coal, lignite)**
	New capacity is planned or is under construction in several European countries, including Bulgaria, Finland, France, Poland, Romania and the UK. The newer generation III and coming generation IV reactors incorporate improved safety features, such as passive safety systems that would limit the effects of an accident in the reactor without human response. Progress has also been made in the development of final storage of spent nuclear fuel.	Hydro power accounts for nearly half of Sweden's electricity generation and is thus the largest source of renewable energy. The build-up of hydro power began nearly a hundred years ago and continued into the 1970s. Since then, only a few plants have been added in Sweden. Four Swedish rivers are protected from the use of hydro power. In Europe, roughly 75% of potential hydro power has been developed. The largest countries in terms of hydro power are the US, Canada, China, Brazil and Norway.	Hard coal is the most commonly used fuel in the world and will continue to be the most important source of energy for the foreseeable future. Coal is cheap to extract and therefore competitive in many countries. Coal can be used in power plants, in combined heat and electricity plants and in heat plants. Many countries that are working to reduce emissions of greenhouse gases want to restrict the use of coal and other fossil fuels. However, new technology for separating carbon dioxide and storing it could make coal virtually CO_2 emission-free.
Advantages	• Good fuel availability • No CO_2 emissions in electricity generation	• High efficiency • No emissions to air or water • Water (and thus energy) can be stored • Easy to regulate generation	• Good fuel availability from politically stable regions and an effective world market for hard coal. The world's coal reserves are expected to last at least 250 years
Disadvantages	• Long construction time and high technological complexity results in high cost of capital • Safety concerns • Final storage of spent nuclear fuel is an unsolved issue in many countries	• Highly dependent on water supply • Major intrusion on nature that changes landscape • Few exploitation objects • High investment cost	• Relatively long construction time • High environmental impact, mainly through CO_2 emissions. Lignite CO_2 emissions are roughly 30% higher than for hard coal
Cost example*	Generation capacity: 1,600 MW Annual generation: 12 TWh	Generation capacity: Small scale: up to 10 MW (in EU) Large scale: up to 440 MW Normal generation: approx. 4,000 hrs/year	Generation capacity: 700 MW Annual generation Hard coal: 4.2 TWh Lignite: 5.25 TWh
Fixed cost, mainly cost of capital, € cents/kWh	3.2–3.9 (incl. tax on nuclear capacity of 0.4)	4.4–6.6 incl. tax, operation and maintenance	Hard coal: 1.9–2.3 (incl. operation and maintenance) Lignite: 2.0–2.6 (incl. operation and maintenance)
Variable cost (mainly fuel, including CO_2 emission allowances, € cents/kWh)	0.5 (incl. cost for final storage of 0.2)	0 (No value has been assigned to the so-called water value)	Hard coal: 3.1–3.3 Lignite: 2.9–2.9
Total cost, € cents/kWh	**3.7–4.4**	**4.4–6.6**	**Hard coal: 5.0–5.6** **Lignite: 4.9–5.5**

The chart above shows cost estimations for various types of electricity generation facilities. The calculations are based on typical size, lifetime and annual generation output for the respective type of plant.

*) It should be noted that the costs indicated cannot be interpreted as Vattenfall's actual costs, since the conditions for each specific investment can differ from these assumptions.

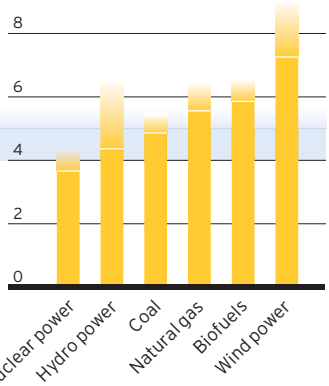
Investments in new electricity generation capacity require a long-term electricity price of at least € 4–5 cents/kWh.

German and Nordic electricity spot and forward prices, 2001–2010
€ cents/kWh

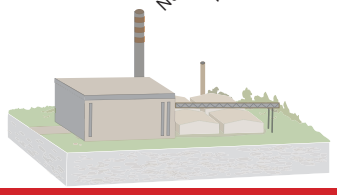


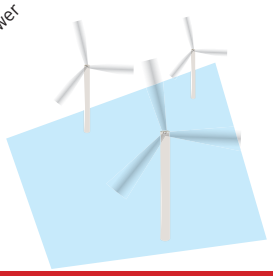
Sources: Nord Pool and European Energy Exchange (EEX).

Total cost for new electricity generation
€ cents/kWh



- EEX spot price – monthly averages
- EEX forward price
- Nord Pool spot price – monthly averages
- Nord Pool forward price





€ cents 5.6–6.5	€ cents 6.0–6.6	€ cents 7.3–9.1
Natural gas combined cycle	**Combined heat and power from biofuels**	**Wind power**
Natural gas is cleaner than coal and oil. Upon combustion, the only emissions are essentially carbon dioxide, steam and nitrogen oxides – plus lower volumes of CO_2 than when using coal and oil. This is why natural gas is the fastest growing source of electricity generation in the world. Many countries want to replace coal and oil with natural gas for environmental reasons. The largest natural gas wells are in Russia and the Middle East.	From an environmental perspective, biofuels are very good if they are used in a plant with controlled combustion and flue gas cleaning. If growing trees absorb as much carbon dioxide that is emitted upon combustion, then there will be no net emission of carbon dioxide into the atmosphere. Plant costs vary widely, depending on size. Small plants have a higher investment cost per MW.	Wind is a source of energy that has been used over the ages by people to run various types of equipment, such as mills, pumps and boats. Around 30 years ago, wind power was also harnessed for the commercial generation of electricity. Wind is a renewable source of energy that is available around the world. Operation of a wind power plant has virtually no environmental impact. The growth of wind power has progressed quickly – annual growth has been around 30% in recent years.
• Lower environmental impact and higher efficiency than coal and oil • Low investment cost	• Low environmental impact from large, modern facilities • CO_2-neutral	• No emissions to the air or water
• Concerns over fuel availability (the largest reserves are in politically unstable regions) • High and unpredictable fuel cost (major price fluctuations) • Environmental impact (emissions of CO_2, among other things)	• The market for biofuels is still undeveloped in many countries, and conflicts with other uses for the fuel can arise • Particle emissions from poorly equipped facilities	• Higher need for balancing power due to the unpredictability of wind-based electricity generation • Stability of the electricity grid can be adversely affected with a high share of wind power in the system • Requires subsidies • Landscape aesthetics
Generation capacity: 400 MW Annual generation: 2.4 TWh	Generation capacity: 30 MW electricity and 80 MW heat Annual generation: 0.14 TWh electricity and 0.36 TWh heat	Generation capacity: 110 MW Annual generation: 0.33 TWh Pertains to an offshore wind power farm
1.1–1.3	4.6–5.1	7.3–9.1 (including maintenance costs of approx. 1.7)
4.5–5.2	1.4–1.5	0
5.6–6.5	**6.0–6.6**	**7.3–9.1**

Assumptions: Cost of capital: 8%–9%. Price för CO_2 allowances: EUR 20/tonne, Hard coal: USD 70/tonne, Natural gas: EUR 27/MWh. Exchange rate: EUR 1 = SEK 9.05.
References: Elforsk rapport 03:14, 2003, Morgan Stanley Research February 2007.

Organic growth

BUILDING THE NEW GENERATION OF COAL-FIRED POWER PLANTS

Large parts of Germany's energy production must be replaced by 2020. Vattenfall, which is the country's third-largest producer of electricity, is one of the most important players in this transformation process in which outdated, inefficient energy generation is being replaced by modern, state-of-the-art power plants.

In 2006 Vattenfall made the decision to expand the Boxberg coal-fired power plant in Sachsen, where a new 675 MW plant will complement the existing facilities (1,907 MW) starting in 2011.

"In the new plant, all processes will be optimised," says Reinhardt Hassa, head of the Mining and Generation and Electricity Generation business units at Vattenfall Europe. "The plant will have an efficiency rate of 44%, which is an increase of 2 percentage points over existing plants, with a sharp reduction in emissions. For example, CO_2 emissions will be 30% lower than in older coal-fired plants."

Investing heavily in fossil fuels when the struggle for climate change is at the top of everyone's agenda may sound like a contradiction in terms. But in today's situation, there are no other realistic alternatives for meeting Germany's energy needs – coal is and will continue to be Germany's dominant source of energy. Lignite is cost effective, and the country's domestic reserves will last for many decades into the future, which is also important when natural gas and oil supplies are uncertain.

There are considerable synergies in expanding the Boxberg facility. Not far from the power plant is Nochten, Vattenfall's own open-cast mine, where Vattenfall can cost-efficiently extract 20 million tonnes of lignite per year, corresponding to approximately 20TWh in electricity generation. "We are also developing a new open-cast mine in Reichwalde," adds Hassa. "The assets in our open-cast mines will last an average of 30–40 years."

Despite the near proximity of the raw material, emission allowance trading in the EU will put pressure on the plant's economy.

"But the same requirements apply for our competitors. In Boxberg we will be developing a plant with optimal performance, so I am not particularly worried," says Hassa.

Parallel with the investment at Boxberg, Vattenfall is developing entirely new technology to separate, handle and convert carbon dioxide into liquid form, where it can be pumped into bedrock. In May 2006, German Chancellor Angela Merkel participated in the groundbreaking ceremony at the Schwarze Pumpe pilot plant (30 MW), 20 km from Boxberg. The plant will be commissioned in 2008.

"In 15 years we will be able to have large and competitive coal-fired plants that can generate electricity without emitting any carbon dioxide. And we at Vattenfall are the engines behind this development," says a proud Reinhardt Hassa.

Europe's energy markets

PRICE CONVERGENCE IN THE NATIONAL ELECTRICITY MARKETS

Internationalisation and deregulation of the European energy market continued in 2006, but a great deal remains to be done before certain markets can be regarded as liquid, effective markets. The year was also characterised by high and volatile energy prices.

In 2006, energy was at the top of the European agenda – among politicians as well as the general public. A number of major factors put their mark on the energy market during the year: high and fluctuating fuel prices, growing awareness about the climate issue, and the growing dependence on imports.

Deregulation in the EU electricity and gas markets is a key driving force in the development of the European energy market. The aim of liberalisation is to create effective price mechanisms, avoid unnecessary overcapacity, and to provide incentives for investment in new energy generation.

Deregulation began in 1989 in the UK, and thereafter a growing number of European countries have gradually opened their markets for competition. The Nordic countries, where deregulation has been completed, is home to the largest regional electricity exchange, Nord Pool. Slightly more than 40% of total trading in wholesale energy is done on Nord Pool's spot market, which was established in 1993 in Oslo. Prices on the electricity exchange are set when supply meets demand and form a benchmark for bilateral trading throughout the Nordic countries.

One of the purposes of deregulation of the energy markets has been to achieve lower consumer prices through competition. However, in recent years, prices have been at historically high levels. This has given rise to intensive debate and media attention, where the very notion of deregulation and the benefits of an open market are being called into question. Critics point to high profits and a high level of market concentration.

For the large energy companies, the market's development has thus entailed continued challenges: stricter regulations, tougher oversight of competition and heavy pressure from public opinion and politicians with respect to prices and how the companies are dealing with environmental issues. At the same time, deregulation has opened new opportunities for the energy companies. Through acquisitions across national borders, many energy companies have advanced their positions and gained access to new and larger markets. As a result of continuing consolidation, fewer but larger players are active in the European energy market (read more on page 26).

Far to go before full competition is achieved

The EU's electricity and gas market directive from 2003 calls for all countries to deregulate their electricity and gas markets and open them to competition by 1 July 2007 at the latest. Many have deregulated their markets, but many still have a long way to go. In spring 2006 the EU sent formal notices to 17 of the Member States in which it criticised the countries for not fulfilling their obligations according to the directive. Moreover, high energy prices in 2005 and 2006, and the sluggish implementation of the EU's directive, have prompted the EU's competition authority to conduct a sector inquiry to find out if the market is working satisfactorily. In its final report, which was published in early 2007, the EU Commission has recommended continued active measures and tougher rules in order for the internal energy market to become a reality.

Bottlenecks in transmission capacity

The idea of deregulation in the EU is that consumers should be able to freely choose suppliers throughout Europe. The goal is to merge national markets into regional markets and thereafter to build these markets together into a uniform European market.

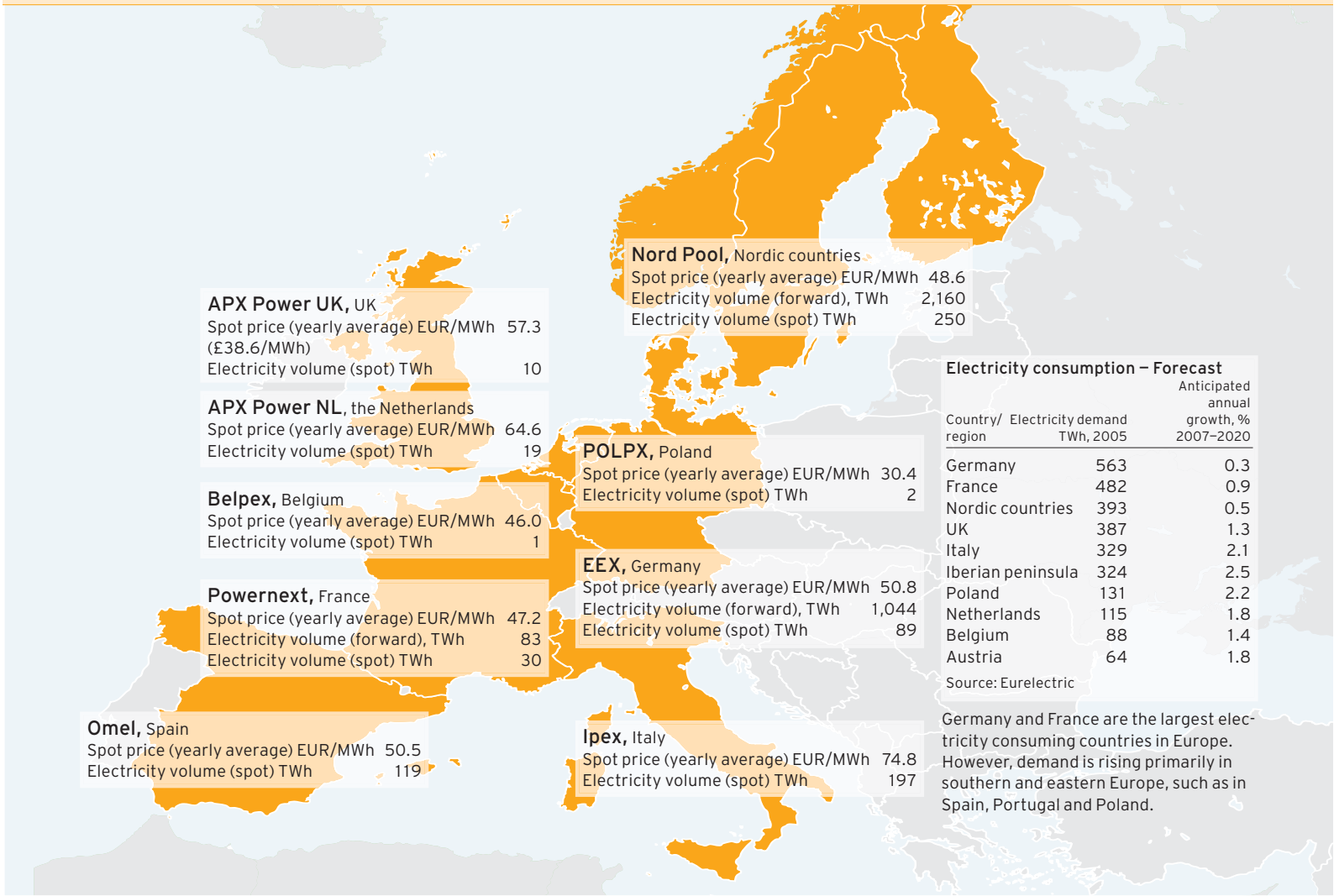
However, the technical conditions for doing this are still lacking. Electricity networks are fundamentally national, and transmission capacity between and within the EU's Member States is insufficient. Less than 10% of trading takes place between countries. As a result, Europe has become divided into a number of different price areas. Strengthening electricity connections and removing transmission bottlenecks through investment are top-priority matters within the EU.

Measures of this type during the year included the inauguration of the Estlink cable (350 MW) between Finland and Estonia. In addition, a cable is currently being laid between Norway and the Netherlands (700 MW). Yet another cable (800 MW) between Sweden and Finland is planned and is expected to come on stream in 2010.

Record-high energy prices

Energy prices reached new record levels in early 2006. The average spot price for electricity in Europe rose by an aver-

Prices and demand in the electricity markets



Electricity consumption – Forecast

Country/ region	Electricity demand TWh, 2005	Anticipated annual growth, % 2007–2020
Germany	563	0.3
France	482	0.9
Nordic countries	393	0.5
UK	387	1.3
Italy	329	2.1
Iberian peninsula	324	2.5
Poland	131	2.2
Netherlands	115	1.8
Belgium	88	1.4
Austria	64	1.8

Source: Eurelectric

Germany and France are the largest electricity consuming countries in Europe. However, demand is rising primarily in southern and eastern Europe, such as in Spain, Portugal and Poland.

A growing share of Europe's electricity trading is conducted on the electricity exchanges, where electricity generators, retailers and very large industrial companies trade in electricity. Some of the largest players consist of both generators and suppliers on the electricity exchanges, i.e., they both buy and sell electricity on the exchanges. Trading is conducted either for direct delivery, on the spot market, or for future delivery in the forward market.

The Nordic (Nord Pool) and German (EEX) electricity exchanges are by far the largest exchanges in terms of volume and number of traders. Relatively large volumes are also sold on the spot markets in Spain (Omel) and Italy (Ipex). Trading is also conducted in emission allowances on several of the electricity exchanges.

age of 70% in early 2006 compared with the same period a year earlier.

In the Nordic countries, the system price on Nord Pool in early 2006 was approximately EUR 40–50/MWh (compared with EUR 25–30/MWh in 2005). This was mainly due to low water levels in hydro reservoirs, a very cold winter and the impact of the price of CO_2 emission allowances. During the summer, Nordic electricity prices were still high due to low replenishment rates in reservoirs. However, electricity prices fell during the autumn, mainly due to a high water supply to dams combined with unusually mild weather and lower prices for emission allowances.

Even though the EU is divided up into different price areas, electricity prices are converging to a higher degree between the various national and regional markets, due to an increase in international trading. Another contributing factor to this is trading in emission allowances, which began in 2005. The aim of emission allowances is to introduce market principles and thereby effectively reduce CO_2 emissions in the aim of achieving the EU's climate objectives under the Kyoto Protocol. Companies each receive a certain amount of emission allowances. If this level is inadequate, they must purchase additional emission allowances.

In early 2006 the price of emission allowances was approximately EUR 30/tonne, which increased electricity prices by approximately EUR 18–20 per MWh of electricity. This was a result of high oil and gas prices, which led to higher demand for coal-fired electricity generation – and thereby also increased the price of emission allowances.

In May the EU presented data on the actual emission levels in 2005, which were at a considerably lower level than had been anticipated. This led to an immediate drop in prices to approximately EUR 10/tonne before prices stabilised at around EUR 15/tonne. Electricity prices quickly followed suit.

It is difficult to project future prices of emission allowances. In November 2006 the European Commission decided on national allocation plans for ten countries for the second trading period 2008–2012. Through its decision the Commission is demanding a significant reduction in the amount of emission allowances. Nine of the ten countries reviewed have received demands for cuts in the amount of emission allowances.

Major investments needed

According to EU estimations, Europe's energy dependence will be rising sharply in the coming decades. Today approximately 50% of the EU's primary energy is imported from non-EU countries. By 2030, estimates indicate that approximately 70% will be imported – in many cases from countries with unstable political conditions. This was illustrated early in the year when the Russian company Gazprom choked gas supplies to Ukraine due to a disagreement over prices, which sent a shock wave across large parts of Europe.

Against this background, the issue of security of supply has come into focus in the EU. In a Green Paper published in March 2006, the EU Commission estimates that EU countries will have to invest over a trillion euro in the next 20 years in order to meet electricity demand. This would involve replacing old generation facilities as well as expanding existing capacity with efficient and modern plants that meet high environmental standards.

The EU is home to approximately 240 million electricity consumers, of whom nearly 20% are in Germany. Total electricity demand is roughly 3,200 TWh per year. During the period 2005–2020, demand is expected to increase by approximately 1.4% per year. The rate of growth is highest in eastern and southern Europe. In northern Europe the rate of growth is expected to be lower, with the Nordic countries and Germany posting the lowest growth, at approximately 0.3%–0.5%.

In the Nordic countries, the supply of electricity generation is satisfactory during "normal" years, i.e., when the hydrological balance is at average levels. The upgrading of existing nuclear power plants in Sweden and the construction of a fifth nuclear reactor in Finland (ready in 2010/2011), as well as new gas power plants in Norway and Sweden, will lead to further increases in capacity. Over time, generation of renewable energy is also rising in the Nordic countries due to major investment in wind power, mainly in the Baltic Sea area.

In Germany, the rise in demand for electricity is ex-

Varying regulatory models for network companies

Deregulation of Europe's energy markets has resulted in a break in the value chain. Generation and sales have been exposed to competition, while transmission (high-voltage) and distribution, which are natural monopolies, are still regulated.

Consequently, the tariffs for using the networks are monitored and regulated by independent national authorities. The principles for this vary from country to country, and various models are used: return regulation, cost-based regulation and incentive-based regulation.

In Sweden, the so-called network performance assessment model was introduced in 2004. This model uses a virtual network to assess companies' performance and indicates a permissible income level. The relation between this level and actual income then forms the basis of the regulator's determination of network tariffs.

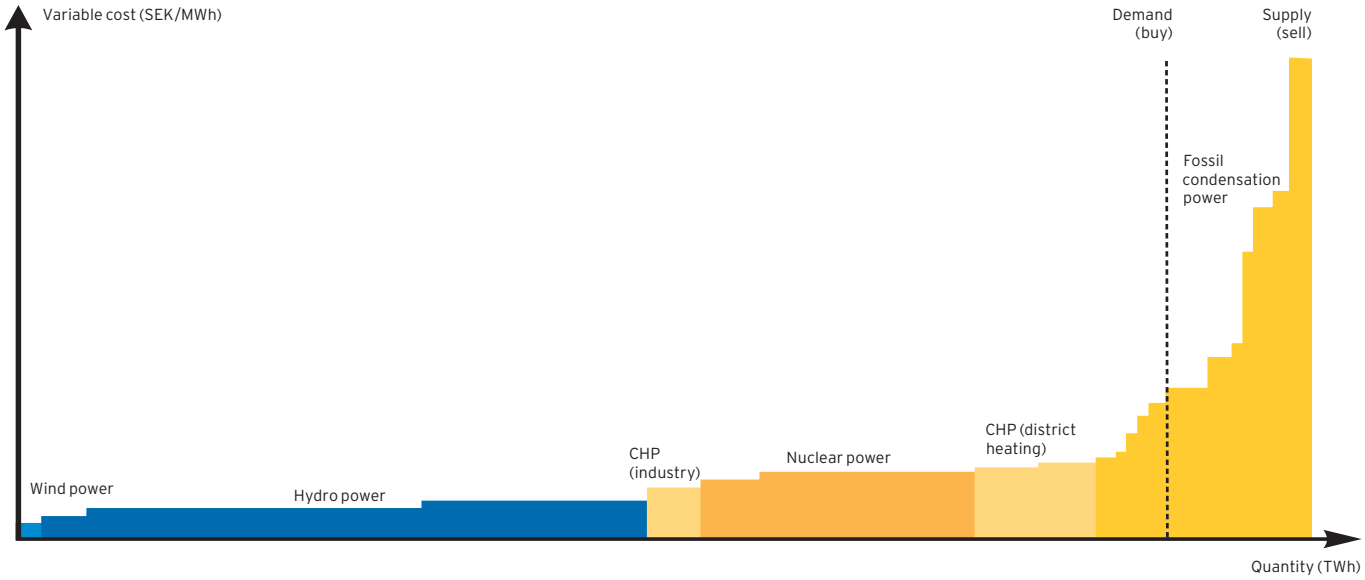
In Finland, a return-based model was introduced in 2005, which sets a maximum level for returns.

In Germany, all tariffs must be approved by the Germany network regulator. This regulation is cost-based, but in 2008 an incentive-based regulation model will be introduced, which will give network companies greater incentives to improve efficiency.

In Poland, network tariffs are approved in advance. This model is cost-based.

The UK has an incentive-based regulation system which gives energy companies stable conditions and opportunities to achieve a reasonable return on invested capital.

Merit Order Curve[1]



Pricing in the Nordic electricity market

In Nord Pool's spot market, players trade in hourly contracts for the next day. Every morning the traders submit their buy or sell offers. Bidding closes every day at 12 noon, and a buy and a sell curve are then plotted. The market price for the next 24 hours is set at the point where these curves meet, at the so-called market point. Vattenfall's variable generation cost is very low, but since its hydro power can be store in reservoirs, the water value is used instead of the variable generation cost in bidding on Nord Pool. In this way, the favourable regulating ability of hydro power is used in an optimal way. The market price on Nord Pool is thus often a water value which reflects the hydrological balance and cost of the fossil power generation that hydro power replaces.

Due to competition in the electricity market, pricing is based on this market price, which in turn leads to the most efficient use of generation resources. Normally, the cheapest forms of generated electricity are used first, while more expensive forms are not used until required by demand.

This market pricing ensures that every electricity generation plant is covered for at least its variable cost for electricity generation. Wind power, hydro power, nuclear power and combined heat and power plants have the lowest variable costs in the Nordic region. When these resources are inadequate, fossil condensation power must be drawn upon.

Market pricing is also transparent, and all customers receive their electricity prices according to the same terms.

Free market pricing also sends clear signals on whether future investments will be economically feasible or not.

In the Nordic countries, pricing is primarily dictated by water supply. However, capacity development, fuel prices, temperature and the price of CO_2 emission allowances also affect the price of electricity.

In many other countries, such as in Germany, the merit order curve is considerably flatter, resulting in narrower price variations.

1) The order in which generation capacity is utilised.

pected to be weak, however, the country has a great need to replace older generation facilities. The same applies for Poland, although demand there is expected to rise faster in the years ahead, by approximately 2.2% per year.

Stable heating market

The market for district heating looks different from place to place in Europe. In all there are some 100 million district heating consumers in Europe, while district heating market shares vary from 1% to 50% in the various countries.

The largest district heating markets in Europe are Poland, Germany, Sweden the Czech Republic and Slovakia. The district heating market is characterised by stability and a relatively low rate of growth.

In parts of the district heating sector, especially in the Nordic countries, a shift is currently taking place from oil and coal to gas and renewable fuels, which is contributing to a smaller CO_2 footprint.

A large part of district heating comes from combined heat and power (CHP) plants. But the differences are great from country to country: in Finland and Denmark, 75%–80% of heat is generated by CHP plants, compared with 35%–40% in Sweden and Poland. In Sweden and Poland, a gradual conversion is taking place of thermal power plants to CHP plants.

Higher gas prices

Natural gas prices rose sharply during the year due to higher oil prices. The market for natural gas is equivalent to slightly more than 5,000 TWh, which is 60% greater than for the electricity market. The three largest markets are the UK, Germany and Italy, which account for 50% of this volume. The largest application areas for natural gas are heating, electricity generation and industrial processes.

Most natural gas comes from European fields – mainly in the North Sea and the Netherlands – while approximately 40% of gas is imported, mainly from Russia and Algeria. Most is transported via pipelines, however, in recent years the use of liquid natural gas (LNG) has risen. This gas is cooled to a liquid state and transported in tanker vessels. It is then converted to gas again and delivered by gas pipelines.

Competitive situation

CONTINUED CONSOLIDATION OF ENERGY MARKET

During the year, several mergers and acquisitions were initiated in Europe. Most of the major players benefited from higher electricity prices, however, uncertainty grew with respect to energy policies, network regulation, taxes and emission allowances.

Today thousands of companies are working in the various national and regional energy markets in Europe – everything from local, municipal companies to very large international companies with operations spanning the entire value chain: generation, distribution, sales and trading. Several companies also have substantial sales of gas and are actively striving to integrate their electricity and gas operations.

However, companies that previously pursued a so-called multi-utility strategy, such as electricity/water/waste collection, are beginning to abandon this strategy due to the absence of anticipated synergies. An example of this can be seen in the German company RWE's sale of its British and US water distribution business.

Sweeping structural transformation

Ever since the local energy market companies began being exposed to competition in the early 1990s, a sweeping structural transformation has been in progress across national borders. The trend has moved toward increasingly fewer but larger international players.

Based on expansion plans and capital strength, the major European energy companies can roughly be broken down into two categories:

- Companies that are investing in growth throughout Europe or globally, such as E.ON, RWE, EDF, GDF, Enel, Iberdrola and Vattenfall
- Companies that are primarily focusing on national and regional markets, such as Gas Natural, Fortum, EnBW, EWE, Dong and Centrica

Some 50 companies are currently listed and/or issuers of corporate bonds, which means that their performance is continuously monitored by investors and analysts.

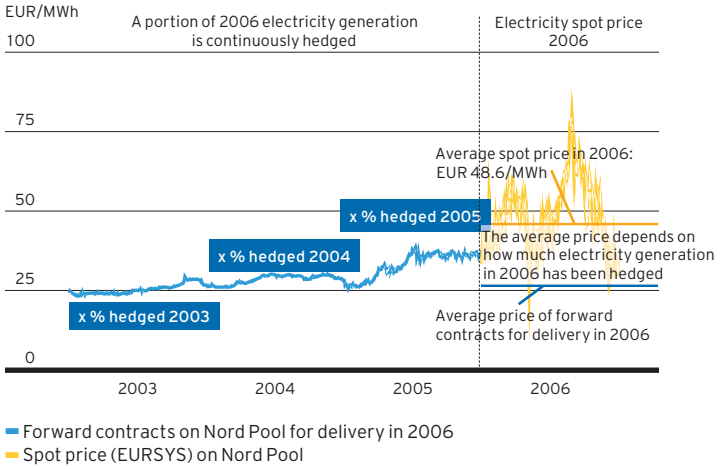
About a dozen or so companies are so large or have such a large market position that they are often pointed out as potential buyers in the ongoing consolidation in the market. Among these are E.ON and RWE (Germany), EDF, Suez and Gaz de France (France), Enel (Italy), Iberdrola (Spain), Gazprom (Russia), Vattenfall (Sweden), and to some extent Fortum (Finland) and CEZ (Czech Republic). Acquisition

Hedging of future electricity generation

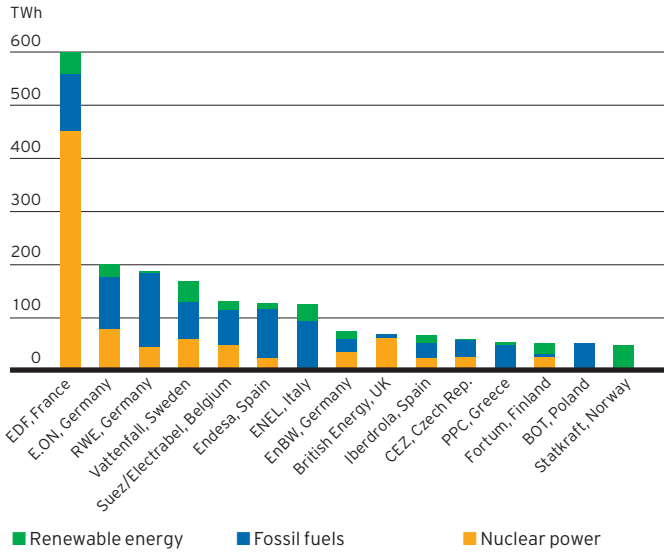
Electric utilities hedge their future electricity generation to varying degrees by selling it under forward contracts. This entails that companies lock in part of their future electricity generation at a fixed price for a number of years forward in time. In view of widely fluctuating electricity prices, forward trading is an important way of smoothing out and balancing the major price risk that is inherent in the business. If all generation were to be sold in advance under forward contracts, the spot price would not have any impact on earnings. The percentage of generation that is hedged by forward contracts can vary sharply from company to company and year to year. Companies that do not hedge their electricity generation under forward contracts expose themselves to price fluctuations in the spot market, which can be extremely large and lead to dramatic swings in their earnings. The inference is that you cannot judge electric utilities' earnings only by studying the trend in the spot market. The example at right shows, in simple terms, how hedging works. The example is based on Nord Pool, the Nordic Electricity Exchange, which is the exchange that has the most highly developed forward trading in Europe (see page 23).

The example shows the price development from 2003 to 2005 for a forward contract set for delivery in 2006. The forward contract for 2006 is traded through the end of 2005 and then goes to delivery. The yellow curve shows movements in the spot price in 2006. The average spot price on Nord Pool in 2006 was EUR 48.6/MWh. Since the forward prices for delivery in 2006 were lower in 2003–2005 than the spot price in 2006, a company that had hedged its generation for that year would receive a lower price than the spot price. If the spot price had instead been lower than the forward prices for the year in question, then the effect would have been the opposite – the company would receive a higher price for its generation compared with the spot price.

Example chart – hedging on Nord Pool



Europe's largest electricity generators



Major M&A activity

Major M&A activity in the European energy market in 2006

Company	Acquisition target	Amount, EUR billion
E.ON, Germany	Endesa, Spain (deal not completed)	41
Iberdrola, Spain	Scottish Power (deal not completed)	17
Suez and Gaz de France, France	Merger (not completed)	0
National Grid, UK	KeySpan, USA (deal not fully completed)	6.2

Company	Divestments	Amount, EUR billion
RWE	Thames Water, UK (sale to Kemble Water consortium)	11.9
RWE	American Water (in the form of planned IPO in 2007)	6–6.5 (estimated enterprise value)

candidates frequently mentioned are Scottish & Southern, Centrica, energy companies in the Netherlands, and Stadtwerke (Germany). There are more than 700 Stadtwerke companies, several of which have considerable size and operations in several different areas. In the Netherlands, many see a merger of some of the large companies as a logical measure.

Increase in M&A activity

Following a few years of consolidation, merger and acquisition (M&A) activity gained momentum again in 2005 and 2006. Strong cash flows resulting from a focus on energy, combined with higher energy prices, have put many companies in a very favourable cash position. In addition, the capital markets are currently offering favourable financing opportunities.

During the year, the German company E.ON made a EUR 37 billion bid for Spain's largest energy company, Endesa. The offer was raised in February 2007 to EUR 41 billion. During the autumn, Spain's Iberdrola made a EUR 17 billion bid for Scottish Power in the UK. At the initiative of the French government, Gaz de France and Suez are currently involved in a merger. Many market watchers view this as a defensive action to prevent Italy's Enel from taking over parts of Suez, including its Belgian subsidiary Electrabel. Russia's natural gas company Gazprom has ambitions to expand forward in the value chain by acquiring companies that have a large base of gas customers.

A new phenomenon in 2006 was the appearance of private equity investors on the scene, most notably in the UK.

Strong operating profits in 2006

Most energy companies strengthened their financial positions in 2006. Operating profits rose at the same time that cash flows strengthened and net debt decreased.

Commodity and electricity prices generally have a large impact on earnings, but they can have a widely varying effect depending on the companies' specific situations. They have the largest effect on companies with own generation capacity, such as EDF, RWE and Vattenfall. When prices go up, these companies can sell any surplus electricity at good margins. At the same time, these companies can lack adequate capacity during power peaks, which EDF experienced in summer 2006.

The companies' earnings are also affected by their product mix. Companies with fixed-cost generation, such as nuclear or hydro power, are not affected by rising fuel prices and therefore achieve higher margins. This applies, for example, to EDF and the Nordic power companies. Nor do higher raw material prices affect companies that own fuel assets, such as companies with own coal mines, including RWE, Endesa and Vattenfall.

Earnings performance during the year was also influenced by the companies' hedging activities in recent years (see preceding page). However, not all companies disclose how much of their production is hedged or at what price levels.

Future outlook

Much points to a continued rise in M&A activity in 2007. The same applies for the level of capital expenditures, which must increase in order to meet the rising demand for generation capacity and transmission.

At the same time, the situation is overshadowed by uncertainty about how political regulation, demands for ownership unbundling of network activities, taxes and environmental directives will affect the market. Greater volatility in electricity prices, emission allowances, and oil and gas prices entail that trading skills – i.e., knowledge about and access to commodity assets – is increasing. This will ben-

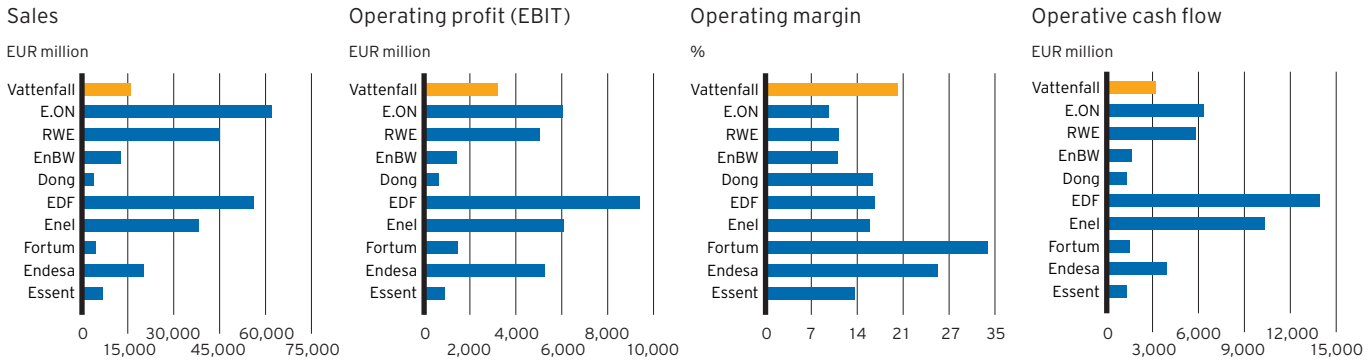
efit the large, diversified companies, especially those with integrated power and fuel handling. Most energy analysts are of the opinion that the major energy companies' profit margins will be relatively stable in 2007.

Should the investment opportunities that are currently on the table not measure up to required rates of return, the alternative is often to distribute any surplus liquidity to the shareholders through special dividends or share buybacks – actions that several companies have announced.

Comparison of Europe's utilities

The following tables provide a comparison of the major

Comparison of certain European energy utilities (Data as per 30 September 2006, unless indicated otherwise)

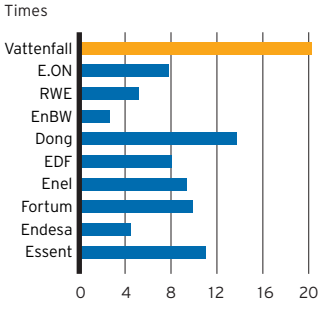


	Vattenfall	E.ON	RWE	EnBW	Dong
Country	Sweden	Germany	Germany	Germany	Denmark
Listing info	Unlisted 100% state-owned	Listed (free float: 85%)	Listed (free float: 67%)	Listed (EDF owns 45.01%)	Unlisted 73%-owned by Danish state (IPO planned in 2007)
Electricity sales 2005, TWh	200 (221 incl. delivery to minority owners)	404 (of which, Europe 367)	299	107	18
Number of customers, millions	Electricity: 6 (incl. network customers)	Electricity: 22 Gas: 8	Electricity: 20 Gas: 10	Electricity: 5 Gas: 0.4	Electricity: 1 Gas: 0.1
Primary products	Electricity, heat	Electricity, gas (upstream, downstream)	Electricity, gas. (Water operations are being divested)	Electricity, gas, (heat, waste, water)	Gas, oil, electricity
Primary markets	Nordic countries, Germany, Poland	Central and Eastern Europe, UK, Nordic countries, Italy	Germany, UK, Central and Eastern Europe	Germany, Central and Eastern Europe	Denmark, (Sweden, Germany, the Netherlands)
Strategies	To be a leading European energy company Five strategic ambitions: • Profitable growth in neighbouring areas through M&As and new production facilities • Benchmark for the Industry • Number One for the Customer • Number One for the Environment • Employer of Choice	• To be the world's leading power and gas company • Integrate and strengthen electricity and gas operations • Expand in gas production • Organic growth • Focus on new markets, such as Russia and Italy	• Focus on electricity and gas • Focus on core markets • Divestment of water operations in the USA and the UK • Organic growth	• Focus on core business • Strengthen the German operations. Ambition to be number three in German energy market • Advance positions in Central and Eastern Europe • Focus on value creation	• Integrate and consolidate recent acquisitions • Secure gas supplies • Expand electricity operations • Integrate gas and electricity operations • International growth (Sweden, Germany, the Netherlands)

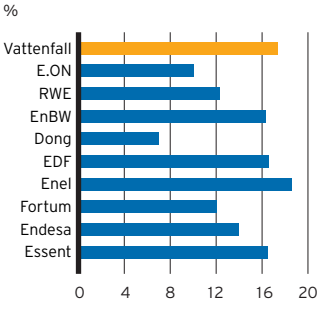
12-month year-on-year values as per 30 September 2006 for all companies except EDF and Essent, which are reported as per 30 June 2006.
Sources:
Graph values: Barclay's Capital.
Electricity sales, number of customers, primary products, primary markets, strategies: Vattenfall's research, various analysts' reports and annual reports, interim reports and websites.

European utilities with respect to size, operations, strategies and a number of key ratios. The presentation is not asserted as being exhaustive. Nor are the various companies ranked in any way. Compared with the corresponding comparison in Vattenfall's 2005 Annual Report, it can be noted that the companies have further refined their operations to the energy sector and that they are focusing on integration between electricity and gas. At the same time, several companies are seeking growth in new markets, such as Russia (E.ON, Fortum), Spain, Italy (E.ON) and Eastern Europe (E.ON, RWE, EnBW, Enel). There has been a general strengthening in their profitability and financial positions.

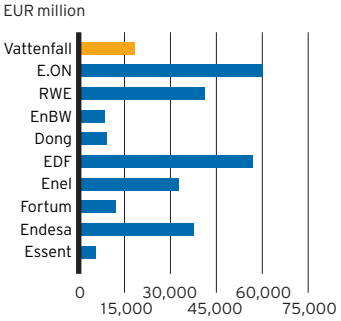
Interest coverage ratio, net



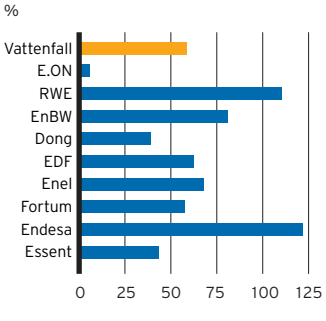
Operating profit/Capital employed



Capital employed



Debt/equity ratio, net



	EDF	Enel	Fortum	Endesa	Essent
	France	Italy	Finland	Spain	Netherlands
	Listed in 2005 (85%-owned by French state)	Listed (32.2%-owned by Italian state)	Listed (50.82%-owned by Finnish state)	Listed (Free float: 91%)	Unlisted
	628	271 (incl. retailers)	60	181 (of which, Europe 129)	49
	Electricity: 40 (Of which, Europe 37)	Electricity: 32 Gas: 2	Electricity: 1.4 (incl. network customers)	Electricity: 23 (of which, Europe 12) Gas: 0.7	Electricity: 2.5 Gas: 1.9
	Electricity, gas	Electricity, gas	Electricity, heat	Electricity, gas	Electricity, gas, heat
	France, UK, Germany, Italy, Eastern Europe (Asia, USA and Africa)	Italy, (Spain, France, Slovakia, Bulgaria, Romania)	Nordic countries, Baltic countries, Russia, Poland	Spain, Portugal, Latin America, Italy, France	Netherlands, Germany, Belgium
	• Strengthen positions in Western and Central Europe • Divest non-core businesses (e.g., Brazilian assets) • Improve productivity and reduce costs • Invest in gas assets in order to be able to offer customers both electricity and gas	• Leading player in Europe • Focus on core energy business (water and telecoms have been divested) • Expand in Eastern Europe and Russia • Focus on increasing generation from renewable energy sources	• To create a leading power and heat company in the Nordic region through profitable growth • Expand in Nordic countries, Baltic countries, Poland and Russia	• Maintain a leading position in the Iberian peninsula • Organic growth by building new generation capacity • Growth in Latin America (both generation and distribution)	• Aspiration to become a leading utility in northwestern Europe • Safeguard the company's independence and handle demands on transmission grid undbundling. (In early 2007, plans were announced for a merger with the Dutch company Nuon) • Look for collaboration with other companies in northwestern Europe, primarily in the Netherlands

Definitions:
Capital employed = Interest-bearing liabilities + equity including minority interests.
Operative cash flow = FFO +/– change in working capital.

Renewable energy and energy efficiency improvement

STRONG INVESTMENT IN WIND POWER

Vattenfall is making a concerted effort to take a leading role in renewable electricity and heat generation where commercial conditions exist. In 2006, work was begun on Lillgrund, one of Europe's largest wind power farms. Vattenfall's environmental work also includes analyses and advice on energy efficiency.

Renewable sources of energy will be playing an increasingly prominent role in the future, as fossil fuels become more expensive and assets become depleted. Naturally, the environmental factor is also critical: renewal forms of energy result in small net CO_2 emissions and must therefore increase as a proportion of the total energy mix if humankind is to successfully tackle the major climate issues. Thus far, however, renewable forms of energy account for a very small part of total energy generation. The investment costs are high, and it will take a long time before these forms of energy can make any major volume contributions.

Of global electricity consumption, today just under 2% consists of renewable energy, excluding hydro power, which accounts for approximately 16%. Most is generated by fossil fuels (oil, coal and natural gas), which account for nearly two-thirds of global electricity generation, while nuclear power accounts for roughly 16%, according to the IEA.

The EU's goal is that 20% of total energy will be derived from renewable energy sources by 2020, compared with 6% in 1997. With respect to electricity generation, the goal is 21% by 2010, compared with 14% in 1997.

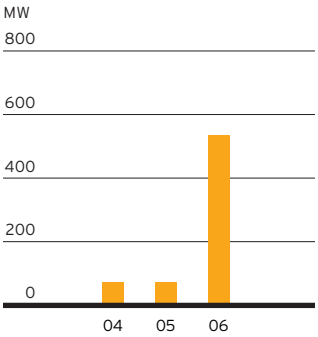
To increase the share of electricity generated from renewal forms of energy, many European countries have introduced economic support systems designed to favour such generation. Sweden has a system based on so-called electricity certificates. Electric utilities receive one electricity certificate for each MWh of renewable electricity they generate. Electricity customers must buy these certificates based on their own electricity consumption. Poland has also introduced "green certificates", which can be traded on the electricity exchange or bilaterally, while Germany has a system of subsidies for renewable electricity that provides a fixed price to electricity producers.

Vattenfall a driver in this development

Vattenfall's ambition is to play a leading role in renewable electricity and heat generation where ecological, technological and commercial conditions exist. The focus is

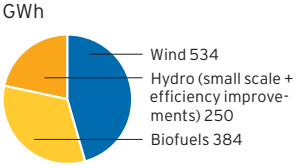
Generation of renewal energy in the Nordic countries

Installed wind power



Through the acquisition in Denmark, Vattenfall more than quadrupled its wind power generation in the Nordic countries in 2006. The rate of growth will continue to be high in the years ahead as a result of the investments currently being made in the Lillgrund wind power farm, among others.

Generation of renewable energy



Wind power accounts for the largest part of Vattenfall's generation of renewable energy, excluding large-scale hydro power generation.

Return on Vattenfall's investments in renewable generation in the Nordic countries 2006

	Wind	Hydro	Heat	Total
Operating profit, SEK million	61.5	117.1	253.2	431.7
Investments, SEK million	3,793.4	23.3	315.1	4,131.8
Property, plant and equipment, SEK million	5,627.9	271.8	3,822.0	9,721.7
Return on property, plant and equipment, %	2.0	43.1	6.6	6.1

Vattenfall's renewable energy generation in Nordic countries[1] (GWh)

	2002	2003	2004	2005	2006
Electricity					
Hydropower (small scale + efficiency improvements)	156	150	211	214	250
Windpower	51	54	58	46	534
Biofuels	525	503	497	547	384
Heat					
Biofuels	4,020	3,844	4,506	4,577	4,138

1) "Renewable energy" pertains to newly started and existing electricity generation that qualifies for electricity certificates in Sweden, newly started and existing electricity generation from plants in the other Nordic countries which, if they had been in Sweden, would have qualified for electricity certificates, and newly started and existing heat production from renewable energy sources.

More offshore wind power farms on the horizon

Vattenfall's wind power capacity will be increasing sharply in the years ahead. In autumn 2007, the first wind power turbines at Lillgrund, off Swedens' Skåne coast, will begin spinning. In all, the farm will include 48 wind power turbines, which together will be able to generate electricity for 60,000 households. The total investment in this project is approximately SEK 1.7 billion.

In addition, during the year, 24% of the generation capacity of the Danish power companies Elsam/E2 was brought into the Vattenfall Group. The acquisition included, among other things, more than 400 wind power turbines and with combined generation capacity of 447 MW. Vattenfall is also planning to build additional offshore wind power farms, at Kriegers Flak, Borkum West and Trolleboda, among other locations (see map at right).

on hydro power, biofuels and wind power. Vattenfall is also participating in national and European research programmes in areas such as wave energy, hydrogen gas, fuel cells, geothermal power and solar energy.

By positioning itself at the forefront and driving this development under commercially feasible conditions, Vattenfall can contribute to ecologically and economically sustainable development. This is in line with the company's strategic ambition to be Number One for the Environment.

In 2006 Vattenfall invested SEK 761 million (650) in research and development (R&D), of which SEK 64 million (56) pertained to R&D in renewable energy and SEK 126 million (61) pertained to other ways of reducing climate-affecting CO_2 emissions from Vattenfall's operations.

In the Nordic countries, Vattenfall stepped up its ambition level even further in 2006. In Sweden the goal is to increase electricity generation from renewable energy sources by 10 TWh by 2016. Most of the projects pertain to wind power, and the total investment can amount to upwards of SEK 40 billion. In summer 2006 the Swedish government extended its electricity certificate program until 2030, which is a necessary precondition in order for these investments to be profitable.

At the forefront of wind power development

In 2006 Vattenfall began construction of a wind power farm at Lillgrund, 7 km off Sweden's Skåne coast. Lillgrunden is the largest wind power investment in Sweden and one of the largest in Europe, and will yield 330 GWh of electricity per year. The farm is scheduled to be commissioned in 2007.

In addition, Vattenfall has acquired the rights to develop the Swedish part of Kriegers Flak, an area in the southern Baltic Sea, where there is an opportunity to build one of the world's largest wind power farms. In total the project involves approximately 130 wind power turbines with approximately 2 TWh in annual electricity generation. Also in Germany, Vattenfall is investigating opportunities to build large offshore wind power farms. As an initial project, 12 large offshore wind power turbines (approx. 5 MW/turbine) are being planned, together with partners, at Borkum West in the North Sea.

In 2006 Vattenfall also took over 24% of the production capacity from the Danish energy companies Elsam/E2, which includes more than 447 MW of wind power. Altogether, Vattenfall is now one of the top five wind power generators in Europe, with total generation of 0.6 TWh in 2006.

Major investments in biofuel-based generation

Vattenfall has some 90 biofuel-fired heat and combined heat and power (CHP) plants and is thus one of the world's largest buyers and users of biofuel. The goal is to use biofuel as far as possible, often as the main fuel in a mix of fuels, but also as a sole fuel source. Continuous development and optimisation of

biofuel boilers is currently being conducted within the Group in an effort to increase efficiency, lower corrosion damage and achieve lower emissions, such as of nitrous oxides.

Biofuel-fired plants are steadily accounting for a greater share of total energy generation. In Sweden and Finland, facilities are being continuously upgraded to accommodate a greater share of biofuel and a lower share of fossil fuels. In Germany and Poland, work is in progress on upgrading old plants in order to change the fuel mix and achieve a higher share of renewable fuel. The Zėrán plant in Warsaw, Poland, is a prime example, where coal and biofuel are being used in parallel with successful results. In Denmark, investments are being made in the Fynsverket and Amagerverket facilities to accommodate combustion of hay to a higher degree.

Vattenfall is also making major new investments in the field of biofuels. In Hamburg, Vattenfall has built a CHP plant based on recycled lumber and demolition lumber, while in the German town of Sellessen, near Cottbus, and in the Swedish town of Motala, CHP plants based on biofuels have been inaugurated. In Denmark, two CHP plants that will use hay are currently being built.

More efficient hydro power

Hydro power plays a very important role in Nordic electricity generation and accounts for about 50% of total electricity generation in the region. Vattenfall has more than a hundred hydro power plants in the Nordic countries – mostly in Sweden – which during a normal year generate roughly 33 TWh of electricity.

Vattenfall's many hydro power plants have provided a wealth of knowledge about how hydro power can be generated with minimal environmental impact and how new research findings and technological solutions can be used to improve the efficiency of today's hydro power plants.

Vattenfall invests heavily in hydro power. The goal of these investments is to secure generation over the long term, improve environmental aspects, lower maintenance costs and increase production.

In Germany, Vattenfall operates six hydro power plants and eight pumped storage power plants. The latter are used to store energy in order to even out generation between periods with low and high consumption. They are important tools for balancing the irregular input of wind power into the electricity grid.

Greater focus on energy efficiency-improvement

Energy efficiency-improvement is a vital tool in the work on reducing CO_2 emissions. In a green paper in spring 2006, the EU laid down the goal of improving the efficiency of energy use by 20% in the Member States by 2020. This corresponds to annual savings in the billions of euro. The measures include, among other things, energy certifications for buildings, an increase in and more targeted information, and subsidies for energy-efficient technologies. Moreover, every Member State has been required to implement a national action plan for improving energy efficiency.

Industries as well as households can save a lot of money through more efficient use of energy. Vattenfall offers advice on energy efficiency-improvement measures both to private and corporate customers.

Improving the efficiency of industrial energy use

Vattenfall is committed to strengthening its customers' competitiveness by providing customised solutions for improving the efficiency of both their energy use and their processes. In the Nordic region, Holmen, Höganäs and Korsnäs have all commissioned Vattenfall to review their energy use. For customers, this entails that Vattenfall identifies efficiency-improvement measures and evaluates them together with the customer. A list is of priority efficiency-improvement measures is then prepared.

In the actual implementation for the cases at hand, Vattenfall has stood for the financing – planning, purchase of technical equipment, installation and operation – and the gains have then been shared over a number of years. The customers have not had to invest time or money, and their operating cash flows have thus not been affected. Vattenfall also offers to devise and implement energy management systems for industrial companies.

Vattenfall also offers energy efficiency-improvement services in Germany. One example is the Havelhöhe Hospital in Berlin, where Vattenfall installed new energy technology to lower the use of water, heat and electricity. The one-time cost of this measure was EUR 900,000, with annual energy savings of EUR 180,000. The measure is financing itself through the major savings that have been achieved. In a similar manner, Vattenfall has helped the city of Berlin improve the energy efficiency of some 200 building in recent years.

Vattenfall also co-operates with customers to devise suitable strategies and risk policies related to electricity contracts. Market pricing can benefit customers that have the opportunity to reduce their consumption when electricity prices are high, such as during high load periods or power peaks. This contributes to efficient utilisation of the power system.

Advice and tips for household customers

Vattenfall provides advice on a continuing basis to households on how they can lower their energy consumption. This advice is distributed both on Vattenfall's websites, in information brochures and by Vattenfall's customer service units. Vattenfall's approach in its advice to customers is that electricity is a product which in many ways simplifies and raises the quality of life, and that it should be used efficiently.

Vattenfall's consumer publications provide practical tips on how to improve energy efficiency. Among other things, descriptions are provided of how much electricity various household appliances use and how customers can reduce their use of household electricity through very small measures. Vattenfall also describes how home heating affects electricity consumption and how households themselves have the opportunity to affect their total electricity consumption.

SUSTAINABILITY INITIATIVES

Vattenfall's energy solutions should meet customers' requirements and at the same time contribute to long-term sustainable development. The company's goal is to create value economically, socially and environmentally.

Throughout history, people have struggled with the challenge of how to use nature's resources. The challenge confronting humankind today is no longer one of mastering nature. Rather, it's about sustainability – about finding a balance between using and conserving our natural resources.

This also means that the demands and expectations placed on energy companies by society have changed. We must take the step from being solely a producer of energy to also being a good citizen. All our engineering know-how, all our economic strength and all our influence must – together with all the other players in society – be focused on solving the tough challenges that lie ahead in securing the energy supply while supporting sustainable development of society.

Vattenfall's interpretation of sustainable development is the same as the Brundtland Commission's: Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

We emphasise a holistic view of sustainable development as a continuous process that takes economics, the environment and societal aspects into account. Vattenfall must be successful at creating value in each of these dimensions, where economic strength is fundamental in order to create value in the other two dimensions.

As one of Europe's largest energy companies, Vattenfall has a responsibility to provide energy solutions that meet our customers' needs while at the same time contributing to sustainable societal development.

Vattenfall has high ambitions and contributes actively to sustainable development, both by contributing our knowledge and through the decisions that we make. We run our plants in the best possible way and do everything that is within our reach to be the benchmark of the industry. Supporting sustainable societal development means that we strive to use our resources efficiently and responsibly, that we limit our impact on nature and biological diversity, and that we contribute to better living standards and health for people. This concerns everything from small changes for becoming more effective in our daily work, to major investments, such as in CO_2 emission-free power plants (read more on page 4).

There is always a trade-off between the provision of energy and environmental consequences. The criteria for acceptable impact must be set in dialogue with society.

To communicate how we work with sustainability issues, Vattenfall has been publishing a Corporate Social Responsibility Report for the past three years. This is a vital tool for carrying on a dialogue with stakeholders on how we are living up to the expectations that are put on us and our role in society.

In the 2005 report, six themes were chosen to convey how we actively work with matters that are crucial for sustainable development of society – curbing climate change, safeguarding the nuclear fuel cycle, investing in renewable energy, securing energy supply to customers, utilising fossil fuels efficiently, and leading the energy sector.

For more information, visit www.vattenfall.com/csr.

Vattenfall's CSR report conforms to the most widely used standard for CSR reporting, namely, the guidelines of the Global Reporting Initiative (GRI). These guidelines consist of a set of indicators that measure the company's impact on the environment, society and the economy. GRI is an independent institution whose mission is to develop and disseminate globally acceptable sustainability reporting guidelines. These guidelines are voluntary and are currently used by approximately 1,000 companies around the world. For more information, visit www.globalreporting.org.

Growth through acquisitions

DENMARK ADDS NEW ARM TO VATTENFALL'S ENERGY GENERATION

If you were to view the energy market as a puzzle, then another important piece was added to Vattenfall's European business in 2006. On 1 July Vattenfall took over 24% of the generation capacity from the Danish companies Elsam and Energi E2, following a deal with the energy company DONG.

Under the deal, Vattenfall acquired five combined heat and power (CHP) plants and over 400 wind power stations in exchange for shares in Elsam.

"The Danish CHP and wind power assets complement Vattenfall's hydro and nuclear power generation in Sweden and its coal power plants in Germany," says Per Ebert, general manager of Vattenfall Denmark.

Annual generation from the plants amounts to approximately 6 TWh of electricity and 6 TWh of heat.

"Vattenfall has gained both larger and more even electricity generation through the Danish plants. But it is not only a matter of power generation. Vattenfall has also gained access to a wealth of expertise that exists in this organisation," says Ebert.

The Danish plants will not form a separate business unit, but will be incorporated organisationally in Vattenfall's Nordic operations, in the units for wind power, combined heat and power, and sales. Slightly more than 600 employees of Elsam/Energi E2 were transferred to their new employer, Vattenfall, on 1 July, and integration has progressed very smoothly.

"There haven't been any culture clashes," Ebert notes. "In part, because the cultural differences between Denmark and Sweden are small, and in part because Vattenfall is not a Swedish company any more, but an international one, which has created many new opportunities for the employees."

The Danish operations posted very good figures for the year, both regarding production and revenues. The goal now is for Vattenfall to grow in Denmark. Work is currently in progress on modernising block 1 at the Amagerverk plant in Copenhagen. In addition, a new CHP plant is being built in Fyn, which will be based on hay. The plant, which will use 170,000 tonnes of hay per year, will be ready in 2009 and will have a capacity of 35 MW of electricity and 84 MJ/s heat.

"But before then, additional pieces will certainly have been added to Vattenfall's puzzle of Europe," says Ebert.

NORDIC COUNTRIES: LOW WATER LEVELS AND DROP IN ELECTRICITY GENERATION

Sales for the year increased through the acquisition of generation capacity in Denmark and high electricity prices. However, earnings fell due to low water levels and the loss of nuclear power generation.

Sales and earnings

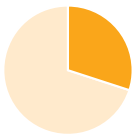
The Nordic operations performed slightly worse compared with a year ago, mainly due to low water levels in reservoirs, a significant disruption of generation at Forsmark, and sharply higher generation taxes. Operating profit excluding items affecting comparability decreased by 3.6%, to SEK 13,217 million (13,704). Earnings should be assessed exclusive of items affecting comparability, since the net compensation of SEK 3,057 million for the closure of Barsebäck 2 was booked in 2005. Sales increased, however, by 17.1% to SEK 49,205 million (42,021) as a result of higher wholesale prices of electricity and consolidation of the combined heat and power and wind power assets in Denmark.

Generation of electricity and heat

Having a highly diversified generation portfolio is of central

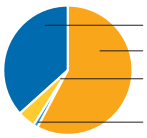
Brief facts

Share of Group's external net sales, 33%



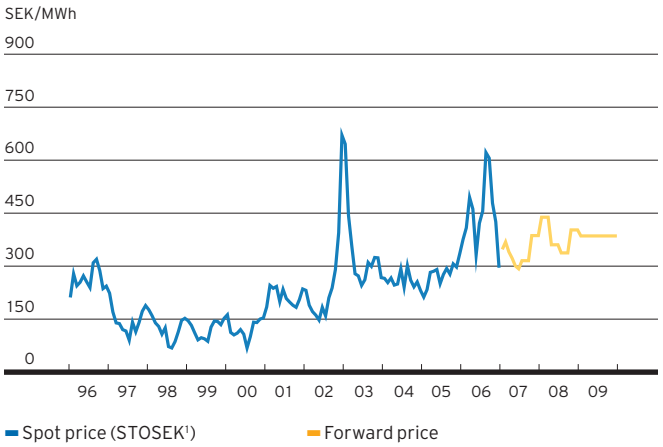
Share of Group's operating profit, excl. items affecting comparability, 50%

Generation mix, generated electricity, %



Vattenfall is the leading energy company in the Nordic region, with a market share in generation of slightly more than 20%. In Sweden and Finland Vattenfall generates, distributes and sells both electricity and heat, while in Denmark operations are limited to the generation of electricity and heat. Although hydro power and nuclear power are the platform of our electricity generation, wind power, biofuels, waste and fossil fuels are also used. Electricity is generated by seven nuclear power plants, approximately one hundred hydro power plants, 500 wind power plants, ten heating plants and five combined heat and power plants. Vattenfall is the fourth largest supplier of heat in the Nordic region, with 50 district heating plants and 140 so called "Färdig Värme" heating plants. Vattenfall also conducts contracting activities for the operation and maintenance of networks and hydro power, energy consultation, and research and development.

Swedish electricity prices 1996–2009, monthly averages



Source: Nord Pool
As per 31 December 2006

1) Stockholm price area in SEK

SEK million, unless indicated otherwise		2006	2005	Change, %
Net sales[1]	▲	49,205	42,021	17.1
Operating profit	▼	13,287	16,794	–20.9
Operating profit excl. items affecting comparability	▼	13,217	13,704	–3.6
Operating margin excl. items affecting comparability, %	▼	26.9	32.6	
Net assets	▲	81,687	77,190	5.8
Return on net assets, %	▼	15.7	24.1	
Return on net assets excl. items affecting comparability, %	▼	15.6	19.4	
Generation capacity, electricity, MW	▲	18,885	16,355	15.5
Generation capacity, heat, MW	▲	5,351	3,440	55.6
Electricity generation, TWh	▼	84.9	89.8	–5.5
Heat generation, TWh	▲	8.5	7.3	16.4
Number of electricity customers	▼	949,000	953,000	–0.4
Number of network customers	▲	1,294,000	1,291,000	0.2
Number of employees, full-time equivalents	▲	9,158	8,788	4.2

1) Of which, external net sales in 2006: 48,235 and 2005: 40,713.

importance for being able to handle variations in weather and market conditions. Vattenfall's generation in the Nordic countries consists primarily of hydro and nuclear power, however, waste, biofuels and fossil fuels are also used. In 2006, electricity generation in the Nordic countries decreased by 4.9 TWh compared with 2005. Hydro power generation was 5.5 TWh lower than in 2005 due to lower water supply in reservoirs during most of the year. Nuclear power generation was 3.7 TWh lower due to the incident at Forsmark, but also to a fire at the Ringhals nuclear power plant and the closure of Barsebäck 2 on 31 May 2005. Fossil-based power increased by 3.9 TWh following the acquisition of the combined heat and power assets in Denmark. The acquisition also entailed an increase in heat production by 1.8 TWh.

In July the generation assets from Vattenfall's acquisition in Denmark were acquired. These consist of five combined heat and power (CHP) plants, several land-based wind power plants, and Horns Rev – one of the world's largest offshore wind power farms. All of the facilities are very efficient, and the fuels used in the CHP plants consist primarily of hard coal but also hay, natural gas and a small portion of oil. Vattenfall generates approximately 6 TWh of electricity in Denmark, corresponding to 17.5% of Danish electricity consumption, and approximately 6 TWh of heat, corresponding to 17% of heat consumption in Denmark. Fuel prices rose sharply during the year which, together with higher taxes, put a burden on the heat operations. However, the earnings decline was mitigated by higher electricity prices and our success at cutting costs. In addition, the tax on waste combustion was lower than feared.

Electricity network

Earnings of the electricity network operations are being pressed downward by constant changes in regulations which do not provide opportunities for a reasonable return on invested capital. In order to lower costs and take advantage of synergies in administration, expertise and development projects, the electricity network operations in Finland and Sweden were merged in May 2006. During the year, Vattenfall also worked hard at improving its information, which led to a tangible reduction in problems for our customers in association with disruptions.

Sales

Sales activities are characterised by competition and small margins. Various surveys show that customers in all categories have grown increasingly dissatisfied. There is a general distrust toward the entire energy industry – the perception is that electricity prices are too high and the quality of service is too low. To improve service and boost confidence, Vattenfall is taking several initiatives, including work on reorganising its customer service organisation and on developing unique products that are adapted to individual needs. In June 2006 the "Trygghetsavtalet" contract was introduced (read more on page 5). It became an immediate success and has attracted a new inflow of customers to Vattenfall.

Investments

Investments in the Nordic countries have increased during the past three years, even excluding the acquisition in Denmark. Most of the increase has consisted of generation assets. Large investments in electricity generation lead to a greater supply in the market and contribute indirectly to keeping prices down. The investment programmes for nuclear and hydro power will increase Vattenfall's annual generation capacity by 8.5 TWh. Vattenfall's ambition is to increase generation from renewable energy sources by approximately 10 TWh in Sweden by 2016, mostly wind power (read more on pages 30–31).

Opportunities to build new hydro power stations are also being looked into under the condition that environmental and profitability requirements can be met. Vattenfall is also investing major sums in improving security of supply by upgrading and making improvements to the electricity networks. The ongoing investment programmes in Sweden and Finland aimed at improving the quality of the electricity networks and in installing remote readable electricity meters will amount to slightly more than SEK 3.5 billion in 2007. To date, 571,000 customers have had new meters installed, of whom 384,000 are in Sweden and 187,000 in Finland.

Investments have also been increased in the heat segment, including a new CHP plant in Motala, the acquisition of a generation plant in Tavastehus and the upgrading of a CHP plant in Uppsala.

Market development

Electricity prices fluctuated sharply in 2006. The winter months were characterised by cold weather. Electricity and commodity prices rose sharply due to a poorer hydrological balance and very high prices for CO_2 emission allowances. In late April it became apparent that emission allowances had been over-allocated, causing a dramatic drop in the price for these. Electricity prices soon followed suit, both on the spot and forward markets. During the summer months, electricity prices rose sharply again due to rising coal and oil prices, very warm weather on the Continent, a steadily weaker hydrological balance in the Nordic countries and the loss of nuclear power generation. Mild weather and heavy rainfall combined with lower oil prices and lower prices for emission allowances during the remainder of the year resulted in a steady drop in the forward market and steadily lower spot prices. The hydrological balance for the Nordic countries as a whole was considerably worse on average in 2006 than a year earlier. At the end of December the hydrological balance showed a surplus of 10.7 TWh, compared with a deficit of 3.7 TWh at year-end 2005. Average spot prices (SYSSEK[2]) on Nord Pool were SEK 450/MWh in 2006, which was 65% higher than a year earlier (SEK 272/MWh). During the fourth quarter, the average price was SEK 408/MWh, compared with SEK 306/MWh during the same period in 2005.

Forward contracts for 2007 and 2008 in the Nordic countries closed the year at EUR 37.0/MWh and EUR 42.3/MWh, respectively.

2) Nordic system price in SEK.

Challenges for operations in the Nordic countries

- Continued good profitability development
- Improve safety routines in our nuclear business
- Expansion in Nordic countries
- Boost the public's and media's confidence in Vattenfall
- More satisfied customers
- Actively participate in setting framework and terms of our operations
- Ensure competence succession

Activities based on Vattenfall's strategic ambitions

Profitable Growth

- Ensure implementation of nuclear and hydro power investment programmes
- Develop investment strategies and plans for combined heat and power and wind power
- Ensure conditions for hydro power generation and improve conditions for building new hydro power capacity
- Continue to evaluate opportunities to grow the customer base through acquisitions
- Combine low price and unique products with greater use of Web solutions
- Increase the percentage of direct sales

Benchmark for the Industry

- Effectively implement generation and distribution investment programmes
- Continue integration of the network operations in Finland and Sweden
- Develop new, long-term fuel strategies for the Heat business unit
- Develop new products that reduce the risk and costs associated with mass-market sales
- Refine the IS/IT initiative regarding SAP, between segments and countries
- Continue implementation of the shared services concept
- Implement the "One IT infrastructure" project

Number One for the Customer

- Provide electricity contracts to industrial customers and other major consumers in order to support their short- and long-term capacity requirements and at the same time offer stable and competitive electricity prices
- Reorganise customer service so that Vattenfall will be the leader in Scandinavia with respect to quality for customers and cost effectiveness
- Continue implementing and communicating "Reko Fjärrvärme" in combination with information on a new pricing policy
- Facilitate customer contacts with Vattenfall by intensifying co-operation and developing processes between different units
- Realise quality improvements and cost reductions in the SAP platform
- Continue to implement remote electricity meter reading
- Complete investments in quality assurance of the electricity networks in Sweden and Finland

Number One for the Environment

- Increase generation from renewable energy sources and nuclear power
- Recommend and apply for locations for permanent storage of spent nuclear fuel, and apply for storage licence
- Minimise environmental risks by handling and following up transformer oils, impregnating of poles, and insulation gases
- Material recycling
- Increase the share of biofuels in combined heat and power plants

Employer of Choice

- Define competencies that will be in demand in the future
- Work systematically with management and competence planning
- Further develop communication surrounding Vattenfall as the Employer of Choice, both internally and externally
- Continue active co-operation with universities and schools to create contacts with young, potential employees
- Encourage and facilitate internal mobility in order to develop employee competencies
- Ensure that management systems containing strategies, processes, follow-up and control are implemented throughout the organisation

GERMANY: EARNINGS LIFT FROM ELECTRICITY AND HEAT GENERATION

Operating profit in Germany rose by slightly more than 25%. Above all, electricity and heat generation performed strongly. However, the Transmission and Distribution business units were adversely affected by new network regulations.

Sales and earnings

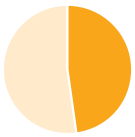
Vattenfall's German operation performed strongly during the year. Net sales rose 6.6%, to SEK 111,970 million (104,995). Operating profit excluding items affecting comparability rose 25.7%, to SEK 12,886 million (10,251). The sales and earnings increases are mainly attributable to rising electricity prices, a better outcome from hedged electricity generation and slightly higher generation volumes. The Mining and Generation business unit, which accounts for the absolute largest part of earnings, improved its operating profit by 64% compared with 2005. Allocation of CO_2 emission allowances for the first trading period was in parity with demand and therefore had no negative impact on earnings for the year. The Sales business unit improved its earnings by 22%, mainly due to lower sales and administrative costs. In the sales activities, work has been focused on further adapting the product portfolio to customers' needs and to improving customer service. The Heat business unit increased its operating profit by approximately 33% despite a stagnation in heat volume caused by warm weather. The Distribution unit, on the other hand, reported a sharp drop in earnings, by 56%. Following the adoption of new rules and a decision by Bundesnetzagentur, the German network regulator, Vattenfall's distribution assets were written down by SEK 1,019 million (EUR 110 million). The Transmission unit was also adversely affected by the new network regulations.

Generation of electricity and heat

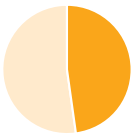
Electricity and heat generation were marginally higher in Germany in 2006 compared with 2005. On the whole, the generation facilities had a very good level of availability.

Brief facts

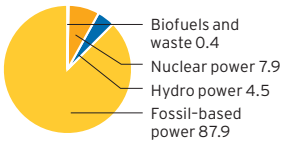
Share of Group's external net sales, 48%



Share of Group's operating profit excl. items affecting comparability, 48%



Generation mix, generated electricity, %



In Germany, Vattenfall generates, transmits, distributes and sells electricity and heat and is currently the country's third-largest generator of electricity and the largest supplier of district heat. Operations comprise open-cast lignite mines in Lausitz, power plants in eastern and northern Germany, the transmission network in eastern Germany, and regional and local networks in Berlin, Hamburg and Mecklenburg Vorpommern. Vattenfall operates several combined heat and power plants and thermal power plants, four large lignite-fired power plants, a hard coal-fired power plant, eight pumped storage power plants, and five gas turbine power plants. Vattenfall is also a part-owner of three nuclear power plants. Vattenfall has approximately 2.9 million electricity customers and 3.3 million network customers, mainly in Berlin and Hamburg. Vattenfall also provides a wide offering of energy-related services.

SEK million, unless indicated otherwise		2006	2005	Change, %
Net sales[1]	▲	111,970	104,995	6.6
Operating profit	▲	13,059	10,113	29.1
Operating profit excl. items affecting comparability	▲	12,886	10,251	25.7
Operating margin excl. items affecting comparability, %	▲	11.5	9.8	
Net assets	▼	61,818	68,717	–10.0
Return on net assets, %	▲	18.2	13.0	
Return on net assets excl. items affecting comparability, %	▲	18.0	13.2	
Generation capacity, electricity, MW	▲	15,221	15,112	0.7
Generation capacity, heat, MW	▲	8,727	8,697	0.3
Electricity generation, TWh	▲	76.2	75.9	0.4
Heat generation, TWh	▲	15.5	15.4	0.6
Number of electricity customers	▼	2,861,000	2,916,000	–0.2
Number of network customers	▼	3,285,000	3,287,000	–0.1
Number of employees, full-time equivalents	▼	19,821	20,096	–1.4

1) Of which, external sales 2006: 68,905 and 2005: 70,304.

However, heat generation was considerably lower at the end of the period due to warm weather.

Investments

Curbing greenhouse emissions is one of today's most imperative global challenges, and the debate on the greenhouse effect is taking up an increasingly greater place in the German media. Electricity generation from renewable energy sources will most likely increase in significance in the future and account for a greater share of total electricity generation. For example, the German government's target is that renewable energy sources will account for 25% of Germany's electricity generation by 2020, which would be a doubling of today's level. Vattenfall is currently evaluating the technological and economic conditions for building offshore wind power plants, such as through participation in the Borkum West test development project. In addition, the CO_2 emission–free pilot coal-fired plant project is proceeding according to plan (read more on page 4).

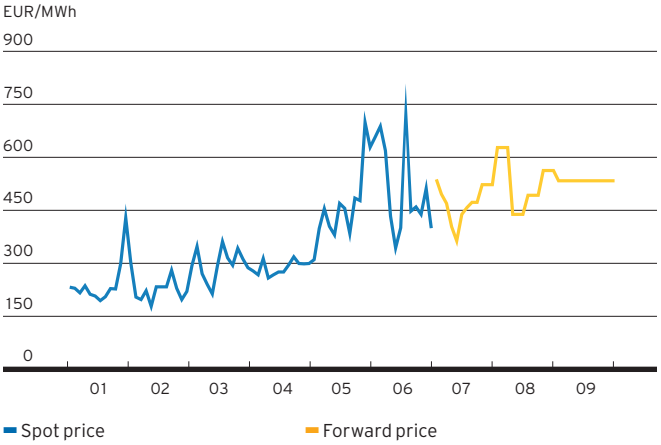
However, lignite and – to a lesser extent, nuclear power – will continue to be the most important energy sources for Vattenfall in Germany. Vattenfall, which already operates the world's most technically advanced lignite power plant, will continue to increase the efficiency and economic effectiveness of its plants, and will continue to invest in the development of CO_2 emission–free technology. The decision has also been made to build three new power plants. The Boxberg lignite-fired power plant in Sachsen will be expanded by 675 MW, involving optimisation of capacity utilisation of the nearby open-cast mine (read more on page 20). In Hamburg (Moorburg), a coal-fired combined heat and power plant with a capacity of 1,640 MW will be built, and in Rostock a waste combustion plant with an output of 20 MW is planned. In addition, further growth opportunities in the Berlin area are also currently being evaluated.

Market development

Price trend

Coal and oil prices were at high levels throughout 2006, which is a result of global economic and political developments and speculation on the commodity exchanges. During the fourth quarter the price of oil fell to USD 68 by year-end. Prices of electricity, gas and coal showed a similar trend. After rising to approximately EUR 31/tonne, prices of emission allowances fell to about EUR 14/tonne by the end of April, when it came out that actual emissions in Europe in 2005 were considerably lower than what had previously been assumed. Electricity prices soon followed suit, both on the spot and forward markets. In September, prices of emission allowances fell even further when it became increasingly likely that there will not be any shortage of emission allowances during the first trading period, which will conclude in 2007. The average price of emission allowances during the year was EUR 18.2/tonne. On 29 November the EU rejected Germany's national allocation plan for the second trading period, which runs from 2008 until 2012. The EU is demanding reductions of 6%, to 453 million tonnes/year and a ban on guaranteeing future emission allowances for new plants. At year-end, the price of emission allowances for 2007 and 2008 were EUR 6.5/tonne and EUR 18.3/tonne, respectively, compared with year-end 2005 levels of EUR 18.5/tonne and EUR 18.3/tonne, respectively.

German electricity prices 2001–2009, monthly averages



Source: European Energy Exchange (EEX)
As per 31 December 2006

On the European Energy Exchange (EEX) in Germany, spot prices in 2006 (base load) averaged EUR 50.8/MWh, compared with EUR 46.0/MWh in 2005. The corresponding prices during the fourth quarter were EUR 44.7/MWh and EUR 60.0/MWh, respectively. Forward contracts for 2007 and 2008 closed at EUR 50.7/MWh and EUR 56.2/MWh, respectively.

The high spot and forward prices led to intensive debate on electricity prices and has put greater political pressure on utility companies.

Political developments

The political situation in Germany is characterised by a greater propensity to further regulate the energy market. This is reflected not only in Bundesnetzagentur's decision to cut the network operators' network tariffs, but also by several new proposals on how energy policies should be formulated in Germany. An example can be seen in the proposal to introduce price controls. Moreover, the new government is sticking by its decision to gradually phase out nuclear power generation.

Challenges for operations in Germany

- Continue growing through future acquisitions
- Improve safety in our nuclear business
- Ensure profitable gas heat generation and replace older heat generation
- Manage the rising competition in the mass market sector
- Maintain profitability of the electricity networks despite new regulations
- Further reduce CO_2 emissions and increase the share of renewable energy in the generation portfolio
- Increase Vattenfall's attractiveness as an employer and ensure the recruitment process

Activities based on Vattenfall's strategic ambitions

Profitable Growth

- Build the power plants in Moorburg, Boxberg, Rostock and Rüdersdorf
- Build district heating network in Moorburg in Hamburg and expand the heat network in Berlin
- Actively evaluate business opportunities in connection with the privatisation of the municipal energy companies (Stadtwerke)
- Study opportunities for joint ventures in new markets
- Develop gas activities for Vattenfall Trading Services and Sales

Benchmark for the Industry

- Involvement in projects designed to improve the efficiency of processes and establish best practice across business units
- Increase efficiency by combining various telecom activities
- Implement the "One IT infrastructure" project
- Heat: Benchmark with the municipal heating companies and study if the fuel specifications used in the power plants can be expanded and made more flexible
- Mining and Generation: Maintenance programme to guarantee the value of our plants
- Networks: Conduct overview of all costs and optimise management of all assets
- Sales: Create a competitive organisation by further integrating middle-office and control
- Shared Services: Implement a service unit and make administrative processes more efficient

Number One for the Environment

- Continue to position Vattenfall as a pioneer and leader in technology for CO_2 emission-free power plants
- Implement a CO_2 emission-free pilot plant at the Schwarze Pumpe facility
- Acquire a share in the Borkum West offshore test area (12 5 MW wind power turbines) at an investment cost of approximately EUR 181 million, with planned commissioning in 2008
- Analyse opportunities to expand activities in offshore wind power projects

Number One for the Customer

- Adapt the product portfolio to changed customer needs and evaluate a dual-fuel offering using electricity and gas
- Inform about Vattenfall's contribution to environmentally friendly solutions
- Clearly position Vattenfall Europe as a company that provides new, environmentally friendly, differentiated products
- Provide advice and information to customers on energy

Employer of Choice

- Ensure early and goal-oriented competence planning in recruitment and development of young employees
- Ensure retention of knowledge and experience of experienced employees
- Implement age-adapted career paths and avoid promotions based on seniority
- Improve and develop the Group's trainee programme
- Expand marketing at universities

POLAND: CONTINUED EARNINGS IMPROVEMENTS

Operating profit rose nearly 17%. Heat and Distribution accounted for most of earnings, while the sales activities were hurt by lower margins.

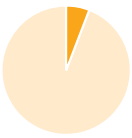
Sales and earnings

Vattenfall had a very good year in Poland in 2006. Sales rose 6.8% to SEK 9,449 million (8,850). Operating profit excluding items affecting comparability rose 16.6% to SEK 942 million (808). Most of earnings are generated by the Heat business unit, which accounts for roughly two-thirds of operating profit. Slightly lower heat volumes caused by warm weather were compensated by better heat tariffs and higher electricity prices. The Distribution business unit has shown a significant earnings improvement, mainly through operational streamlining, improved gross margins, lower transmission losses and a drop in "electricity theft".

Operating profit for the sales activities decreased during the year due to lower margins. Sales prices, which are regulated, have remained at the same level, while market-based wholesale prices rose sharply due to a shortage of renewable energy and the introduction of emission allowances. As a result, large industrial customers have begun purchasing their electricity directly from generators.

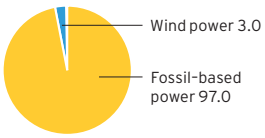
Brief facts

Share of Group's external net sales, 6%



Share of Group's operating profit excl. items affecting comparability, 4%

Generation mix, generated electricity, %



Vattenfall has actively participated in the shaping of the Polish energy market since starting activities there in 2000. Vattenfall was involved in one of the largest deals ever in the country as a result of the privatisation of the Polish energy sector, and acquired a majority stake in Elektrociepłownie Warszawskie S.A. (EW), one of the largest heat suppliers in Europe and a leading electricity generator in Warsaw. In 2001 Vattenfall also acquired a stake in the first Polish electricity distribution company offered for sale by the Polish government – Górnoslaski Zakład Elektroenergetyczny (GZE), in southern Poland. GZE is one of the largest distribution companies in the country and serves more than a million industrial, corporate and household customers. Since 1 January 2006, Vattenfall's companies have been working under the Vattenfall name in the Polish market.

Polish electricity prices 2001–2009, monthly averages

Source: Gielda Energii SA
As per 31 December 2006

SEK million, unless otherwise indicated		2006	2005	Change, %
Net sales[1]	▲	9,449	8,850	6.8
Operating profit	▲	1,072	842	27.3
Opeating profit excl. items affecting comparability	▲	942	808	16.6
Operating margin excl. items affecting comparability, %	▲	10.0	9.1	
Net assets	▼	8,812	9,295	–5.2
Return on net assets, %	▲	12.2	10.1	
Return on net assets excl. items affecting comparability, %	▲	10.7	9.7	
Generation capacity, electricity, MW	▲	1,008	981	2.8
Generation capacity, heat, MW	▼	4,986	4,996	–0.2
Electricity generation, TWh	▼	3.3	3.4	–0.3
Heat generation, TWh	▼	11.2	11.4	–0.2
Number of electricity customers	▲	1,107,000	1,104,000	0.3
Number of network customers	▲	1,108,000	1,104,000	0.4
Number of employees, full-time equivalents	▼	2,836	3,029	–6.4

1) Of which, external sales 2006: 8,981 and 2005: 8,790.

Challenges for operations in Poland

- Strengthen market position by acquiring and developing both "brownfield" and "greenfield" projects
- Continue to streamline activities in the aim of being a benchmark in productivity and service
- Adapt the organisation to a deregulated market, including a legal separation of sales and network activities and adaptation of current systems and processes to facilitate third party access and changes of suppliers
- Reduce emission levels in accordance with EU directives

Activities based on Vattenfall's strategic ambitions

Profitable Growth		
• Benefit from organic growth in the heat and sales operations	• Establish a stronger presence in generation through acquisitions and/or development of projects with existing/non-existent infrastructures (brownfield/greenfield)	
Benchmark for the Industry		
• Continue efficiency-improvement work, especially in support functions	• Continue improving technical service in the network activities	• Implement the "One IT infrastructure" project
Number One for the Customer		
• Adapt current systems and processes in an effort to facilitate third party access and enable customers to change electricity suppliers	• Strengthen customer loyalty by being a benchmark in customer service and the product offer	• Make the customer relations process more effective in order to reduce waiting times
Number One for the Environment		
• Comply with environmental standards for emission levels of particulates, SO_2 and NO_x	• Change the fuel mix in the heat operations to include biofuels (5% by 2012)	• Act to improve energy efficiency in Poland
Employer of Choice		
• Keep a high level of satisfied employees and measure employee satisfaction through "My Opinion" surveys	• Continue to develop the human resources function by constantly training and developing employees, offering going-rate salaries and implementing Vattenfall's core values	• Develop human resources through external recruitment • Provide good leadership in line with the required management competence

Generation of electricity and heat

Generated volume of heat and electricity for the year as a whole was marginally lower compared with 2005. Toward the end of the year, both heat and electricity generation were considerably lower, mainly due to warm weather.

Investments

During the year, the Heat business unit continued its medium-term investment programme to reduce, NO_X and SO_2 emissions. During the coming three years, approximately SEK 1,652 million (PLN 700 million) will be invested in lowering emissions and modernising production equipment in the heat operations. In the electricity distribution operations, investments are being focused on improving network quality. In connection with the acquisition of GZE in 2001 and as a supplement to the reinvestment undertaking, Vattenfall committed itself to ensuring that the company will have invested SEK 3,304 million (PLN 1.4 billion) in growth by 2011. By year-end 2006, growth investments in GZE amounted to SEK 151 million (PLN 64.1 million).

Market development

Coal prices rose during the year, as Polish mines could not produce sufficient amounts of hard coal. Prices also rose due to more stringent environmental regulations. Trading in CO_2 emission allowances was introduced, and uncertainties surrounding the allocation of emission allowances during the second trading period (2008–2012) caused major price fluctuations. Compared with Nord Pool and EEX, liquidity on the Polish electricity exchange (POLPX) is still low, especially in the forward market. The average price on POLPX during the year was 3.3% higher than in 2005 – PLN 117.3/MWh, compared with PLN 113.5/MWh. During the year, Vattenfall Trading Services in Poland began setting prices for electricity and CO_2 emission allowances.

Value creation

STRENGTHENING EARNINGS THROUGH EFFECTIVE CUSTOMER PROCESSES

Why stand in a long queue when all you have to do is lift the phone or visit a website?

Vattenfall's Polish operation has witnessed an organisational revolution in recent years – from internal bureaucracy to centralised processes with the customer in focus.

Eighteen customer service offices have been reduced to three. In their place, since 2003 a single call centre has been taking care of virtually all matters that the offices previously handled.

"Customers shouldn't need to be transferred between various departments when they call. Our goal is that customer contacts will be handled seamlessly and conveniently according to our motto: One issue, one customer contact," says Grzegorz Lot, Head of Vattenfall Customer Services Poland, which was established on 1 January 2006.

Backing up Grzegorz are the staff at Vattenfall's call centre, who provide answers to everything from contracts to moves and payments.

"All of our electricity customers – except for the absolute largest ones, who have their own key account managers – can now call a single number and get an immediate answer to their questions," says Lot.

Vattenfall Poland has outsourced its call centre function to an external company.

"Their experience and flexibility made them the most cost-effective solution for us," Lot explains. "What's more, many of our former employees landed new jobs with our call centre."

The call centre is just one example of an administrative function that has been made smoother and more efficient. Another example can be seen in the handling of invoices sent by post, where Vattenfall Poland will save EUR 170,000 in 2007.

"We are constantly on the lookout for new ways to improve our efficiency," says Lot. "The savings we generate allow us to invest in further measures to improve our customer service."

Over time, customers will be able to handle more of their matters online, even though it will take a while before these services are launched. It's not only new tools and services that are in the pipeline – efficiency must be improved through the entire organisation.

"It's a matter of changing attitudes and constantly making the customer number one. We are going through all of our processes and trying to find out how we can be more efficient. This is only the beginning," assures Grzegorz Lot.

Employees and competence

ENSURING FUTURE GROWTH THROUGH STRATEGIC COMPETENCE PLANNING

Competition for employees is increasing in the job market. To manage stable growth and create value in all areas, Vattenfall is making a concerted effort to create a culture and environment that are conducive to employee development. This strategy has generated results: in 2006 Vattenfall was ranked as Sweden's Best Employer in a major survey of young professionals.

Vattenfall will be carrying out a number of major investment projects over the next ten years. Parallel with this, a significant number of employees will be retiring at the same time that competition in the job market is expected to increase. To ensure continuous access to necessary competence, Vattenfall must be an employer that can attract and develop employees today and in the future. This is also one of the five strategic ambitions that forms the foundation of the Group's work on value creation.

Strategic competence planning

All of Vattenfall's business units work according to a yearly strategic competence planning process. This process is designed to ensure access to the competence that the Group will be needing also in the future. We have identified the future risk areas that we must focus on in order to manage our operations as well as our planned investments. Our investments in new technology give rise to a natural demand for new and different competencies. But this does not only involve developing the competence of our existing employees; it also means that newly recruited employees must be willing to learn old technologies in order to be able to run and maintain older facilities, and that senior employees must be motivated to share their knowledge. Moreover, our employees will be facing greater demands to manage change and the integration of various operations. To ensure our access to competence, we are working on numerous long-term measures, including new ways of working, new forms of competence development and knowledge-sharing, leadership focused on commitment and work performance, a highly effective and high-quality recruitment process, and a more distinct positioning of Vattenfall as an employer.

Excellent leadership

Excellent leadership is critical for Vattenfall's continued success. The Group's management planning process aims to secure current and future leadership needs. The process encompasses all leaders and potential leaders in the Group.

In 2006 a total of 1,458 managers and potential managers were assessed and had a dialogue with their immediate superiors. The result of this work was positive, and in 2007 we will be focusing on further increasing mobility, change management and increasing the share of female managers.

Our own Vattenfall Management Institute (VMI) is a primary avenue for developing managers within the Group. VMI provides basic management training for newly installed managers and advanced programmes at the strategic level for senior management. Vattenfall's second international trainee programme, with candidates from all countries within the Group, was started during the autumn. In 2007 a new, international rotation programme will be initiated.

Compensation and benefits

At Vattenfall we strive for differentiated and individually-set salaries with a clear reward component for demonstrated results. For employees who have variable salaries or the potential for bonuses, the Group's value creation targets are a key incentive. We are continuously developing our models for flexible forms of compensation, and we offer pension plans, vehicle leasing and other benefits in exchange for salary.

Sweden's Best Employer

To meet our future competence needs, the employer aspects of the Vattenfall brand are growing increasingly important. Building relationships with students has high priority and includes trainee programmes, apprentice programmes, internships and opportunities to do thesis work with Vattenfall. Other initiatives include participation in research projects and providing financial support to professorships and Ph.D. programmes.

In Sweden, Vattenfall was named as Sweden's Best Employer in 2006 in a survey conducted by Universum Communications of 22,000 young professionals throughout Sweden. Vattenfall employees gave especially high marks to development opportunities at Vattenfall, to their ability to influence their own work, and Vattenfall's company culture.

Development dialogue leads to employee commitment

"My Opinion" is Vattenfall's annual employee survey aimed at supporting continuous improvement throughout the organisation. The process revolves around a dialogue on results between all managers and their employees, who then agree on an action plan for areas in need of improvement.

After five years in use, the survey is now firmly established within the Group. In 2006 more than 30,000 employees had the opportunity to participate, and the response rate was a record-high 72%. Parallel with this, improved results were noted in many areas. Particularly large progress was made in areas that most work groups had focused on in their action plans: "Goals and feedback" (+6 percentage points), "Work/private life balance" (+3), "Leadership" (+3), "Co-operation" (+2), and "Company management" (+2).

Vattenfall's management planning process

Identification

A systematic review is conducted within the Group to find future management candidates and develop the Group's current managers. At total of 217 upper-level managers and 519 potentials have been identified.

Assessment

All potentials are assessed based on the following criteria, among others: goal achievement, Vattenfall's leadership criteria, the employees' assessment of leadership, language skills, and personal potential.

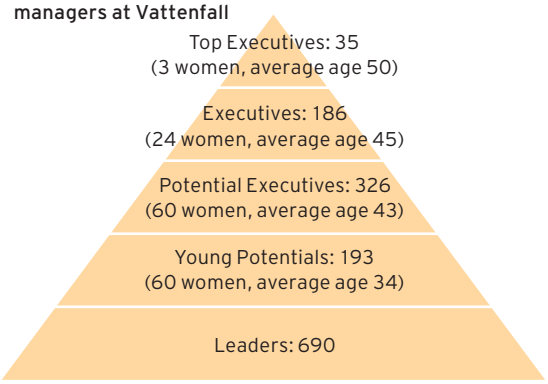
Review

Once a year, a review is conducted with the respective business unit managers of all candidates included in the process. A final review is conducted of the respective Business Groups together with the Group CEO. A total of 24 reviews were performed in 2006.

Development

All participants in the process have a personal development plan, covering such opportunities as change of position, leadership development programmes, mentor programmes, etc. Development plans for a few selected individuals are drawn up together with the Group's HR function.

Managers and potential managers at Vattenfall



Challenges

- A leadership planning and development process that will ensure Vattenfall's access to first-rate leaders at all levels
- Competence planning strategies and processes that give Vattenfall the right competence at the right place in its organisation
- A high performance culture and organisation based on clear decision-making principles and which stimulates employee commitment
- A safe, healthy and inspiring work environment that is conducive to employee development
- Compensation and benefit models that contribute to value creation and which reward performance, focus on potential and contain flexible solutions

Outcome 2006

- Vattenfall ranked as Sweden's Best Employer in a survey conducted by Universum Communications among young professionals who evaluated their own employers
- Major progress in several key areas according to annual employee survey, including goals and feedback, work/private life balance and leadership
- In Germany, a collective agreement was reached for the core business
- 1,458 managers and potential managers were assessed and had a dialogue with their superiors
- Approximately 300 participants in the Group-wide leadership development programmes
- Start-up of Vattenfall Business Institute, offering Group-wide programmes in controlling, purchasing, HR and for senior specialists

Goals 2007

- Start of a new, international job rotation programme for some 200 Young Potentials
- Greater share of female managers in every Business Group
- Maintain high internal mobility for managers
- Start of a new concept for specialists aimed at more effective use of their knowledge within the Group and opportunities for competence development
- Start of a three-year programme aimed at reducing work injuries by 20% by year-end 2009

VALUE–CREATING CORPORATE GOVERNANCE

Dear reader:
The Parent Company of the Group, Vattenfall AB, is 100%-owned by the Swedish state. It is thus the Swedish people, represented by Swedish parliament, who are ultimately Vattenfall's owners.

With the key role that a leading energy company plays in society, it is of central importance for Vattenfall that citizens have confidence in Vattenfall as a company and for the operations we conduct. Vattenfall's ability to attract customers is affected to a high degree by the Company's reputation. We are aware that confidence in the energy sector has its ups and downs, and of the recurrent criticism that has been directed at Vattenfall as well as other energy companies for not always succeeding in meeting everyone's demands for low electricity prices, disruption-free electricity supply and energy generation without adverse environmental impact. It is therefore an important task both for Vattenfall's board and management to show that we regard all of society as our principal and that our operations and knowledge truly measure up to the needs of society and our customers.

The Board has discussed the issue of nuclear power safety at length. The events at the Forsmark nuclear power plant and the subsequent reporting in the media have made the public aware of the work that is conducted at our nuclear power plants. It goes without saying that safety must be the number one priority at our nuclear plants. As the main owner of the Forsmark and Ringhals nuclear power plants, the Board takes Vattenfall's responsibility in this regard with utmost gravity. The Board has appointed a safety committee – which I personally chair – which is closely monitoring this safety work and reports on its findings to the Board. The safety committee's work is focused on ensuring adherence to safety routines and that the company culture promotes safety consciousness. The public's right to feel confident in the safe operation of nuclear power plants must be upheld.

Climate issue decisive for energy companies

In recent years it has become increasingly apparent that climate impact is the greatest long-term challenge facing energy companies. Emissions of greenhouse gases, especially carbon dioxide, are warming Earth's atmosphere, and fossil fuel combustion is the main source of these emissions. For several years Vattenfall has been making a concerted effort to radically reduce emissions of greenhouse gases – partly through ambitious technology development programmes, and partly through opinion-shaping activities. At Vattenfall's 2005 Annual General Meeting, our responsibility in this area was more clearly defined through the addition of an amendment to the Company's articles of association, which prescribes: "Within the framework of demands for business professionalism, Vattenfall shall be the leading company in the shift to ecologically and economically sustainable Swedish energy supply." For the Board, the work on this shift has high priority, and Vattenfall's ambition is to be a driver of development toward more environmentally adapted energy generation.

High profitability and increased dividend

Being a responsible company in the energy market with a long-term perspective requires good, sustainable profitability. It is therefore positive to note that in 2006, Vattenfall was once again able to report a new high point in its financial performance. Because of the favourable earnings that have been maintained in recent years, Vattenfall can – without jeopardising its financial stability – implement its major investment programmes for increased generation capacity, improved delivery reliability, lower CO_2 emissions, and greater reliance on renewable energy.

However, Vattenfall contributes to the national economy not only by delivering energy and investment in future generation, but also by paying share dividends directly to the state treasury. The dividend to the Swedish state is to be in line with the going rate in the market, and a new dividend interval has been set which entails that 40%–60% of profit is to be distributed. To enable Vattenfall's future investment, the owner – the Swedish state – has chosen to allow most of profits to remain in the Company. According to the Board's proposal for this year, Vattenfall's dividend to the Swedish state will amount to SEK 7.5 billion, so it is with great pleasure that the Board notes that Vattenfall has thus set a new dividend record for the Group. To put this in perspective, this amount would cover – with a margin to spare – the annual basic curriculum grants made by the Ministry of Education and Research to the universities in Uppsala, Lund, Gothenburg and Stockholm, as well as to the Royal Institute of Technology and Chalmers engineering universities.

Electricity prices remained high during the year, which has benefited electricity generators like Vattenfall. The negative reactions have not gone unnoticed, however. Our customers are expressing concerns over rising energy costs. We understand these concerns and share them in large part. There are two main reasons for the higher prices: rising wholesale prices for primary fuels, such as coal, oil and natural gas, but also higher prices for CO_2 emission allowances. However, higher electricity prices also lead to greater investment in new electricity generation and in technologies that are much cleaner than that used in older plants. And this is one of the aims of emission allowances.

Long-term strategic discussions

The climate issue was one of the most important matters that

the Board worked with in 2006. Equally important has been the strategic discussion of how we can best realise Vattenfall's vision – to be a leading European energy company with robust growth and profitability. This strategy was adopted by the Board four years ago, and it was discussed at length at several meetings during the autumn. The Board has ascertained that the primary market trends that led Vattenfall to a growth strategy still apply today, and that the Company has developed very favourably since then, with the acquisition in Denmark as the single largest event. At the same time, we have noticed certain developments that have become more significant than we believed in 2003, such as the impact of climate policies on electricity prices, or the efforts being made by certain countries to protect their national companies from acquisitions. In summary, we are sticking to our growth strategy, and our path to achieving Vattenfall's vision must take into account both the changing world we live in and the changes taking place within our company.

Appreciated open Annual General Meeting

The Swedish government exercises long-term and active ownership management with value creation as the over-arching objective. The government encourages state companies to conduct open AGMs with the opportunity for people from the general public to attend and to ask questions directly to company management. This principle has been embraced by Vattenfall, which since 2005 has invited the public via advertising in newspapers and announcements on the Company's website to attend entirely open AGMs. This has been an appreciated initiative that has given rise to interesting questions and discussions with private persons, spokespersons from various organisations, and publicly elected members of parliament.

The Ministry of Enterprise, Energy and Communications has a special division for state ownership which is responsible for governance of state-owned companies. Like other company owners, this state ownership division has a number of governance tools at its disposal and works actively on such matters as the board's composition, auditing, and descriptions of company activities.

To clarify the state's view on certain matters and to achieve uniformity among the companies under its administration, the government has adopted guidelines on external financial reporting, terms of employment for senior executives, and employee incentive programmes. In addition, the government has identified certain, special policy issues of major importance, where state-owned companies are to act as a model. These concern such aspects as equal opportunity, the environment, diversity, work environment and companies' role in society. To promote clarity and uniformity on liability and information matters in state-owned companies, the Ministry of Enterprise, Energy and Communications has drawn up a proposal to support boards in adopting and revising rules of procedure and for handling certain information matters.

Improvements following evaluation

Vattenfall AB abides by the same laws as privately owned companies in Sweden and complies where applicable, with the recommendations and norms that apply for companies listed on the Stockholm Stock Exchange. The Swedish Code of Corporate Governance (the Code) is part of the government's framework for its administration as company owners. Vattenfall applies the Code and regards it as one of several important sets of rules for external reporting and communication.

In line with the aims of the Code, in 2006 Vattenfall conducted an evaluation of the Company's board work. The Board commissioned a thorough review of its routines and decision-making processes. The report pointed to areas in need of improvement, including the Board's handling of competence planning within the executive management, executive compensation and existing routines for crisis management. Based on the findings of this report, the Board has made a number of decisions in order to further improve and streamline its work. The routines for the work on succession matters have been formalised in the Rules of Procedure and have become a standing agenda item for the Board's August meeting. A compensation committee has been established to deal specifically with the matter of executive compensation, and the Board conducts risk management seminars on a regular basis.

Dag Klackenberg
Chairman of the Board

GOVERNANCE OF OPERATIONS AND DECISION–MAKING

Application of the Code and contents of the Corporate Governance Report

Vattenfall applies the Swedish Code of Corporate Governance ("the Code") and considers it as one of several important sets of governing regulations for external reporting and communication. Information on corporate governance according to the Code for the 2006 financial year is provided below. For information already provided in the Annual Report, reference will be made to the appropriate section.

General information on Group's Management System

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

To ensure that Vattenfall develops in the intended direction and lives up to ethical and legal requirements, the CEO has established a Group Management System (GMS), which also includes a description of how the Group is governed. The GMS is available to all employees on the Group's intranet. The GMS consists of a number of building blocks (see GMS diagram below). Management is based on Vattenfall's mission and vision, the Group-wide Code of Conduct and company philosophy, and on the Group's policies in key areas. The GMS is documented in governing documents, consisting of Group policies, Group instructions and other documents. The Group policies describe the intentions for action on matters of importance for the Group, while Group instructions provide more detailed and operative control, and lay down mandatory rules.

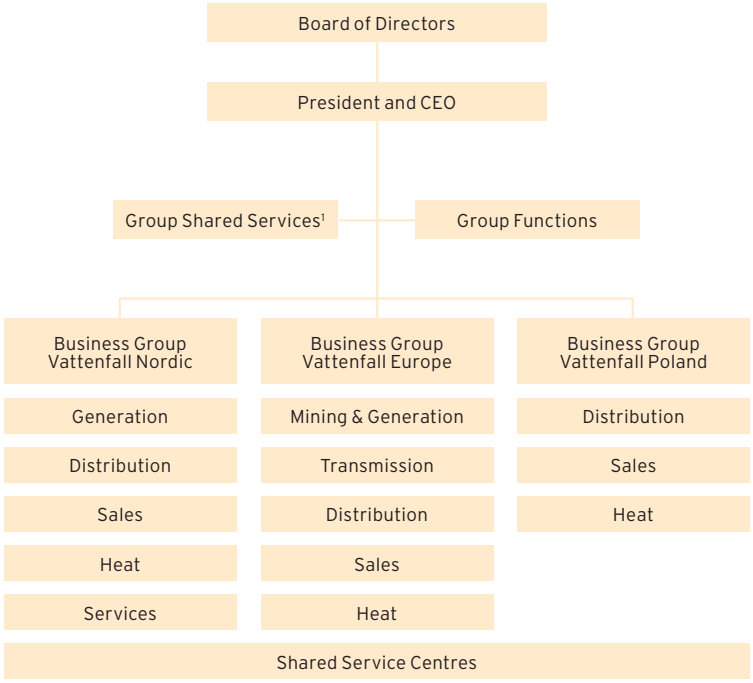
The "Roles and Allocation of Responsibility" instruction defines decision-making bodies and fundamental roles within the Group. The "Principles for Decision-Making and Delegation" is another central instruction that covers delegation from the CEO to the heads of the Business Groups, Group Functions and Group Shared Services. The Group's management processes for strategic planning, business planning and follow-up are central governance tools for the Executive Group Management (EGM).

The Group functions are responsible for proposing, developing and following up Group policies and instructions. The Vattenfall Group has a Quality Function charged with co-ordinating the GMS. Both the Head of Group Quality Function and the Head of Group Environment must approve all Group policies and instructions prior to final approval. All governing documents are submitted to the EGM for approval.

All activities within Vattenfall are obligated to comply with the GMS governing documents. Consequently, each Business Group has a complementary management system that is adapted to the detailed requirements of its operations. Group Function Internal Audit is responsible for ensuring compliance with the GMS.

Vattenfall's organisation

Group Management System building blocks



1) Vattenfall Trading Services, Vattenfall Treasury, Vattenfall Insurance and Vattenfall Research and Development AB.

Deviations from the Swedish Code of Corporate Governance
Vattenfall's corporate governance for the 2006 financial year deviates on the following points from the requirements stipulated in the Swedish Code of Corporate Governance:

Code requirements	Description	Comment
1.1.2 Shareholders' initiative rights	Shareholder information on website	Information on the Annual General Meeting is provided on Vattenfall's website. However, because of the ownership structure, this stipulation is not directly applicable.
1.1.3 Notification of general shareholder meetings	Registration by e-mail or the Company's website	Because of Vattenfall's ownership structure, this stipulation is not applicable.
1.4.4 The Chairman's role	Shareholders' right to ask questions at the Annual General Meeting	At the 2006 Annual General Meeting, Vattenfall arranged for an open question/answer session for the general public. In addition, members of Swedish parliament have the right to ask questions in connection with the AGM. However, because of Vattenfall's ownership structure, this stipulation is not directly applicable.
2.1.1 Appointment of nomination committee	Nomination committee criteria	The nomination process conforms to the Swedish state's ownership policy. Information on this process is provided on Vattenfall's website.
2.1.2 Composition of nomination committee	Minimum of three members	The nomination process conforms to the Swedish state's ownership policy. Information on this process is provided on Vattenfall's website.
2.1.3 Publication and information about nomination process	Names of the members of the nomination committee	The nomination process conforms to the Swedish state's ownership policy. Information on this process is provided on Vattenfall's website.
2.2.1 Nomination committee's recommendations for directors and fees	The nomination committee's recommendations for directors, chairman and apportionment of fees	Recommendations are made in the AGM notice. The nomination process conforms to the Swedish state's ownership policy.
2.2.2 Nomination committee's documentation for its recommendations	The nomination committee makes a profile of requirements	The nomination process is in compliance with the Swedish state's ownership policy. Information on this process can be found on Vattenfall's website.
4.2.1 Compensation committee	Committee members shall be independent in relation to the Company	In the Compensation Committee, one committee member, who is not an AGM-elected director, is employed by Vattenfall. This gives the employee representatives an opportunity to participate in the committee.
4.2.3 Share- and share price-related incentive programmes	To be decided by AGM	Not applicable, since Vattenfall is not a listed company.

Organisation and processes

Vattenfall's organisational model is based on the electricity and heat value chains: for electricity – generation, transmission, distribution and sales, and for heat – generation, distribution and sales. The President, who is also the Chief Executive Officer, heads the Group's business operations and administration in accordance with the Swedish Companies Act and the Board's instructions. Reporting and follow-up of the business operations are conducted with full transparency in accounting, control, profitability and value creation.

In terms of management, Vattenfall's operations are broken down into three categories:

- Business operations are handled by Business Groups and their Business Units in defined geographic areas. These are governed as profit centres.
- Group functions that support their respective management teams. These are governed as cost centres.
- Shared Service units, which provide services that support their customers' (internal Business Units and others) efforts to optimise their business operations. Shared Service activities are run on a full cost basis and are governed by internal customers. Shared Service units operate at both the Group (Group Shared Services) and Business Group levels.

A number of management processes that are essential for the Group have been established. Each process is managed by a process owner, usually a member of the 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 follow-up	Chief Financial Officer
Risk management	Chief Financial Officer
Mergers & acquisitions	Head of Legal Affairs and M&A
Investments	Chief Financial Officer
Communications	Head of Communications
Management planning	Head of Human Resources
Capacity management	Head of Capacity Management

The strategy and business planning process culminates in yearly 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 the EGM. Strategy planning includes the Group's long-term operations as well as its financial performance.

Each year a five-year strategic plan is drafted for decision 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 ultimately approved by the ExCom. The business plans for the following calendar year are adopted by the Board.

Governing business ethics

Vattenfall's core values are:
Openness, Effectiveness and Accountability
In 2005 the Board approved Vattenfall's joint-Group Code of Conduct and company philosophy, which stipulate that all employees shall adhere to and work in accordance with Vattenfall's core values, policies and Group instructions. The stipulations of the Code are concretised in other parts of the GMS, such as in instructions for general legal and business-ethics principles, and competition matters. Further information on governing business ethics is provided in Vattenfall's CSR Report, which can be downloaded and ordered from Vattenfall's website: www.vattenfall.com.

The Board's composition and work

The duties and allocation of work in the Board

The Chairman's duties are outlined in both of the Swedish Companies Act and the Board's 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.

Each year the Board establishes its Rules of Procedure, based on the supporting document for rules of procedure in state owned companies issued by the State Enterprises Division of the Ministry of Enterprise, Energy and Communications. Apart from mandatory items pursuant to the Swedish Companies Act, the Rules of Procedure regulate such things as the Chairman's duties, information to the Board, the form of board meetings, and evaluation of the work of the Board and the CEO.

Matters to be dealt with by the Board are stipulated by the Swedish Companies Act and the Board's Rules of Procedure. The main duties of the Board, apart from appointing the CEO and deputy CEO, are to establish the strategic direction of operations, approve major investments, acquisitions and substantial organisational changes in the Group, and to establish central policies and instructions. In addition, the Board oversees the Company's financial development and has ultimate responsibility for internal control and risk management.

The Board's risk management process

Operational risk management is regulated by Group instructions with a special focus on risks associated with energy and commodity trading, and financial, insurance and credit risks. The Board decides on overall risk limits for the Group in all these areas. Operational risks are followed up on a regular basis and are reported within the respective Business Groups. At each board 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 on for follow-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 overall responsibility for the Group's financial activities and risk management, and ensures compliance with the Group's policies and instructions in this area. A Group risk committee has been established to support the CFO in these issues with the primary task of ensuring qualitative risk management in the Group by, for example, approving risk management methods, ensuring standardised routines for risk management and risk reporting, and proposing mandates and limits. Since 2003, the Group also conducts an annual environmental risk evaluation which is co-ordinated by the Head of Group Environment. The results of this evaluation are presented to the EGM and Vattenfall's risk committee. Environmental risk management is co-ordinated with other risk management. For more information about Vattenfall's risks and risk management, see pages 66–99 of this annual report and Note 34 to the consolidated accounts.

Composition of the Board of Directors

Vattenfall's board has eight directors elected by the Annual General Meeting (AGM) plus three directors and three deputies elected by the employee organisations. No members of the EGM are board members. Of the board members, three are women and two are foreign citizens. The average age of board members is 54.

At the 2006 AGM, Maarit Aarni-Sirviö, Christer Bådholm, Dag Klackenberg, Peter Lindell, Hans-Olov Olsson, Lone Fønss Schrøder and Anders Sundström were re-elected as directors, and Greta Fossum was elected as a new director. The AGM appointed Dag Klackenberg as Chairman of the Board. The employee organisations appointed Carl-Gustaf Angelin, Johnny Bernhardsson and Ronny Ekwall as employee representatives, with their deputies Lars Carlsson, Stig Lindberg and Per-Ove Lööv, respectively. In accordance with the Swedish state's ownership policy, the CEO is no longer a director on the Board. For further information on the Board of Directors, see pages 58–59 of the annual report.

Directors' fees

Directors' fees are set by the AGM. For information on directors' fees for 2006, see Note 44 to the consolidated accounts in the annual report.

Directors' independence

The Swedish state's ownership policy stipulates that nomination of directors is to be made public in accordance with the guidelines of the Code. However, independence in relation to major shareholders is not reported. Of the company's directors, Dag Klackenberg, Maarit Aarni-Sirviö, Christer Bådholm, Greta Fossum, Peter Lindell, Hans-Olov Olsson, Lone Fønss Schrøder and Anders Sundström are independent in relation to the company and the EGM.

Appointment of the Board

For enterprises that are wholly owned by the Swedish state, uniform and joint principles for a structured nomination process are applied, which take the place of the Code's rules on the appointment of directors and auditors. The nomination process is run and co-ordinated by the State Enterprises Divi-

sion of the Ministry of Enterprise, Energy and Communications. A work group 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. Board members are 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 are conducted largely according to a plan established by the Rules of Procedure. This specifies that seven ordinary meetings are to be held each year. In addition to ordinary meetings, the Board is summoned to further meetings if the need arises. According to the Rules of Procedure, at least one meeting each year must be held at a place other than the head office. In 2006 a meeting was held in Copenhagen. In connection with this, the Board visited local facilities and was provided with more in-depth information about the operations that Vattenfall acquired in Denmark.

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

- The Group's strategic plan
- The Group's total risk exposure
- Safety and environmental issues within the Group's nuclear power operations
- Personnel issues within the Group, including the ability to attract and retain skilled personnel
- Research and development activities within the Group

In addition, the following are reported at each meeting:

- Important business events since the previous meeting, under the item "Business status"
- 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, competitive scenario and risk management.

The Board had 11 meetings in 2006, including the statutory meeting. Following is a compilation of the meetings and some of the more important items of business that were discussed.

Evaluation of the Board's and CEO's work

The Board evaluates its own work and the CEO's work once a year. This evaluation is headed by the Chairman and is reported to the Board. The most recent evaluation was presented at the board meeting on 26 April 2006 and pertained to the Board's work in 2005. The evaluation of the Board's work in 2006 is ongoing and will be reported at the board meeting in October 2007.

Matters handled by the Board appointed by the 2005 AGM

Meeting date	Focus and important matters discussed
31 January 2006 (extra meeting)	• Acquisition matters • Investments in the German network operations
7 February 2006	• Year-end report
22 February 2006	• Year-end book-closing, annual report and audit report • Credit risk mandate • Management planning and development • Vattenfall's R&D activities • Report on corporate governance and internal control • M&A activities
26 April 2006	• Vattenfall's three-month interim report • Evaluation of the Board and CEO • Financial targets for Vattenfall AB • Amendments to the Articles of Association

Matters handled by the Board appointed by the 2006 AGM

Meeting date	Focus and important matters discussed
Statutory board meeting, 27 April 2006	• The Board's Rules of Procedure • Members and Rules of Procedure for the Audit Committee • Investments in the German operations
17 May 2006	• Finance instructions and instructions for the handling of energy and commodity risks • Follow-up of investments made during the first half of 2003 • Investment in the Uppsala electricity network • Plan for renewable energy • General update of M&A activities • Current M&A activities
26 July 2006	• Vattenfall's half-year interim report • Establishment of a compensation committee
31 August 2006	• Date for 2007 AGM • Information on the Forsmark nuclear power plant • Payment routines within the Group • Plan for renewable energy and the wind power project • Follow-up of investments made during second half of 2003 • M&A activities • Investments in the German operations • Strategic plan • HR matters within the Group • Report from Audit Committee
24 October 2006	• "Curbing Climate Change" initiative • Environmental strategy • Review of the Vattenfall Group's media image locally and internationally • The investment process • Investments in the Danish operations • Information on the Forsmark nuclear power plant • M&A activities
30 October 2006	• Vattenfall's nine-month interim report
11 December 2006	• Safety and environmental issues surrounding the Group's nuclear power operations • Annual follow-up of investment programme in hydro and nuclear power in the Nordic countries • Investment programme for wind power in the Nordic countries • Current investment activities • Approval of business plans and investment budget for 2007 • Report from Audit Committee • Method for evaluation of the Board's work

Directors' attendance at meetings

	Board appointed by 2005 AGM				Board appointed by 2006 AGM						
	31/01/06	07/02/06	22/02/06	26/04/06	27/04/07	17/05/07	26/07/06	31/08/06	24/10/06	30/10/06	11/12/06
Maarit Aarni-Sirviö	–	X	–	X	X	X	X	X	X	X	X
Christer Bådholm	X	X	X	X	X	X	–	X	X	X	X
Greta Fossum					X	X	X	X	X	X	X
Lars G. Josefsson	X	X	X	X							
Dag Klackenberg	X	X	X	X	X	X	X	X	X	X	X
Peter Lindell	–	X	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	–	X
Carl-Gustaf Angelin	X	X	X	X	X	X	–	X	X	X	X
Johnny Bernhardsson	X	X	X	X	X	X	X	X	X	X	X
Ronny Ekwall	X	X	X	X	X	X	X	X	X	–	X
Lars Carlsson*	X	X	X	X	X	X	X	–	X	X	X
Stig Lindberg*	X	X	X	X	X	–	X	X	X	X	X
Per-Ove Lööv*	X	X	X	X	X	X	X	X	X	X	X

X Present – Not present *) Deputies

Committees

Audit Committee

The Audit Committee is a board committee tasked with gaining greater knowledge of, insight into and control over the Company's accounting, financial reporting and risk management. The Audit Committee has special responsibility for ensuring application of the Code and for preparing required reports. In conjunction with audits, the Company's auditors report their observations at Audit Committee meetings. No formal decision-making authority has been delegated to the committee, since its members are all directors on the Board.

In 2006 the Board appointed the following members to serve on the Audit Committee: Peter Lindell, Christer Bådholm and Lone Fønss Schrøder, plus deputy board member Per-Ove Lööv from the non-AGM elected board members. With respect to fees paid the committee's members, see Note 44 to the consolidated accounts in the annual report.

The Audit Committee prepares the Board's work as a means of quality-assuring the company's financial reporting. The Board has adopted rules of procedures for the committee. The committee reports its work to the Board by submitting meeting notes to the Board and, when requested, by making presentations at board meetings.

The Audit Committee held four meetings in 2006. The auditors were present at all meetings and presented their observations from the audit of the annual accounts and the 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 22 February 2006.

Members present at Audit Commitee meetings in 2006

	27/01/06	24/04/06	22/08/06	30/11/06
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

Vattenfall AB has no nomination committee. For more detailed information on the nomination process, see the section "Appointment of the Board" on page 55.

Compensation Committee

In 2006 the Board established a compensation committee to prepare ongoing matters regarding the compensation of senior executives, including matters pertaining to annual salary reviews and other terms of employment for the CEO.

In addition, a going-rate principle is adhered to regarding the salaries and remuneration of all deputy CEOs and heads of the Group functions. The committee reviews current salaries, fixed and variable salaries, and other compensation where applicable, including pension terms, of significance to all such executives. The committee also drafts principles regarding the salary and remuneration.

The following persons were appointed by the Board to serve on the Compensation Committee: Dag Klackenberg, Anders Sundström and Maarit Aarni-Sirviö, plus Johnny Bernhardsson from the non-AGM elected board members. The head of Human Resources and deputy head of Human Resources make presentations at the committee's meetings.

The Compensation Committee has adopted rules of procedure for its work. The committee reports on its work to the Board, whereby the committee chair informs the Board about the committee's decisions. However, the Board as a whole must decide on matters concerning the CEO's employment and decide on the CEO's terms of employment.

The Compensation Committee held one meeting in 2006, on 31 August, at which all the members were present.

Remuneration of senior executives

The Board has approved a programme that complies with the Swedish government's guidelines on remuneration and incentive programmes for senior executives. The programme covers all employees in Sweden and took effect in 2005. Each year Vattenfall's internal auditors perform a review to ensure compliance with these guidelines. The result of this review is reported to the Board.

According to these guidelines, the CEO does not receive any variable salary. Other executives and employees in Sweden do not have higher variable salary than the equivalent of two months' salary a year, or 16.7% of their normal base salary. The normal base salary for certain executives can be decreased by 16.7%, depending on performance. Local practice applies in other countries. As previously, the Group's long-term value creation forms the basis of compensation levels. The Group's targets apply for all employees. Executives' individual performance is also measured, as is the performance of their respective units.

More detailed disclosures about taxable salaries, benefits and pension costs for the Chairman of the Board, company directors, the CEO and other senior executives are provided in Note 44 to the consolidated accounts in the annual report.

Ensuring the quality of financial reporting

In its separate report on internal control (page 55), the Board has reported on the company's internal control structure in the financial reporting routines.

The Audit Committee's work is a part of this control exercised by the Board, where external and internal auditors present their observations to the directors who are members of the Audit Committee. The external auditors presented, among other things, their observations concerning the six-month accounts and the annual accounts at each audit committee meeting in 2006. At these meetings, Vattenfall's internal audit function is represented by its head, 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 2007.

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

Auditors

The 2004 Annual General Meeting appointed Ernst & Young AB as auditor, with Authorised Public Accountant Lars Träff as Auditor-in-charge. This appointment applies for a term lasting through the 2008 AGM. Lars Träff has served as Auditor-in-charge since the 1997 AGM. In addition to Vattenfall, Lars Träff has auditing assignments with the following companies, among others: Lantmännen, Swedbank, JM, Observer, Ticket and TV4. Lars Träff has no assignments with companies that affect his independence as an auditor of Vattenfall.

The Swedish National Audit Office has appointed Authorised Public Accountant Per Redemo to serve until the 2008 AGM. He has held this position since 2004. Per Redemo is the appointed auditor for Vattenfall AB, Green Cargo AB, Sveriges Radio AB and Sveriges Utbildningsradio AB, and he is chief auditor for the following authorities/state enterprises: the Swedish Tax Agency, the Swedish National Board of Student Aid (CSN), the Swedish Financial Supervisory Authority and Swedish State Railways. Per Redemo has no assignments for companies that affect his independence as an auditor of Vattenfall.

The auditors are present and report at the 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 maintain ongoing contact and attend meetings of the Board's audit committee. When more extensive consulting is required from the elected auditors, such assignments must first be considered and approved by the Audit Committee. The Group's audit costs are described in more detail in Note 47 to the consolidated accounts and Note 39 to the parent company accounts in the annual report.

Consulting provided by Ernst & Young AB from 2004–2006 pertained primarily to tax and accounting issues.

Audit of the Corporate Governance Report

The Corporate Governance Report and the description below of the company's internal control of financial reporting have not been reviewed by the company's auditors.

The Board's report on internal control of financial reporting

This report has been prepared in accordance with section 3.7.2 of the Code. It includes a description of the most important internal control routines regarding Vattenfall's financial reporting. In reference to a statement by the Swedish Corporate Governance Board, this description does not include any statement by the Board with respect to how well these routines have worked during the year, and it has not been reviewed by the company's auditors.

Apart from relevant legislation, the framework surrounding the Board consists of the Swedish state's ownership and administration policy and the Code.

In 2005 the Board approved Vattenfall's Group-wide Code of Conduct, which expresses the expectation that all employees agree to adhere to Vattenfall's company philosophy, Code of Conduct, core values, policies and rules.

The formal decision-making structure in the Group is based on the division of responsibility between the Board and CEO, which the Board has established in its Rules of Procedure. The Group's management system is decided on primarily by the EGM and includes, among other things, Group instructions for decision-making, delegation and authorisation, management of subsidiaries, risk management and internal control.

The rules and outcome of the Group's risk assessment and risk management processes are reviewed by the Board each year. The Board has appointed an audit committee tasked with, among other things, assessing the scope and focus of the Group's risk management. The Group's risk management and reporting are co-ordinated by a risk committee that is headed by Vattenfall's CFO.

The Board receives monthly financial reports, and the Parent Company's and Group's financial position are discussed at every board meeting.

Work is currently under way in the Group to complement Vattenfall's management system with a complete description of how its internal control is set up and works with respect to the financial reporting. The management system serves as a platform for internal control for all units within the Group. A process will be developed that will allow for the systematic implementation and documentation of the controls that are performed in various areas in order to ensure the accuracy of the financial reporting. In this work, risks and control requirements in the various business processes will be defined in a uniform manner throughout the Group. The EGM's communication of the importance of satisfactory internal control is an important part of this work. The EGM's internal communication channels consist primarily of the Group's intranet, management conferences, and regular follow-up meetings focusing on financial results.

BOARD OF DIRECTORS

Dag Klackenberg (born 1948) is Chairman of the Board and was elected to the Board in 2001. He has an MBA from the Stockholm School of Economics and Bachelor of Law degree from Stockholm University. After completing an internship with the Ministry for Foreign Affairs in 1974, he held various positions at the Ministry for Foreign Affairs until 1993, when he was named Director-General for Administrative Affairs, a position he held until 2001. He is currently President of the Swedish Trade Federation, Chairman of Handelsbanken Regionbank Mellansverige, and a director on the board of Atrium LjungbergGruppen AB.

Maarit Aarni-Sirviö (born 1953) is a director and was elected to the Board in 2003. She has an M.Sc. in Technical Chemistry and an MBA from the Helsinki University of Technology. She has served in various positions in the Borealis Group since 1977 and is currently Vice President of one of Borealis's business units. She is a director on the board of Borealis Polymers Oy (Finland) and Rautaruukki Oy (Finland).

Carl-Gustaf Angelin (born 1951) is an employee representative (for CF) and was elected to the Board in 2003. He has an M.Sc. in Engineering from the Royal Institute of Technology, in Stockholm. Between 1977 and 1988 he worked at AB Svenska Fläktfabriken, and has since serviced in various positions within the Vattenfall Group. He is currently active in Nordic Sales and Risk Management.

Johnny Bernhardsson (born 1952) is an employee representative (for SiF) and was elected to the Board in 1995. He is a qualified engineer and has completed supplementary coursework in economics. He has held various positions within the Vattenfall Group since 1970.

Christer Bådholm (born 1943) is a director and was elected to the Board in 2002. He has an M.Sc. in Engineering from Chalmers University of Technology (Gothenburg) and has also completed courses in Corporate and Group Management from IFL and in International Management from MiL. He has a long record of experience as a CEO for various companies in the transport industry, including ABV Southern Region, NCC International AB, ABB Traction AB, Adtrans GmbH and Bombardier Transportation GmbH. He has had his own consultancy business since 2002. He is also a director on the boards of Green Cargo AB, Metronet Rail Ltd and Icomera AB, and is Chairman of Bombarier Transportation Sweden AB.

Lars Carlsson (born 1951) is an employee representative (for SiF) and deputy director, and was elected to the Board in 1991. He has a degree in engineering from Katrineholm Technical College. He has held various position within the Vattenfall Group since 1972.

Ronny Ekwall (born 1953) is an employee representative (for SEKO) and was elected to the Board in 1999. He has electrical engineering training from the Stora Kopparberg Vocational College. From 1969–1977 he served as principal electrician at Stora Kopparberg, and has since then worked as an electrician within the Vattenfall Group.

Greta Fossum (born 1947) is a director and was elected to the Board in 2006. She has an M.Sc. in Engineering and an Engineering Licentiate from the Royal Institute of Technology in Stockholm, and an Honorary Doctorate from Umeå University. From 1974 until 2000 she served as a departmental manager and research manager at Modo R&D in Örnsköldsvik, and is currently an executive at Skogsindustrierna with responsibility for research policies. She is a director on the boards of Innovationsbron Umeå, the Marcus Wallenberg Foundation, Allehanda Media AB and Tryckteknisk Forskning AB, and a member of the Royal Swedish Academy of Engineering Sciences (IVA).

Lars G. Josefsson (born 1950) has been a director on Vattenfall's board since 2001. He is currently President and CEO of Vattenfall AB. By decision of Vattenfall's Annual General Meeting on 27 April 2006, he is as of this date no longer a director on the Board. For further bibliographical information about Lars G. Josefsson, see page 58, Executive Group Management.

Stig Lindberg (born 1946) is an employee representative (Ledarna) and deputy director, and was elected to the Board in 1990. He has a degree in technical engineering and has served as a supervisor at Kraftbyggarna Entreprenad AB and Ringhals AB, and in various positions within the Vattenfall Group since 1995.

Peter Lindell (born 1972) is a director and was elected to the Board in 2002. He has an M.A. in Political Science from Lund University and a Diploma of Economics from the London School of Economics. From 1998 to 2000 he worked as a journalist for Bloomberg News and has subsequently worked as an analyst and company administrator for the Swedish Ministry of Enterprise, Energy and Communications with responsibility for Vattenfall AB, SOS Alarm Sverige AB, AB Svensk Bilprovning. He has held various positions within the Vattenfall Group since 1987.

Per-Ove Lööv (born 1961) is an employee representative (for SEKO) and deputy director and was elected to the Board in 1999. He has a degree in Business Economics from the Luleå University of Technology, and a degree in Engineering from Midskogsskolan Luleå. He has held various positions within the Vattenfall Group since 1987.

Hans-Olov Olsson (born 1941) is a director as was elected to the Board in 2004. He has an M.Sc. in Political Science from Göteborg University and has completed coursework in Information Management at the Göteborg University School of Business, Economics and Law. From 1966–1974 he held various positions at Volvo Lastvagnar. He then spent a few years as a Project Manager for Volvo Car Corporation in the USA, followed by a position as General Manager for Volvo Dalslandsverken, from 1977–1981. He has held various management positions in marketing and sales for the Volvo Group in Japan, Europe and the USA. From 2000–2005 he was President and CEO of Volvo Cars North America. He is currently Senior Vice President and Chief Marketing Officer for Ford Motor Company and Chairman of Volvo Personvagnar AB.

Lone Fønss Schrøder (born 1960) is a director and was elected to the Board in 2003. She has an M.Sc. in Law from the University of Copenhagen, and an M.Sc. in Economics from the Copenhagen Business School. From 1982–2000 she held various executive positions at A.P. Möller/Maersk A/S, and since 2003 she been service as Managing Directors of Wallenius Lines AB Sweden. She is a director on the boards of DSB and Yara ASA, Chairman of Bioneer A/S, WWL A/S, and Vice Chairman of Aker ASA.

Anders Sundström (born 1952) is director and was elected to the Board in 2004. He has a BA in Social Science from Umeå University. He served as Municipal Commissioner for the Municipality of Piteå from 1980–1994, Chairman of the Norrbotten Chapter of the Swedish Social Democratic Party from 1989–1999, and was a member of the Social Democratic party board and executive committee from 1990–2005. He has also held several minister posts in the Swedish government: Minister of Labour from 1994–1996, Minister of Enterprise, Energy and Communications from 1996–1998, and Minister of Health and Social Affairs from 1996–1998. From 1999–2002 he was President of Sparbanken Nord. He is currently Managing Director of Folksam Liv and Folksam Sak, Chairman of the Luleå University of Technology, and a director on the boards of Boliden AB and Falck A/S.


Dag Klackenberg


Lars G. Josefsson


Johnny Bernhardsson


Lone Fønss Schrøder


Maarit Aarni-Sirviö


Lars Carlsson


Stig Lindberg


Peter Lindell


Carl-Gustaf Angelin


Hans-Olov Olsson


Christer Bådholm


Ronny Ekwall


Greta Fossum


Anders Sundström


Per-Ove Lööv

EXECUTIVE GROUP MANAGEMENT

Lars G. Josefsson (born 1950) has been serving as President and CEO since 2000. He has an M.Sc. in Engineering from the Chalmers University of Technology in Gothenburg and began his career at Ericsson in 1974, where he held several positions until 1993 in the Radar Section and Surface Sensor Division. From 1993–1997 he was Managing Director of Schrack Telecom AG, Vienna, and thereafter served as Managing Director of Celsius until 2000. He is a director on the boards of Böhler Uddeholm AG, the Business Executives Council of the Royal Swedish Institute of Engineering Sciences and ESKOM Holdings Ltd, and Chairman of the Germany–Swedish Chamber of Commerce. At year-end Lars G. Josefsson did not have any material shareholdings in companies with which Vattenfall has business dealings.

Matts Ekman (born 1946) served as First Senior Executive Vice President and Chief Financial Officer from 2000–2006. He has an MBA from Lund University and an MBA (Finance & International Business) from the University of California at Berkeley. From 1972–1980 he held various positions in finance for Gränges AB. He thereafter served as CFO for Electrolux AB until 2000. He is Chairman of the trading firm Ekman Co AB, a director on the boards of Investment AB Öresund, Spendrup Invest AB and Profoto AB, and is a member on the Advisory Board for CALYON, Stockholm branch.

Jan Erik Back (born 1961) took office as First Senior Executive Vice President and Chief Financial Officer in January 2007. He succeeds Mats Ekman, who retired in December 2006. He has an MBA From Uppsala University and began his career with Handelsbanken, in 1987. Between 1987 and 1998 he held several positions in the areas of money markets, foreign operations and central business control. He joined Skandia in 1998 as Head of Group Accounting and was subsequently named Group Controller. He became CFO of Skandia in 2002 and was also named as an Executive Vice President, a position he held until autumn 2006.

Dr Klaus Rauscher (born 1949) has been serving as Senior Executive Vice President of Vattenfall AB since 2003 and Head (Vorstandsvorsitzender) of Vattenfall Europe AG since 2002. He has a Doctor of Laws degree from Erlangen University. From 1975–1988 he held various management positions at Bayerische Staatskanzlei and Bayerische Staatsministerium der Finanzen, in Munich. He then served as a bank director at Bayerische Landesbank in Munich, until 1991. Following this he joined the executive management (Vorstand) of Bayerische Landesbank in Munich, until 2001.

Hans von Uthmann (born 1958) has been serving as Senior Executive Vice President of Vattenfall AB and Head of Vattenfall Nordic since 2003. He attended the Stockholm School of Economics. From 1984–1994 he held various management positions with the Shell Group. He then served as Head of Business and Strategy Consulting for Shell International, London until 1996, when he was appointed as Managing Director of AB Svenska Shell. In 2000 he was named President and CEO of Duni AB, a post he held until 2003. He is a director on the boards of the Confederation of Swedish Enterprise, FD AB and Fryshuset, Vice Chairman of Svensk Energi, and Chairman of EFA.

Lennart Billfalk (born 1946) has been serving as Executive Vice President, Group Function Strategies since 1998. He has an M.Sc. in Engineering from Chalmers University of Technology in Gothenburg and a PhD in Hydraulic Engineering from the Royal Institute of Technology in Stockholm. From 1971–1973 he worked as a Consulting Engineer for Scandinavian Engineering Corporation, In Algeria. He then went took a position as a Research Engineer for the River and Harbour Laboratory in Trondheim, Norway, and also for Vattenfall's laboratory in Älvkarleby, Sweden, until 1979. In 1979 he took over as Head of Vattenfall's Hydro Power Division at Älvkarleby, and in 1982 as Head of the entire operation. Between 1990 and 1992 he served as Managing Director of Vattenfall Development, and after that as Managing Director of Elforsk, until 1998. He then became Head of Group Strategy for Vattenfall AB. He is Chairman of Elforsk AB.

Ann-Charlotte Dahlström (born 1952) has been serving as Senior Vice President, Group Function Human Resources since 2001. She has an MA from Stockholm University and has completed several management courses. Prior to joining Vattenfall she served as Head of Human Resources for the Stockholm County Council, Ericsson and SE-Banken. She is a director on the boards of Etikakademin and EFA.

Mats Fagerlund (born 1950) has been serving as Executive Vice President, Group Function Legal Affairs and M&A since 1992, and as member of the executive management (Vorstrand) of Vattenfall AG and Head of Distribution and Transmission for Vattenfall Europe since 2003. He has a Bachelor of Law from Stockholm University. His professional experience includes work as a company lawyer for Ahlsell AB from 1985–1987 and as General Counsel for Erisson, a position he held until 1992, when he joined Vattenfall AB as General Counsel.

Tuomo Hatakka (born 1956) has been serving as Senior Executive Vice President of Vattenfall AB since 2005 and Head of Vattenfall Poland since 2004. He studied at the Helsinki School of Economics and Business Administration and the Instituto de estudios superiors de la empresa, in Barcelona, Spain. His professional experience includes work as a manager at Bain & Company, London, an executive and partner at Company Assistant Limited, in Warsaw, Poland, Vice President and partner of Enterprise Investors in Warsaw, Poland, and President and CEO of Elektrim Kable SA, Warsaw, Poland.

Knut Leman (born 1950) has been serving as Senior Vice President, Group Function Communications since 2000. He has a Diploma in Market Economics from DIHM, and a PR and Journalism degree from Skurups Folkhögskola. Prior to joining Vattenfall, he served as Information Officer for Volvo AB from 1991–1997, and thereafter as Information Officer for Bure Equity AB, until 2000. He is a director on the board of the Swedish Marketing Federation.

Carl Alf Lindfors (born 1946) has been serving as Executive Vice President and Head of Nordic Generation since 1999 and was a member of Vattenfall's Group Executive Management until June 2006, when he retired.

Hans von Uthmann

Jan Erik Back

Lennart Billfalk

Matts Ekman

Lars G. Josefsson

Dr Klaus Rauscher

Mats Fagerlund

Ann-Charlotte Dahlström

Knut Leman

Tuomo Hatakka

ADMINISTRATION REPORT

The Board of Directors and President of Vattenfall AB (publ), Swedish corporate identity number 556036-2138, herewith submit the annual accounts and consolidated accounts for 2006, encompassing pages 60–110, which has been translated from the Swedish original.

Group operations and structure

Vattenfall works in all parts of electricity value chain – generation, transmission, distribution and sales. Vattenfall also conducts energy trading and lignite mining, and produces, distributes and sells heat. Vattenfall's vision is to be a leading European energy company. The majority of operations are in Sweden, Denmark, Finland, Germany and Poland, and the primary segments consist of the Nordic countries, Germany and Poland. Vattenfall has approximately 6 million electricity customers, including those through partly-owned companies. The Group has slightly more than 32,000 employees. Vattenfall AB is 100%-owned by the Swedish state. The Board of Directors has its registered office in Stockholm.

The year in brief

- Net sales rose 12.9% to SEK 145,815 million (129,158).
- Operating profit decreased by 1.9%, to SEK 27,049 million (27,571). Excluding items affecting comparability[1], operating profit rose 8.5%, to SEK 26,676 million (24,585).
- Profit for the year decreased by 3.2%, to SEK 19,858 million (20,518). Excluding items affecting comparability, profit for the year rose 12.1%, to SEK 19,472 million (17,364).
- Return on equity was 19.1% (23.2%). Excluding items affecting comparability, return on equity was 18.7% (19.4%).
- Return on net assets was 16.6% (17.8%). Excluding items affecting comparability, the return on net assets was 16.3% (15.8%).
- Cash flow before financing activities was SEK 19,560 million (728).
- Investments amounted to SEK 17,220 million (24,497), including SEK 5,191 million in growth investments (14,415) and SEK 12,029 million in maintenance investments (10,082).
- Net debt decreased by SEK 14,936 million to SEK 49,407 million, from SEK 64,343 million on 31 December 2005.

1) Items affecting comparability:

Items affecting comparability in 2006 amounted to SEK 373 million and consisted of capital gains/losses on shares and other non-current assets.

Items affecting comparability in 2005 consisted primarily of net compensation/impairment charges of SEK 3,057 million for the closure of Barsebäck 2.

Electricity and heat generation 2006 compared with 2005

Electricity generation decreased by 2.7% to 164.5 TWh (169.1). Hydro power generation decreased by 13.8%, to 34.3 TWh (39.8), due to low water supply during a large part of the year. Nuclear power generation decreased by 6.3%, to 55.2 TWh (58.9), mainly due to a disruption at the Forsmark nuclear power plant, and to the closure of the Barsebäck 2 nuclear power plant on 31 May 2005. Fossil-based power increased by 5.3% to 73.6 TWh (69.9), and wind power generation rose 500.0% to 0.6 TWh (0.1). Electricity generation based on biofuels and waste rose 75.0% to 0.7 TWh (0.4). Heat production rose 3.2% to 35.2 TWh (34.1). The increases in fossil-based power, wind power and heat production are mainly attributable to combined heat and power assets and wind power assets acquired in Denmark, which were consolidated by Vattenfall starting on 1 July 2006. For more information about Vattenfall's electricity generation and heat production, see pages 114–115.

Important events in 2006:

First quarter

Higher power generation taxes in Sweden

On 1 January 2006, property taxes were raised for hydro power assets, as was the tax on installed nuclear power capacity. For Vattenfall this resulted in higher annual costs of approximately SEK 1.7 billion.

Vattenfall brand introduced in Germany and Poland

On 1 January 2006, Vattenfall's German subsidiaries Bewag and HEW, and the Polish subsidiaries EW and GZE, changed their names to Vattenfall. This is an important step in the build-up of "One Vattenfall" and the introduction of a uniform, cohesive brand for all of Vattenfall, giving the organisation better opportunities to collaborate internally and externally and act as a strong player in the European market.

Squeeze out of minority shareholdings in Germany

In March 2006 an extraordinary general meeting of Vattenfall Europe AG resolved to redeem the minority shareholders' shares, corresponding to a total of 3.19% of the total shares outstanding, through a squeeze out. Vattenfall's offer was worth EUR 42.77 per share, for a total of approximately EUR 276 million (approx. SEK 2.5 billion).

Strong focus on climate issues

Early in the year, Vattenfall presented its "Curbing Climate Change" report. The report discusses a proposed model for reducing global levels of carbon dioxide emissions, combined with favourable conditions for investments in cost-effective and climate-friendly technology. Vattenfall's commitment to the climate issue has attracted a great deal of attention and very positive feedback.

Second quarter

Groundbreaking for construction of the world's first CO_2 emission-free lignite power plant

In May, construction began on Vattenfall's pilot CO_2 emission–free lignite power plant, the first of its kind in the world. The plant is being built adjacent to Vattenfall's Schwarze Pumpe

coal power station in eastern Germany, in an investment worth approximately SEK 600 million. The plant is scheduled to be commissioned in 2008.

Open Annual General Meeting and revised financial targets for Vattenfall

On 26 April, Vattenfall held its second open Annual General Meeting. Following the formal part, visitors in the audience were invited to ask questions directly to Vattenfall's chairman and CEO. The entire meeting was aired live via webcast. The meeting set certain partially new financial targets for Vattenfall:

- The 15% required rate of return was kept, however, in the future it will be calculated on the basis of average equity instead of opening equity.
- The previous interest coverage ratio target based on operating profit was changed to a ratio based on cash flow after maintenance investments within a target interval of 3.5–4.5.
- The dividend policy was changed from a dividend payout corresponding to one-third of profit for the year to a target interval of 40%–60%.
- The goal of maintaining minimum credit ratings of A3 and A– from Moody's and Standard & Poor's, respectively, was reaffirmed.

Strong increase in future investments

In April Vattenfall announced an investment programme worth SEK 104 billion for the five-year period 2006–2010, including SEK 54 billion in Germany, SEK 42 billion in the Nordic countries and SEK 8 billion in Poland. Two major power plants are planned in Germany. In Hamburg (Moorburg) a 1,640 MWh coal-fired combined heat and power plant is planned with commissioning in 2012 and a total investment sum of slightly more than SEK 16 billion. In eastern Germany, the 675 MWh Boxberg 2 lignite plant is planned, with commissioning in 2011 and a total investment sum of slightly more than SEK 7 billion.

In May, Vattenfall presented a plan for greater investment in renewable electricity generation in Sweden. The goal is to increase annual generation of renewal energy by 10 TWh by 2016. This initiative is valued at approximately SEK 40 billion.

Success for Vattenfall's new "Trygghetsavtal" product

In June Vattenfall launched its new "Trygghetsavtal" product – a three-year fixed-price contract that shelters customers against rising electricity prices for three years at the same time that it gives them the right to sign a new three-year contract at a lower price if the price of electricity falls. Both existing and new customers have discovered that "Trygghetsavtalet" is by far the best offer in the market.

Third quarter

Completion of deal between Vattenfall and DONG in Denmark

Under an agreement between Vattenfall and DONG, on 1 July approximately 24% of the combined generation capacity of the Danish companies Elsam A/S and Energi E2 A/S was transferred to Vattenfall in exchange for Vattenfall's 35.3% shareholding in Elsam A/S and participation in I/S Avedöre 2. The assets taken over consist primarily of combined heat and power plants and wind power plants. The takeover increases Vattenfall's annual generation volume by approximately 6 TWh of electricity and 6 TWh of heat.

Substantial loss of nuclear power generation caused by disruptions at Forsmark

On 25 July an emergency shutdown (a "scram") took place at the Forsmark reactor as a result of a short circuit in a switchyard outside the power plant. A complicated series of events ensued and indicated a number of shortcomings in the facility's electricity supply and safety system. This led to considerable media attention, and to allay the public's fears, in September the Swedish Nuclear Power Inspectorate (SKI) issued the following statement: "The incident did not cause any damage to the reactor. The control room personnel acted according to instructions. Cooling of the reactor was present at all times and any risk of radioactive discharge was never present."

Before allowing a restart, SKI demanded that a number of safety measures be performed at Forsmark 1 and also at Forsmark 2, which was closed for an annual overhaul when the incident occurred. On 28 September, SKI gave its clearance for a restart of both reactors. At the same time, SKI issued a statement saying that "Forsmark Kraftgrupp AB has shown defects in safety management and control of operations." The restart of the Forsmark 2 reactor was delayed further by a leakage in the reactor containment and shortcomings in control documentation. Following repairs and a review of the documentation of the repair work, SKI granted clearance for a restart on 24 October. As a principal owner of Forsmark, Vattenfall has taken the events at Forsmark with the utmost gravity. In view of these events, a thorough review of safety routines has been carried out at all of Vattenfall's nuclear power plants and safety work is being strengthened. In February 2007, Forsmark requested, via the Ministry of the Environment, an inspection by the International Atomic Energy Agency, the UN's nuclear power body. The disruption caused a 2.3 TWh loss in generation. The total loss of income amounted to approximately SEK 1.4 billion, of which Vattenfall's share (66%) was approximately SEK 0.9 billion.

Sharp tariff reductions announced by German network regulator

In June Vattenfall was handed a decision by Bundesnetzagentur, the German network regulator, demanding sharp reductions in tariffs for the transmission operations. After Vattenfall appealed the decision, a German court overruled the regulator's demands for retroactive tariff reductions. In September and October, Bundesnetzagentur announced its decision regarding tariff reductions for the distribution networks in Berlin and Hamburg, and for the subsidiary Wemag's network in northern Germany.

As a result of the new rules for electricity network operations and Bundesnetzagentur's decision to lower Vattenfall's distribution tariffs, following a thorough impairment test, Vattenfall's distribution network assets were written down by SEK 1,019 million (EUR 110 million). The decision on the transmission tariffs applied through the end of 2006, while the decision on the distribution tariffs applies through the end of 2007.

Ratings outlook changed from positive to stable

Both Moody's and Standard & Poor's changed their outlook from positive to stable. Vattenfall's current long-term credit ratings are A2 from Moody's and A– from Standard & Poor's. For short-term borrowing, the corresponding ratings are P–1 and A–2, respectively.

Fourth quarter

Authorities give green light for investment in Boxberg plant in Germany

In December, regulatory approval was granted to build the Boxberg 2 lignite power station in eastern Germany. The 675 MW plant is expected to be commissioned in 2011. The plant's high efficiency will reduce fuel needs as well as CO_2 emissions to substantially lower levels than existing lignite power plants. The investment is worth slightly more than SEK 7 billion.

German network regulator approves increase in transmission tariffs for 2007

Germany's network regulator, Bundesnetzagentur, approved a 26% increase in network tariffs for 2007, compared with the tariff in 2006.

Significant structural changes

The single largest structural deal was the completion of the agreement with the Danish company DONG A/S, under which Vattenfall acquired assets – mainly combined heat and power plants and wind power plants – in exchange for primarily its 35.3% shareholding in the Danish company Elsam A/S and a participating interest in I/S Avedöre 2. The value of the acquired net assets was SEK 13,307 million, while the value of the sold assets was SEK 12,621 million. The net investment thus amounted to SEK 686 million. Further details on this deal and on other divestments made in 2006 are provided in a table in Note 3 to the consolidated accounts on page 83.

Personnel

(Number of employees, full-time equivalents)	2006	2005	Change,%
Denmark	319	6	–
Finland	554	546	+ 1.5
Poland	2,851	3 ,031	–5.9
Sweden	8,558	8,350	+ 2.5
Germany	19,936	20,199	–1.3
Other countries	90	99	–9.1
Total	**32,308**	**32,231**	**0.2**

The increase in Denmark is mainly attributable to the acquisition of the combined heat and power assets as per 1 July 2006. On a full-year basis this corresponds to approximately 630 employees. The increase in Sweden is mainly attributable to the extensive investment programme surrounding the renewal of Vattenfall's generation facilities. The decreases in Poland and Germany are mainly the result of rationalisation measures.

Research and development (R&D)

Vattenfall conducts R&D activities within the framework of its five core strategies: Profitable Growth, Benchmark for the Industry, Number One of the Environment, Number One for the Customer and Employer of Choice. In 2006 Vattenfall spent SEK 761 million on R&D (650). Of this, SEK 349 million (325) pertained to Vattenfall's share of the work on developing a safe and approved method for permanent storage of spent nuclear fuel (which is conducted by the subsidiary SKB), SEK 64 million (56) pertained to R&D in renewable energy, and SEK 126 million (61) pertained to work on reducing emissions of climate-impacting CO_2 from Vattenfall's operations.

Expressed as a share of Group sales, R&D spending amounted to approximately 0.5% (0.5%), which is on a par with Vattenfall's industry peers. This may seem low compared with other industries, but it should be kept in mind that Vattenfall is a technology-

Specification of investments 2006 and 2005

	Nordic countries		Germany		Poland		Other		Eliminations		Total	
SEK million	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Electricity generation												
Hydro power	1,092	819	104	97	–	–	–	–	–	–	1,196	915
Nuclear power	2,765	2,140	164	167	–	–	–	–	–	–	2,929	2,307
Fossil-based power	338	–	2,235	1,803	–	–	–	–	–	–	2,573	1,803
Renewable energy	703	18	555	254	–	–	–	–	–	–	1,258	272
Other	191	223	188	186	–	–	–	–	–	–	379	409
Total electricity generation	**5,089**	**3,200**	**3,246**	**2,507**	**–**	**–**	**–**	**–**	**–**	**–**	8,335	5,707
Heat												
Heat	486	657	895	546	334	487	–	–	–	–	1,715	1,690
Renewable	22	–	45	203	–	–	–	–	–	–	67	203
Other	8	17	115	116	–	–	–	–	–	–	123	134
Total heat	**516**	**674**	**1,055**	**866**	**334**	**487**	**–**	**–**	**–**	**–**	1,905	2,027
Electricity networks												
Electricity networks	3,352	2,502	1,364	1,297	303	267	–	–	–	–	5,019	4,067
Other	288	240	426	79	–	–	–	–	–	–	714	318
Total electricity networks	**3,640**	**2,742**	**1,790**	**1,376**	**303**	**267**	**–**	**–**	**–**	**–**	5,733	4,385
Acquisitions (shares)	1,725	10,484	93	56	11	3	1	1,184	–1,687	–19	143	11,709
Acquired network assets in Denmark	540	–	–	–	146	–	–	–	–	–	686	–
Other (excl. Acquisitions)	234	331	121	268	51	55	13	16	–1	–	418	670
Total	**11,744**	**17,432**	**6,305**	**5,072**	**845**	**812**	**14**	**1,200**	**–1,688**	**–19**	17,220	24,497
Per cent of total investments	**68.2**	**71.2**	**36.6**	**20.7**	**4.9**	**3.3**	**0.1**	**4.9**	**–9.8**	**–0.1**	100.0	100.0

Comments: Of total investments in 2006, maintenance investments in property, plant and equipment accounted for 70% (SEK 12,029 million), broken down as follows: Nordic countries SEK 6,853 million, Germany SEK 4,574 million, Poland SEK 600 million and Other SEK 2 million. Growth investments accounted for 30% (SEK 5,191 million), of which SEK 686 million consisted of the net investment resulting from the deal between Vattenfall and DONG. Other growth investments were broken down as follows: Nordic countries SEK 2,518 million, Germany SEK 1,731 million, Poland SEK 245 million and Other SEK 11 million.

using, rather than product-developing, company.

Vattenfall's growth strategy calls for major investments in new plants, among other things. Increasing the value and lowering the risks associated with this are important objectives of the Group's R&D activities. For example, several development projects are being started in the area of wind power, where new technologies are tested prior to being employed on a large scale. This is being done in preparation for future investments in major, sea-based wind power farms.

In its efforts to be a Benchmark for the Industry, Vattenfall strives to run its plants and operations more efficiently – in terms of fuel consumption, operating and maintenance costs, and capital utilisation. The goal of many R&D projects is to increase efficiency by lowering costs. For example, methods and knowledge are being developed to enable the use of cheaper categories of biofuels in heat production, without this leading to operating problems, such as corrosion.

The climate issue is the greatest environmental challenge of our time and is the focal point of Vattenfall's work on being Number One for the Environment. Vattenfall's climate strategy comprises four aspects: increased generation from plants with low CO_2 emissions, including renewable energy and nuclear power; greater efficiency in generation facilities and networks; the "CO_2 emission–free power plant" project; and active support of a global trading system for CO_2 emission allowances. R&D is a cornerstone in the first three aspects.

Vattenfall is investing in new and existing plants that are based on renewable energy sources, ranging from hydro power to biofuels and wind power. However, the Group is also conducting R&D in other forms of renewable energy that could have growing impact on tomorrow's energy system, such as wave power.

A great deal of the energy generated by power plants is used in internal processes or disappears during the course of transmission and distribution. Reducing such losses would eliminate emissions to a corresponding degree. As mentioned above, many projects are being conducted to increase the efficiency of facilities and systems.

The "CO_2 emission–free power plant" is a vital part of Vattenfall's work on being Number One for the Environment. This programme, which spans many years, is based on working with equipment manufacturers and other partners to scale up and demonstrate cost-effective technologies for capturing the carbon dioxide that is formed in the combustion of lignite, for example. An important step in this direction is the construction of a pilot plant employing oxyfuel technology adjacent to Vattenfall's Schwarze Pump power station in Germany.

Key customer demands on Vattenfall's operations include competitive prices, availability, simplicity, comprehensible and predictable invoicing, and customer service contacts. R&D also plays a part in Vattenfall's strategy to be Number One for the Customer. Efficiency and low generation costs are essential prerequisites for keeping wholesale electricity prices down. R&D in efficiency is thus also important in this respect.

To increase availability in electricity distribution, Vattenfall continues to replace overhead transmission lines with underground cables. Parallel with this, R&D work is being conducted on ways to quickly and efficiently locate problems with cables and thereby minimise outages when problems occur. This is considerably more difficult than in overhead lines, since cables are located underground.

Vattenfall is investing billions of kronor in new electricity meters. R&D projects are being conducted to find new applications and functions for meters that customers can benefit from.

As part of its competence succession activities, Vattenfall is engaged in extensive R&D in collaboration with universities and colleges in various key areas in all countries in which Vattenfall has operations. By supporting high-calibre university research in such areas as nuclear power, hydro power and electricity, Vattenfall is helping to ensure high quality instruction in these areas. This is also helping Vattenfall in its efforts to be perceived as an Employer of Choice – the Company's fifth core strategy.

Environmental impact of the Group

The Group conducts operations in Sweden, Finland, Denmark, Germany and Poland that require permits in accordance with national legislation in the respective countries. Such operations include electricity generation, heat production and, in Germany, lignite mining in four open-cast mines.

The Group conducts considerable network operations for the distribution and transmission of electricity under concessions held in Sweden, Finland, Germany and Poland. The Group also conducts its own rail activities in Germany.

The greatest environmental impact of the Vattenfall Group's operations results from the generation of electricity and heat and, in Germany, from coal mining in open-cast mines.

The main environmental impact of Vattenfall's nuclear power plants is the creation of radioactive waste, while for combustion plants the main environmental impact is from emissions of climate-affecting carbon dioxide and acidic compounds. The main environmental impact of hydro power, wind power and the network operations, as well as of open-cast lignite mines, is land use. Other environmental impact includes the production of waste and solid residuals, and the use of water for cooling at nuclear power plants.

The aggregate environmental impact of operations in 2006 was essentially unchanged compared with a year earlier. Trends in environmental impact between two years are often overshadowed by fluctuating energy needs caused primarily by the weather and socioeconomic conditions. Viewed over longer periods of time, the trends become clearer. Specific emissions of carbon dioxide from plants owned currently by Vattenfall are 30% lower today than in 1990 (per KWh) for both electricity and heat. Emissions of other pollutants have decreased even more. Vattenfall's ambition is to continuing reducing its emissions.

Electricity generation is conducted in numerous large and small hydro power plants, nuclear power facilities, wind power plants and in combustion facilities. Some of the hydro power plants are pumped storage plants, of which two are of considerable size. The Group also has an ownership stake in the Stade nuclear power plant in Germany, which was decommissioned in 2003, and has partial responsibility for the decommissioned Barsebäck nuclear power plant in Sweden.

Heat production is conducted in numerous large and medium-sized combustion plants primarily in Germany, Denmark and Poland, but also in Sweden and Finland. In Germany a new lignite-fired combined heat and power (CHP) plant is planned for electricity generation at an existing power plant. This new lignite-fired CHP plant will entail the resumption of lignite mining in an open-cast mine where operations have currently been shut down. The necessary permits to resume mining have been obtained. In Berlin and Hamburg, new coal-fired CHP plants are planned as a replacement for existing and previously

decommissioned CHP plants. In 2006, construction was begun on a pilot plant employing the separation of fossil fuel–based CO_2 in Germany. This pilot facility will be commissioned in 2008. The captured carbon dioxide will be permanently stored in bedrock. Power plants as well as CHP plants require permits under German legislation. A permit for the pilot plant employing the new CO_2 carbon capture and storage (CCS) technology was received in 2006.

Construction of 48 offshore wind power turbines in the Oresund Strait was begun in 2006. According to plans, this wind power farm will come on stream in 2007. Once this wind power farm has been commissioned in autumn 2007, Vattenfall will have more than doubled the number of wind power turbines it operates and increased its electricity generation from wind power sevenfold, from 54 GWh to 370 GWh. The permit required under the Swedish Environmental Code was obtained in 2005. This permit has been appealed by a third party. An additional offshore wind power farm comprising 128 wind power turbines is planned at the Kriegers Flak site in the southern Baltic Sea.

Poland's entry to the EU in 2004 has entailed the adaptation of the country's national laws to the EU's legislation. As a result, Vattenfall's plants in Warsaw that require permits will become subject to reconsideration in the years ahead in accordance with transitional rules for existing plants. Preparations are currently in progress to ensure compliance with the new regulations in time.

Sweden's parliament has set 15 TWh as the target level to be reached by 2015 for the expansion of wind power and other renewable energy. Vattenfall's owner, the Swedish state, has declared that Vattenfall shall work toward realising this goal. An appendix to the Company's articles of association stipultates that the Company should be able to achieve 5 TWh.

The Parent Company conducts operations that require permits in accordance with the Swedish Environmental Code. These consist primarily of combustion plants for electricity generation and heat production, and wind power plants.

The Parent Company has 46 plants for electricity and heat generation that require permits and registration, of which 37 require permits. The Parent Company also has 49 wind power turbines that are located separately as well as in groups. The wind power plants have been erected in such manner that 10 of the facilities require permits and the others require registration. The Parent Company also has hydro power plants with associated water regulation facilities that are subject to review outside of the jurisdiction of the Swedish Environmental Code. The Parent Company conducts fish farming at four facilities requiring permits.

The terms for nine of the Parent Company's small heat plants are subject to review in 2007, while a final decision is pending for one. The Company's earnings and financial position are not dependent on these reviews.

The Group's Swedish subsidiaries also conduct operations requiring permits in accordance with 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 nuclear waste in Forsmark and an installation of intermediate storage of spent fuel in Oskarshamn. In several subsidiaries, electricity and heat are generated primarily in combustion plants. The Group conducts network operations in Swedish subsidiaries for the distribution of electricity, in accordance with concessions.

In accordance with a decision by the Swedish government, Barsebäck was closed on 31 May 2005. The work on winding down the 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 is responsible for the winding down and dismantling in accordance with a power agreement from 1998 between Vattenfall, the former Sydkraft and the Swedish state.

Projects are under way at nuclear power plants and hydro power plants with the aim of increasing the power output of existing facilities. Environmental review work associated with an increase in power output at the subsidiaries Ringhals AB and Forsmarks Kraftgrupp AB continued in 2006.

Along with the network operations, generation of electricity in hydro and nuclear power plants constitutes a central part of the Parent Company's and the Swedish operations. Generation of electricity in hydro power plants is conducted primarily by the Parent Company. Other significant operations are conducted primarily by subsidiaries.

Personnel matters

Competence development

Vattenfall works according to a yearly, strategic competence succession process to ensure that the Company will continue to have access to the business-critical competence that is needed for its operations. This annual process, which is used throughout the organisation, couples business plans with future competency needs and makes use of gap analyses and action plans. Competence development is conducted primarily in the day-to-day activities and through participation in various projects. In addition to this, competence development is conducted at both the Group and local levels. At the Group level, Vattenfall has a Group-wide leadership development programme. The aim of this programme is to spread knowledge about the Group's strategies and values, and to promote a shared understanding of Vattenfall's company philosophy and leadership criteria. The goal is to support managers in their role as leaders and in their personal development, and to stimulate network-building in an international environment. These programmes are offered to managers at various levels. In addition, managers are offered a Group-wide function-focused programme.

Employee turnover

Employee turnover, defined as the number of employees who have left their positions within the Group in relation to the total number of employees, was 2.4% in 2006.

Collective agreements

The right to co-determination is regulated primarily at the country level and is based on the respective countries' labour market laws. At the Group level, as well, Vattenfall works with employee representatives and local unions, mainly via the European Works Council (EWC–Vattenfall). In 2006 a new, joint collective agreement was signed in Germany.

Corporate Social Responsibility report

Vattenfall publishes an annual Corporate Social Responsibility (CSR) report in accordance with the Global Reporting Initiative (GRI) guidelines. The aim of this report is to provide a balanced picture of Vattenfall's efforts with regard to the environment, society and the economy. For more information, see page 33 of this Annual Report.

Parent Company

The accounts of Vattenfall AB, the Parent Company, are prepared in accordance with Swedish GAAP, i.e., in accordance with the Swedish Annual Accounts Act and Swedish Financial Accounting Standards Council recommendation RR 32:05 on reporting for legal entities. Vattenfall has adopted the exemption rule regarding IAS 39 according to RR 32:06.

Financial instruments are reported at cost.

Sales amounted to SEK 33,049 million (26,843). The increase is mainly attributable to higher prices.

Profit before appropriations and tax was SEK 16,106 million (6,168). The increase is mainly attributable to a dividend from Ringhals AB pertaining to compensation for Barsebäck 2, in the amount of approximately SEK 4.1 billion, and to exchange rate effects associated with hedges of investments in foreign companies, totalling approximately SEK 2.6 billion.

Investments for the year amounted to SEK 2,364 million (13,052). Cash and cash equivalents amounted to SEK 181 million (2,360). Funds in the Group account managed by Vattenfall Treasury AB amounted to SEK 30,965 million (30,892).

The work of the Board of Directors in 2006

The Board of Directors conducts its work for the most part in accordance with its established Rules of Procedure. These prescribe that seven regular meetings are to be held each year. In addition to the regular meetings, board meetings can be summoned if the need arises. According to the Rules of Procedure, at least one meeting each year is to be held at a place other than the head office. In 2006 a meeting was held in Copenhagen. In connection with this, the Board visited local facilities and was provided with more in-depth information about the operations that Vattenfall acquired in Denmark.

The Board had 11 meetings in 2006, including the statutory meeting. The Board evaluates its work once a year. In 2006 the Board established a compensation committee to handle executive compensation matters. The Compensation Committee had one meeting in 2006. The Board also has an audit committee, which held four meetings in 2006. Vattenfall AB's auditors were present at all meetings, at which they presented their review of, among other things, the year-end closing and interim reports. For further information on the work of the Board and the Corporate Governance Report, see pages 48–55.

Outlook for 2007

Apart from the availability of its generation facilities, the single most important factor affecting Vattenfall's financial performance is the wholesale price of electricity. Wholesale prices fluctuated sharply in 2006. Prices in the Nordic countries are affected to a great extent by the hydrological balance, which at year-end 2006 showed a surplus of 10.7 TWh, compared with a deficit of 3.7 TWh at year-end 2005. Since Vattenfall hedges future electricity generation to a considerable extent, it can smoothen out the effect of fluctuating wholesale electricity prices on profits. 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. However, the parameters for cost of capital in the network performance assessment model were raised at year-end 2006 which, all else equal, should lead to considerably lower demands for tariff reductions. In Germany, as previously announced, the network regulator announced sharp reductions in distribution tariffs for 2007, while its decision on transmission tariffs allowed for a slight increase over 2006 levels. The trading system for carbon dioxide emissions, whose first trading period will expire in 2007, is not expected to have any negative impact on Vattenfall in 2007.

Proposed distribution of profits

See page 110.

Events after the balance sheet date

In the Company's opinion, no significant events have taken place after the balance sheet date up until the date of this report's publication that require disclosure under this heading.

RISKS AND RISK MANAGEMENT

Vattenfall's operations are exposed to a number of risks. To address these risks, Vattenfall has established an organisation and risk management process that is based on the following components:

- Standardised risk definitions
- Identifying the 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 of Directors has overarching responsibility for internal control and risk management at Vattenfall. The 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 achieved by the units are followed up on a continuous basis and reported to the executive management by an independent risk control function, Group Risk Control, which is also responsible for monitoring the Group's overall risk mandate. Group Risk Control is also responsible for identifying risks in the organisation and for developing appropriate models and measurement methods for managing these risks.

Risk Committee

The Group's risk management and reporting is co-ordinated by a risk committee headed by the CFO. The committee's task is to scrutinise policies and mandates and to approve risk instructions.

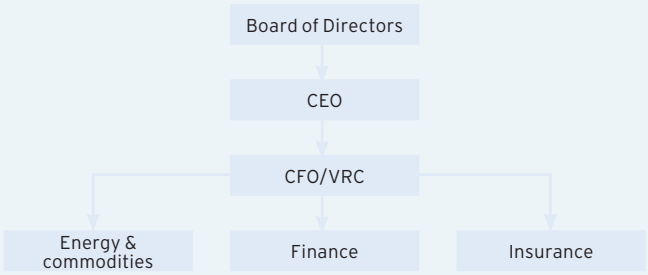
Risks at Vattenfall

Political risks, operational risks, environmental risks and legal risks are general in nature and exist in all units throughout the Group. Insurable risks are managed centrally by Vattenfall Insurance. The more specific risks in each part of the value chain are discussed on page 67. Financial risks are reported in Note 34 to the consolidated accounts.

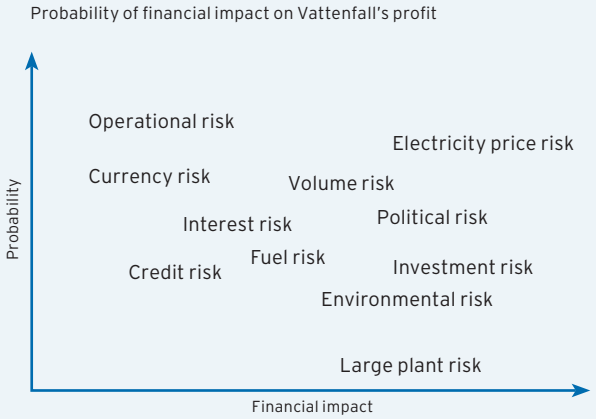
Electricity price risk

Electricity price risk is the risk that has the greatest bearing on Vattenfall's earnings.

Risk organisation



Risks in Vattenfall's operations



One risk that has a high probability of affecting Vattenfall's earnings is electricity price risk. The net position that the Company has is partially hedged through financial contracts. For the unhedged portion, a price movement of 10% for Germany and the Nordic countries can change earnings for the coming three years by approximately SEK 10 billion. If the hedged amount were to be increased, the certainty of the outcome (earnings) would also increase. During the year, forward contracts for 2007, 2008 and 2009 moved by 39%, 25% and 24%, respectively, in the Nordic countries, while the corresponding contracts in Germany moved by 21%, 22% and 22%, respectively. The impact on Vattenfall of fuel price risks is mainly indirect, through the impact on electricity prices. The direct effect of an increase in coal prices that affects generation is marginal, since most of Vattenfall's coal-fired plants use lignite from own mines. With respect to currency risks, these pertain primarily to translation exposure in equity in other currencies than SEK. See the descriptions under the Currency risk section and Note 34 to the consolidated accounts, pages 93–95, where interest rate risks are also described.

Plant risks are described on page 68.

Electricity prices are determined by supply and demand. A key factor for demand is temperature; for example, in the Nordic countries, cold weather leads to greater demand due to increased heating needs, while in continental Europe, hot weather leads to higher demand due to increased use of air conditioning. Other important factors for demand include the industrial economic situation and fuel prices. Supply varies and is dictated by available capacity. For example, in the Nordic countries, available capacity varies mainly with precipitation and the associated supply of hydro power. In continental Europe, available capacity varies along with the irregular feed-in of wind power.

Every hour the price is set to the market equilibrium, that is, the point where supply meets demand. 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 CO_2 emission allowances and the market prices of oil, natural gas and coal. Vattenfall's electricity price risk is therefore also a risk based on weather (temperature and precipitation), and prices of oil, natural gas, coal and CO_2 emission allowances. Continuous analysis of these factors is crucial for the successful management of electricity price risk.

To determine the value of electricity price risk in electricity generation, Vattenfall simulates an anticipated outcome in the electricity spot market. Forecasts of anticipated generation levels are drawn up, which then serve as the basis for how much is to be hedged. Vattenfall hedges its generation and sales to the physical and financial electricity forward contracts available in the market. Such hedging is done while taking into account liquid-

Risk management along the value chain

Following is a compilation of risks along Vattenfall's value chain. Political risks, operational risks, environmental risks and legal risks are general in nature and are encountered by all units within the Group. In the value chain, these risks are listed under the area in which they are most likely to arise.

Generation

Electricity price risk
Earnings risk stemming from changes in electricity wholesale prices.

Plant risk
Vattenfall's generation plants can be damaged by incidents and breakdowns, which as a rule also give rise to costs caused by shutdowns.

Fuel price risk
Risk of loss due to changes in the market price of the fuels that Vattenfall uses in its generation plants. Measurement and management of this risk are conducted by the respective facilities.

Environmental risks and liabilities
Environmental risks refer to the probability of accidents and defects in operations and their impact on the environment. Environmental liabilities refer to identified environmental problems in which demands for corrective measures can be expected.

Trading

Price area risk
Price area risk arises when electricity prices differ between geographic areas due to shortages in transmission between areas. This risk is managed centrally by Vattenfall Trading Services.

Electricity price risk
Risk of loss due to changes in the wholesale price of the electricity that Vattenfall conducts physical and financial trading in.

Credit risk
Risk of loss stemming from a counterparty failing to fulfil its obligations in a transaction.

Currency risk
Currency risk pertains to the risk of a negative impact on the consolidated income statement and balance sheet caused by changes in exchange rates.

Sales

Electricity price risk
Earnings risk stemming from changes in the wholesale price of electricity sold to customers.

Credit risk
Credit risk arises, for example, in transactions with customers and is defined as the risk of a counterparty failing to fulfil its obligations. Measurement and management of credit risk is conducted within the respective sales units.

Volume risk
This is defined as deviations in delivered volumes compared with expected volumes for customers, caused by weather and economic factors. Vattenfall uses simulation models to measure volume risk.

Networks

Network loss risk
Network loss risk stems from short- and long-term variations in generation and loads in the network. The risk entails not being able to predict the size of the variations. Measurement and management of network loss risks are conducted within the respective business units.

Plant risk
The risk of damage to Vattenfall's transmission and distribution networks.

Political risk
The risk of financial loss stemming from political decisions.

Environmental risks and liabilities
Environmental risks refer to the probability of accidents and defects in operations and their impact on the environment. Environmental liabilities refer to identified environmental problems in which demands for corrective measures can be expected.

Credit risk
Credit risk arises, for example, in transactions with customers and is defined as the risk of a counterparty failing to fulfil its obligations. Measurement and management of credit risk is conducted within the respective sales units.

ity in the market at different periods in time. The Group hedges in accordance with established mandates and generally for three years ahead in time. In certain cases, the business arrangement is such that it is the customer that accepts the electricity price risk in the sales activities.

The business units conduct their hedging in Vattenfall's various markets through Vattenfall Trading Services, which hedges its own positions in external markets, such as the Nordic electricity exchange, Nord Pool, and the European Electricity Exchange (EEX) in Germany.

The mandates allocated to the various business units regulate how large of an electricity price risk is acceptable. Exposure is followed up in relation to the mandate on a daily basis. To measure electricity price risk, Vattenfall uses methods such as Value at Risk (VaR) and Profit at Risk (PaR) along with various stress tests.

Price area risk
Price area risk arises when the price of electricity differs between various geographic areas. Vattenfall's price area risk is controlled centrally and is managed by Vattenfall Trading Services. Price area risk is managed through hedging in the respective areas in which delivery is to take place. In the Nordic countries, the Nord Pool electricity exchange provides financial instruments – area swaps – which can be used to manage price area risk. Vattenfall Trading Services is also a market maker on Nord Pool. Through this undertaking, liquidity is ensured in these financial instruments, and Vattenfall also helps spread risks for other players.

Volume risk
Volume risk consists of deviations in anticipated and actually delivered volumes to a customer. Vattenfall manages volume risk by improving and developing forecasts of electricity consumption. Another method involves taking volume risk into account when drawing up the terms of contracts with customers or by including this risk into the customer's price.

Fuel price risk
Measurement and management of fuel price risk is conducted within the individual generation units. Fuel prices are affected by macroeconomic factors, among other things. Vattenfall man-

ages fuel price risk by forecasting and analysing price trends. For example, financial and physical instruments for coal and oil are used to smoothen the result over time. However, most of Vattenfall's coal-fired plans use lignite from Vattenfall's own mines. For coal-fired electricity generation, hedges on electricity and coal prices are co-ordinated to safeguard margins. Uranium is used as fuel in Vattenfall's nuclear power plants. This price risk is limited, however, since the uranium fuel constitutes a relatively small portion of the generation cost.

Credit risk

Vattenfall uses external rating information, where available, to manage and limit its credit risk. In other cases, internal models are used to establish the creditworthiness of its counterparties. Individual limits are established for each counterparty, and each counterparty is assessed on a regular basis. Exposures are followed up in relation to the credit limits on a daily basis. If necessary, additional credit assurances are demanded in the form of a guarantee from the parent company or a bank, for example. In cases were framework agreements are entered into, net calculation of debts and receivables for an individual counterparty are permitted. In cases were Vattenfall has more than one framework agreement with the same counterparty, a master netting agreement is desirable in order to calculate the net debt and receivable amount, even when trading in different commodities, such as electricity, coal and gas. When contracts are made in marketplaces, such as Nord Pool or EEX, which offer central counterparty clearing, the risk is in the market instead.

Investment risk

Vattenfall is a highly capital-intensive company and, consequently, has an extensive investment programme worth SEK 134 billion from 2007 to 2011 (see page 17).

Prior to every investment decision, a risk analysis is performed. By simulating outcomes of price, cost, delays and cost of capital, the risks associated with each individual investment are assessed.

For example, the electricity generation operations in the Nordic countries have a broad investment portfolio, encompassing the repair and maintenance of nuclear and hydro power facilities and dams, which puts greater demands on systematic risk management.

Major planned investments in Germany include the Boxberg lignite-fired power plant (675 MW) and the Moorburg coal-fired combined heat and power plant (2x820 MW), for a combined investment sum of approximately SEK 23 billion. Fuel price forecasts, electricity price forecasts, prices of CO_2 emission allowances, district heating prices, investment costs, operating and maintenance costs, and other costs must be factored into the risk analysis. Sensitivity analyses have been conducted of a vast number of price and cost scenarios. The investment risk associated with these two investments is mitigated by the fact that Vattenfall has its own lignite mine in Boxberg and a heat base in Moorburg.

During the year, a new Group function was established – Capacity Management – which focuses on growth areas such as electricity and heat generation to ensure that capital is invested in a way that will maximise long-term economic value. In addition to a strategic investment roadmap, a list of priority investment projects is continuously updated, above all to guide the Executive Group Management in its investment decision-making process. Projects are ranked according to a number of main criteria: support of Vattenfall's overarching strategic orientation, consequences for the existing generation portfolio, risk profile and profitability.

Plant risk

Vattenfall's largest insurable risks are associated with the operation of power generation and heat production plants. Vattenfall's plants can be damaged as a result of incidents and breakdowns which, as a rule, give rise to substantial costs due to shutdowns.

Such plant risks are minimised through loss-prevention measures, good maintenance, training and effective administrative routines.

Plant insurance

The Group protects itself against major economic loss to the greatest extent possible through insurance. Vattenfall's nuclear power plants in Sweden have insurance cover for property damage through EMANI, a European mutual insurance association. 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's 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 generators have therefore taken out dam liability insurance together.

Vattenfall Reinsurance S.A. in Luxembourg reinsures part of the insurance commitments of Vattenfall Insurance. Economies of scale and direct access to the international reinsurance market help keep total insurance costs low.

Network loss risk

Network loss risk arises from short- and long-term variations in generation and loads in the network. Measurement and management of network loss risk is conducted within the individual units. This risk is managed through detailed follow-up of outcomes in relation to hedged volumes. In the case of deviations that are judged to be permanent, the target volume is altered for ongoing hedges for future periods. In addition, the need for additional purchases for the current period is determined.

Political risk

Political risk is defined as the commercial risk that can arise as a result of political decisions. Examples of this are price regulations in electricity distribution and transmission, uncertainty regarding a new political majority, or changes in finance policies. In connection with acquisitions and other investments, this type of risk is managed by adjusting the cost of capital.

Another type of political risk stems from changes in the rules

governing the energy industry. These can concern such factors as changed taxes, environmental surcharges, changes in how natural monopolies are regulated, and political goals for the composition of the energy system. This type of risk is more difficult to predict and protect against. To mitigate this risk, Vattenfall conducts active business intelligence activities and maintains contacts with decision-makers in relevant markets. Vattenfall also belongs to various national and international trade organisations.

Operational risk

Operational risk refers to the risk of incurring financial loss, or a loss of trust, due to errors or defects in the Company's administrative routines.

Operational risks can be divided into the following categories:
- Administrative risks – the risk of loss due to defects in the Company's division of responsibility, competence, reporting routines, risk measurement and evaluation models, and in control and follow-up routines
- Legal risks – the risk of loss arising from the non-fulfilment of contracts due to shortcomings in documentation, counterparties lacking the right to enter into contracts or uncertainties regarding contract validity
- IT risks – the risk of loss due to defects in IT systems

To limit operational risks at Vattenfall, each business unit is responsible for ensuring that well-documented routines, reliable IT systems and satisfactory internal controls are in place. For more information about internal control, see page 55.

Environmental risks

Environmental risks can be divided into three categories – environmental liabilities, anticipated environmental liabilities, and environmental risks. Environmental liabilities refer to environmental problems that have been identified in production plants, installations or operations and where requirements have been raised to take action as a result of more stringent legislation, permit restrictions or new stipulations in the Company's environmental policy. Anticipated environmental liabilities are those that are influenced by probable future changes in requirements and laws. Environmental risks refer to the probability of accidents and defects in operations, combined with their impact on the environment.

The work on continuously preventing and controlling environmental risks is carried out largely on a local basis and is based on the knowledge and experience that exists in the group's respective units. The business units are responsible for identifying and expressing the risks and liabilities described above in monetary terms. Through this risk inventory, Vattenfall increases its ability to analyse and decide on actions that reduce the Group's environmental impact.

The consequences of an environmental risk can entail the following, for example:
- Contamination/clean-up costs
- Impact on the Vattenfall brand
- Opinions and policies that lead to more cumbersome permit application processes and production limitations

The business units' reporting on environmental liabilities covers the following areas, among others:
- Air, water and ground pollution
- 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

Environmental liabilities are identified and analysed for decisions on actions to be taken. Currently an action programme is being carried out for Vattenfall's hydro power plants in Sweden and for Vattenfall's operations in Poland. Vattenfall sees advance planning 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 contaminated land, and action plans have been drawn up in consultation with the pertinent authorities.

Parallel with this, cross-functional co-ordination work is being conducted at the Group level to identify and adopt uniform methods and application of principles. The main purpose of this work is to ensure that assessments are made as independent of individuals as possible, to promote knowledge-sharing, and to more clearly link environmental risk work to the Group's overall risk management activities.

One of the great challenges for Vattenfall and the energy sector as a whole is to curb emissions of greenhouse gases from fossil-fired power plants and all other business activities. Societal representatives are focusing on this issue with keen interest, and Vattenfall is addressing it from an integrated risk perspective that takes technological and political aspects into account. Toward this end, Vattenfall has initiated a project for large-scale separation and storage of carbon dioxide and is actively searching for cost-effective internal reduction alternatives among all relevant gases and in all aspects of operations.

Financial risks

The Group's financial risks are managed primarily by Vattenfall Treasury AB (the Group's internal bank and finance function). These finance operations aim to provide cost-effective management of the Group's financial risks. The Group's funding, investments and currency trading are carried out primarily by Vattenfall Treasury AB and, to a lesser extent, by Vattenfall Europe AG. The Group's liquidity is centralised in Group cash pool systems. Speculative investments are made to a limited extent within set risk limits. For more detailed description and quantification of financial risks, see Note 34 to the consolidated accounts.

CONSOLIDATED INCOME STATEMENT

Amounts in SEK million, 1 January–31 December	Note	2006	2005
Net sales	5, 6	145,815	129,158
Cost of products sold[1]	7	–106,857	–93,636
Gross profit		**38,958**	**35,522**
Other operating income	8	2,319	5,397
Selling expenses	9	–5,734	–5,844
Administrative expenses	9	–7,806	–6,639
Research and development costs	9	–765	–651
Other operating expenses	10	–1,257	–748
Participations in the results of associated companies	6, 22	1,334	534[7]
Operating profit (EBIT)[2]	6, 11, 12, 13, 46, 47	**27,049**	**27,571[7]**
Financial income[3]	14	3,839	3,810
Financial expenses[4]	15	–5,363	–5,221
Profit before tax[5]		**25,525**	**26,160[7]**
Income tax expense	16	–5,667	–5,642[7]
Profit for the year[6]		**19,858**	**20,518**
Attributable to			
Equity holders of the Parent Company		18,729	19,235
Minority interests	17	1,129	1,283
Total		**19,858**	**20,518**
Earnings per share			
Number of shares in Vattenfall AB, thousands		131,700	131,700
Earnings per share, SEK		142.21	146.05
Dividend, SEK million		7,500[8]	5,800
Dividend per share, SEK		56.95[8]	44.04
Supplementary information			
Operating profit before depreciation and amortisation (EBITDA)		43,166	42,383
Financial items, net excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund		–1,618	–1,440
1) Of which, depreciation, amortisation and impairment losses		–15,007	–14,290
2) Of which, depreciation, amortisation and impairment losses		–16,117	–14,812
2) Including items affecting comparability attributable to:			
Capital gains/losses		373	–71
Closure of Barsebäck 2		–	3,057
3) Including returns from the Swedish Nuclear Waste Fund		2,106	2,089
4) Including discounting effects attributable to provisions excl. of pension provisions		–2,012	–2,060
5) Including items affecting comparability attributable to:			
Capital gains/losses		384	–63
Closure of Barsebäck 2		–	3,057
6) Including items affecting comparability stated above adjusted for tax		386	3,154

7) These figures are adjusted compared to previously published information in Vattenfall's 2005 Annual Report. See Note 2 to the consolidated accounts, Accounting Principles.

8) Proposed dividend.

Comments

Net sales and earnings

Net sales rose 12.9% to SEK 145,815 million (129,158). Sales increased despite significantly lower nuclear power and hydro power generation and can be credited to higher wholesale electricity prices and the consolidation of the combined heat and power and wind power assets acquired in Denmark.

The cost of products sold rose 14.1% to SEK 106,857 million (93,636) and is mainly attributable to higher wholesale electricity prices, which increased the cost of purchased power. Higher property taxes on hydro power assets, a tax on installed nuclear power capacity, higher fuel costs and the impairment loss of network assets in Germany also contributed to the increase.

Depreciation increased by 3.9% to SEK 14,574 million (14,026). See Note 13 to the consolidated accounts. In 2006 the depreciation schedule for the Group's Swedish nuclear power plants was changed from 25 to 40 years, which decreased depreciation of these nuclear power plants by SEK 505 million.

The decrease in Other operating income is mainly due to the booking in 2005 of SEK 4,100 million (gross) in compensation from the Swedish state for future loss of production caused by the closure of Barsebäck 2.

Participations in the results of associated companies improved to SEK 1,334 million (534). This pertains primarily to Elsam A/S, totalling SEK 359 million, and the partly owned German nuclear power companies, totalling SEK 357 million.

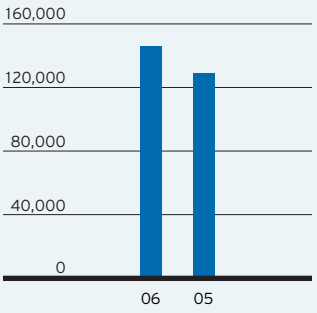
Operating profit decreased by 1.9% to SEK 27,049 million (27,571). This is partly explained by higher Swedish generation taxes, totalling approximately SEK 1,700 million, one-time provisions of SEK 1,445 million, and impairment losses totalling SEK 1,568 million. The net effect of higher prices and lower generation volumes was approximately SEK 6,500 million. Operating profit in 2005 was positively affected in the amount of SEK 3,057 million, net, by the compensation from the Swedish state for the closure of Barsebäck 2.

Excluding items affecting comparability (mainly the compensation for the closure of Barsebäck 2, totalling SEK 3,057 million, net, which was booked in 2005), operating profit rose 8.5% to SEK 26,676 million (24,585). This increase is mainly attributable to Germany and stems from higher wholesale electricity prices, a better outcome from hedged electricity generation and slightly higher generation volumes.

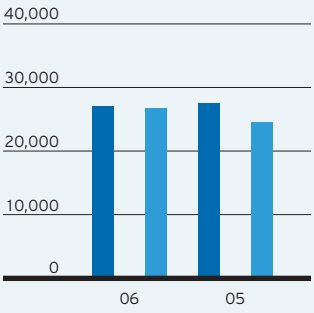
A breakdown of operating profit by Vattenfall's markets (primary and secondary segments) is provided in Note 6 to the consolidated accounts.

Net financial items amounted to SEK −1,524 million (−1,411), a deterioration of 8.0%. The deterioration is mainly due to lower revenues pertaining to changes in value when reassessing the value of derivatives. The balance of net interest income and expense was virtually unchanged compared with 2005. Net interest expense averaged SEK −165 million (−166) per month.

Net sales



Operating profit



Operating profit

Operating profit (EBIT) excl. items affecting comparability

Following is a breakdown of interest income/expense and interest received/paid out:

	2006	2005	% change
Interest income	1,341	980	36.8
Interest expense	3,317	2,967	11.8
Interest received	1,054	875	20.5
Interest paid	2,927	2,230	31.3

Taxes were essentially unchanged, at SEK 5,667 million (5,642). The effective tax rate according to the income statement was 22.2% (22.0%).

Profit for the year decreased by 3.2% to SEK 19,858 million (20,518). Excluding items affecting comparability, profit increased by 12.1% to SEK 19,472 million.

Return on equity decreased to 19.1% (23.2%). Excluding items affecting comparability, return on equity was 18.7% (19.4%). The return on net assets decreased to 16.6% (17.8%). Excluding items affecting comparability, the return on net assets was 16.3% (15.8%).

Segments

The Group's operations are divided into primary and secondary segments. Primary segments consist of geographic areas: the Nordic countries, Germany, Poland and Other.

Secondary segments consist of the Group's business segments: Electricity Generation, Electricity Markets, Electricity Networks, Heat and Other Operations. For the reporting of sales and operating profit for primary and secondary segments, see Note 6 to the consolidated accounts. For comments on sales and profit as well as key ratios for the primary segments – Nordic countries, Germany and Poland – see pages 36–43.

CONSOLIDATED BALANCE SHEET

Amounts in SEK million	Note	31 Dec 2006	31 Dec 2005
Assets	6		
Non-current assets			
Intangible assets: non-current	18	4,260	5,267
Property, plant and equipment	19	201,328	189,016
Investment property	20	936	1,256
Participations in associated companies	22	12,126	23,421
Other shares and participations	23	1,254	747
Share in the Swedish Nuclear Waste Fund	24	23,321	21,403
Current tax assets, long-term	16	1,241	–
Other long-term receivables	25	5,620	4,285
Deferred tax assets	16	1,807	14,569
Total non-current assets		**251,893**	**259,964**
Current assets			
Inventories	26	9,384	7,314[1]
Intangible assets: emission allowances	27	746	–
Trade receivables and other receivables	28	32,499	37,947
Prepaid expenses and accrued income	29	4,338	4,459
Current tax assets	16	2,138	1 310
Short-term investments	30	7,534	8,025
Cash and cash equivalents	31	14,634	6,049
Total current assets		**71,273**	**65,104**
Total assets		**323,166**	**325,068**
Equity and liabilities			
Equity attributable to holders of the Parent Company			
Share capital		6,585	6,585
Translation reserve		1,467	2,949
Reserve for cash flow hedges		−5,811	−10,388
Retained earnings incl. profit for the year		94,348	81,419[1]
Total equity attributable to holders of the Parent Company		**96,589**	**80,565[1]**
Equity attributable to minority holders		**11,085**	**10,344**
Total equity		**107,674**	**90,909[1]**
Non-current liabilities	6		
Capital Securities	32, 34	8,911	9,268
Other interest-bearing liabilities	33, 34	46,868	59,865
Interest-bearing provisions	35	45,364	42,976
Pension provisions	36	16,877	17,432
Deferred tax liabilities	16	29,875	39,927[1]
Other noninterest-bearing liabilities	37	2,320	2,425
Total non-current liabilities		**150,215**	**171,893[1]**
Current liabilities	6		
Trade payables and other liabilities	38	27,676	33,906
Accrued expenses and deferred income	39	14,367	12,040[1]
Current tax liabilities	16	3,585	2,075
Interest-bearing liabilities	40	15,796	9,530
Interest-bearing provisions	35	3,853	4,715
Total current liabilities		**65,277**	**62,266**
Total equity and liabilities		**323,166**	**325,068**

1) These figures are adjusted compared to previously published information in Vattenfall's 2005 Annual Report.
See pages 76–77, Consolidated Statement of Changes in Equity and Note 2 to the consolidated accounts, Accounting principles.

See also information on the Group's pledged assets (Note 41), contingent liabilities (Note 42) and commitments under consortium agreements (Note 43).

Comments

Assets

Total non-current assets decreased by 3.1%, or SEK 8,071 million, to SEK 251,893 million (259,964). Property, plant and equipment increased by SEK 12,312 million in connection with the takeover of combined heat and power and wind power assets in Denmark. Participations in associated companies decreased by SEK 11,295 million, to SEK 12,126 million through the transfer of the shareholding in Elsam A/S to DONG in exchange for the combined heat and power and wind power assets. The share in the Swedish Nuclear Waste Fund increased by SEK 1,918 million. Deferred tax assets decreased sharply, by SEK 12,762 million, to SEK 1,807 million, mainly due to netting against deferred tax liabilities.

Current assets increased by 9.5%, or SEK 6,169 million, to SEK 71,273 million (65,104). Inventories increased by SEK 2,070 million, mainly in association with the acquired assets in Denmark.

Short-term investments and cash and cash equivalents increased by SEK 8,094 million to a combined total of SEK 22,168 million (14,074), corresponding to 10.9% (10.9%) of sales. The increase is mainly attributable to a strong cash flow. Of this total, SEK 3,077 million (corresponding to EUR 340 million) consists of Vattenfall Europe'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.

In addition to short-term investments and cash and cash equivalents totalling SEK 22,168 million, as per 31 December Vattenfall had SEK 9,421 million (17,752) in committed credit facilities and SEK 10,059 million (10,198) in uncommitted credit facilities at its disposal.

In all, total assets decreased by 0.6% to SEK 323,166 million (325,068).

Equity and liabilities

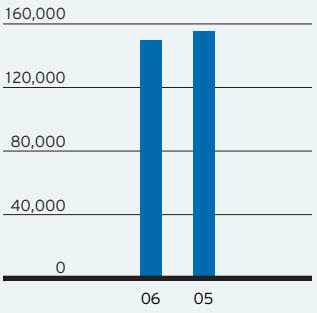
The Group's risk capital, i.e., equity attributable to shareholders of the Parent Company and to minority interests, increased by 18.4% to SEK 107,674 million (90,909). Equity attributable to shareholders of the Parent Company increased by 19.9%, while equity attributable to minority interests increased by 7.2%. The equity/assets ratio increased to 33.3% (28.0%). The reserve for cash flow hedges was changed by SEK 4,577 million to SEK −5,811 million. This item is explained in the comments on the consolidated statement of changes in equity on page 77.

Total non-current liabilities decreased by 12.3%, or SEK 21, 678 million, to SEK 150,674 million (171,893). Deferred tax liabilities decreased sharply, by SEK 10,052 million, to SEK 29,875 million (39,927). This is mainly due to netting against deferred tax assets. For further details on taxes and provisions, see Notes 16, 35 and 36 to the consolidated accounts.

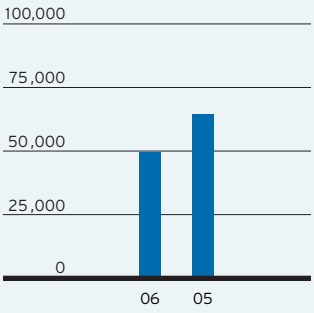
Total interest-bearing liabilities increased by 9.0% to SEK 71,575 million (78,663). This includes SEK 8,911 million (9,268) in Capital Securities issued in June 2005. The rating agencies classify most of these Capital Securities as equity (Moody's 75% and Standard & Poor's 50%). Total interest-bearing liabilities also include SEK 10,951 million (13,731) in loans from Vattenfall's minority-owned Germany nuclear power companies, and SEK 4,956 million (4,640) in loans from minority owners in Vattenfall's Swedish nuclear power plants, among others. The Group's net debt decreased by 23.2% to SEK 49,407 million (64,343).

The net debt/equity ratio was 0.46 on 31 December 2006, compared with 0.71 on 31 December 2005. For further details on the breakdown of loans according to their various types, see Notes 33 and 34 to the consolidated accounts.

Net assets



Net debt



Supplementary information

Net assets

Amounts in SEK million	31 Dec 2006	31 Dec 2005
Nordic countries	81,687	77,190
Germany	61,818	68,717
Poland	8,812	9,295
Other[1]	−4,405	−2,034
Eliminations	2,053	2,069
Total net assets	**149,965**	**155,237**
Net assets, weighted average value	151,155	143,001

1) Includes Energy Trading activities, Treasury operations and Other Group functions.

Net debt

Amounts in SEK million	31 Dec 2006	31 Dec 2005
Capital Securities	−8,911	−9,268
Other interest-bearing liabilities[1]	−62,664	−69,395
Cash and cash equivalents	14,634	6,049
Short-term investments	7,534	8,025
Loans to minority owners in foreign subsidiaries	–	246
Total net debt	**−49,407**	**−64,343**
1) Of which, loans from minority-owned German nuclear power companies.	−10,951	−13,731

CONSOLIDATED CASH FLOW STATEMENT

Amounts in SEK million, 1 January–31 December	Note	2006	2005
Operating activities			
Funds from operations (FFO)[1]		35,673	31,386
Cash flow from changes in operating assets and operating liabilities		−466	−6,963
Cash flow from operating activities		**35,207**	**24,423**
Investing activities			
Investments[2]		−16,534	−24,497
Divestments[3]		1,720	785
Net investments as a result of the deal between Vattenfall and DONG	3	−686	–
Cash and cash equivalents in acquired/divested companies		−147	17
Cash flow from investing activities		**−15,647**	**−23,695**
Cash flow before financing activities		**19,560**	**728**
Financing activities			
Changes in short-term investments		161	−25
Changes in loans to minority owners in foreign subsidiaries		242	3,864
Loans raised		8,187	1,562
Amortisation of debt		−13,495	−9,667
Issue of Capital Securities		–	9,248
Contribution from minority interests		55	–
Dividends paid to equity holders		−5,892	−5,778
Cash flow from financing activities		**−10,742**	**−796**
Cash flow for the year		**8,818**	**−68**
Cash and cash equivalents			
Cash and cash equivalents at the beginning of the year		6,049	5,916
Cash flow for the year		8,818	−68
Exchange rate differences		−233	201
Cash and cash equivalents at the end of the year		**14,634**	**6,049**
Supplementary information			
Cash flow before financing activities		**19,560**	**728**
Financing activities			
Dividends paid to equity holders		−5,892	−5,778
Contribution from minority interests		55	–
Cash flow after dividend		**13,723**	**−5,050**
Analysis of change in net debt			
Net debt at beginning of the year		−64,343	−55,411
Transitional effect of adoption of new accounting principles (IAS 39)		–	−584
Cash flow after dividend		13,723	−5,050
Changes as a result of valuation at fair value		1,458	−10
Interest-bearing liabilities acquired as a result of the deal between Vattenfall and DONG		−2,893	–
Exchange rate differences on net debt		2,648	−3,288
Net debt at the end of the year		**−49,407**	**−64,343**
Free cash flow		23,178	14,341

1) Funds from operations (FFO)

Amounts in SEK million	2006	2005
Profit for the year	19,858	20,518
Depreciation and amortisation	14,574	14,026
Impairment losses	1,568	1,029
Reversed impairment losses	–25	–243
Undistributed results from participation in associated companies	–666	–121
Unrealised items related to derivates	4,404	–1,154
Unrealised foreign exchange gains	–1,808	–694
Unrealised foreign exchange losses	199	804
Capital gains	–752	–403
Capital losses	352	467
Impairment losses, shares	4	13
Change in interest receivables	–481	–306
Change in interest liabilities	478	896
Change in tax liabilities	–333	–52
Change in the Swedish Nuclear Waste Fund	–1,918	–1,956
Change in provisions	219	–1,438
Total	**35,673**	**31,386**

Interest paid totalled SEK 2,927 million (2,230) and interest received totalled SEK 1,054 million (875). Tax paid totalled SEK 6,000 million (5,853). Dividends received totalled SEK 706 million (639).

2) Investments

Amounts in SEK million	2006	2005
Acquisitions of Group companies	–126	–1,384
Investments in associated companies and other shares and participations	–17	–10,344
Investments in intangible assets: non-current	–586	–602
Investments in property, plant and equipment	–15,801	–12,164
Investments in investment property	–4	–3
Total	**–16,534**	**–24,497**

3) Divestments

Amounts in SEK million	2006	2005
Divestments of shares and participations	834	397
Divestments of intangible assets: non-current	2	5
Divestments of property, plant and equipment	884	383
Total	**1,720**	**785**

Comments

Cash flow from operating activities increased by 44.2% to SEK 35,207 million (24,423). Funds from operations (FFO) increased by 13.7%, to SEK 35,673 million (31,386), while the change in working capital was SEK –466 million (–6,963). The negative change in working capital is mainly attributable to the booking of SEK 4,100 million (gross) as a receivable in 2005 for the compensation from the Swedish state for the closure of Barsebäck 2. In addition, in 2005 a deposit of approximately SEK 2,400 million was made in a German bank for the squeeze out of minority shareholders in the German subsidiary Vattenfall Europe AG. The compensation for Barsebäck 2 is being paid out in four partial payments from 2006 to 2009. Additional explanations for the strong increase in cash flow from operating activities are higher electricity prices, accounting for SEK 4.2 billion, and an improvement in margin calls on the EEX electricity exchange in Germany, accounting for SEK 3.1 billion.

Free cash flow, i.e., cash flow from operating activities less maintenance investments, increased by 61.6% to SEK 23,178 million (14,341).

Cash flow before financing activities increased sharply to SEK 19,560 million (728), due to considerably lower growth investments in 2006. At the 2006 Annual General Meeting, the definition and target interval were changed for Vattenfall's interest coverage ratio. Starting in 2006, the target is based on cash flow after maintenance investments in relation to interest expenses, instead of the previous target, which was based on operating profit. For the exact definition, see page 111. For the target interval and outcome, see page 3.

Investing activities

Total investments decreased by 29.7% to SEK 17,220 million (24,497).

Maintenance investments increased by 19.3% to SEK 12,029 million (10,082), while growth investments decreased by 64.0% to SEK 5,191 million (14,415). Maintenance investments were broken down as follows in 2006: Nordic countries SEK 6,853 million, Germany SEK 4,574 million, Poland SEK 600 million, and Other SEK 2 million. Of growth investments, SEK 686 million pertains to the net investment attributable to the deal between Vattenfall and DONG. The value of assets and shares purchased by Vattenfall was SEK 13,307 million, while the value of assets transferred to DONG (mainly shares in Elsam A/S and the participation in I/S Avedöre 2) amounted to SEK 12,621 million. Other growth investments are broken down as follows: Nordic countries SEK 2,518 million, Germany SEK 1,731 million, Poland SEK 245 million, and Other SEK 11 million.

Divested assets amounted to SEK 1,720 million (785), including SEK 834 million (397) in shares. Divested shares consisted mainly of non-strategic shareholdings in wholly and partly owned companies outside of Vattenfall's core operations. In addition, approximately 4% of the shares in Ringhals AB were transferred to E.ON Sverige as part of the agreement on the closure of Barsebäck 2. See Note 3 to the consolidated accounts on page 83.

Investment programme 2007–2011

During the five-year period 2007–2011 Vattenfall plans to invest SEK 134 billion, of which SEK 57 billion in the Nordic countries, SEK 71 billion in Germany, and SEK 6 billion in Poland. The largest part of these investments, SEK 102 billion, are planned in generation, while SEK 31 billion will be in the network operations and the remaining SEK 1 billion in other operations.

Financing activities

Total interest-bearing liabilities, including Capital Securities, decreased by 9.0% to SEK 71,575 million (78,663). The rating agencies classify most of the Capital Securities as equity (Moody's 75% and Standard & Poor's 50%). For further information on Capital Securities, see Note 32 to the consolidated accounts, page 93. In 2006 loans were amortised in the amount of SEK 13,495 million, while new borrowing amounted to SEK 8,187 million. New borrowing consisted primarily of a number of long-term private placements under Vattenfall's EMTN programme, at very favourable terms. One of these issues has a term of a full 30 years.

The Group's net debt decreased by 23.2% to SEK 49,407 million (64,343).

As per 31 December 2006, the average fixed-interest period was 3.3 years (3.4), and the average remaining maturity for net debt was 6.6 years (6.6). Excluding Capital Securities, the average fixed-interest period was 2.6 years and the average maturity was 6.2 years. All public funding is conducted via Vattenfall Treasury AB under guarantee from Vattenfall AB.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Amounts in SEK million	Attributable to equity holders of the Parent Company					Attributable to minority holders	Total equity
	Share capital	Translation reserve	Reserve for cash flow hedges	Retained earnings incl. profit for the year	Total		
Balance carried forward 2004	**6,585**	**821**	**–**	**65,588**	**72,994**	**10,114**	**83,108**
Adjustment of retained earnings[1]	–	–	–	2,443	**2,443**	–	**2,443**
Transitional effect of adoption of new accounting principles (IAS 39)	–	2	–264	–154	**–416**	–24	**–440**
Cash flow hedges:							
Changes in fair value	–	–	–14,174	–	**–14,174**	–250	**–14,424**
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**
Income, net, recognised directly in equity	**–**	**2,126**	**–10,124**	**–**	**–7,998**	**151**	**–7,847**
Profit for the year	–	–	–	19,235	**19,235**	1,283	**20,518**
Total recognised income and expense for the year	**–**	**2,126**	**–10,124**	**19,235**	**11,237**	**1,434**	**12,671**
Dividends paid to equity holders	–	–	–	–5,600	**–5,600**	–178	**–5,778**
Group contributions to minority, net after tax	–	–	–	–	**–**	–119	**–119**
Changes in ownership	–	–	–	–	**–**	–976	**–976**
Transfers within equity	–	–	–	–93	**–93**	93	**–**
Balance carried forward 2005	**6,585**	**2,949**	**–10,388**	**81,419**	**80,565**	**10,344**	**90,909**
Cash flow hedges:							
Changes in fair value	–	–	–1,606	–	**–1,606**	–50	**–1,656**
Dissolved against income statement	–	–	8,717	–	**8,717**	109	**8,826**
Transferred to cost of hedged item	–	–	–56	–	**–56**	–4	**–60**
Tax attributable to items reported directly against equity	–	–	–2,478	–	**–2,478**	–49	**–2,527**
Hedging of net investments in foreign operations	–	1,856	–	–	**1,856**	–	**1,856**
Translation differences	–	–3,338	–	–	**–3,338**	–265	**–3,603**
Income, net, recognised directly in equity	**–**	**–1,482**	**4,577**	**–**	**3,095**	**–259**	**2,836**
Profit for the year	–	–	–	18,729	**18,729**	1,129	**19,858**
Total recognised income and expense for the year	**–**	**–1,482**	**4,577**	**18,729**	**21,824**	**870**	**22,694**
Dividends paid to equity holders	–	–	–	–5,800	**–5,800**	–92	**–5,892**
Group contributions from minority, net after tax	–	–	–	–	**–**	114	**114**
Changes in ownership	–	–	–	–	**–**	–151	**–151**
Balance carried forward 2006	**6,585**	**1,467**	**–5,811**	**94,348**	**96,589**	**11,085**	**107,674**

NOTES TO THE CONSOLIDATED ACCOUNTS

(Amounts in SEK million unless stated otherwise.)

1) Reappraisal decision by the Swedish Tax Agency
Vattenfall AB has previously been the subject of an extensive tax audit which dealt with Vattenfall's transition from a public utility (affärsverk) to a limited liability company in 1992. The County Administrative Court and Administrative Court of Appeal, after appeals on verdicts, have established that the Swedish Parliament's decision at the time of the conversion of Vattenfall into a limited liability company did not take applicable tax legislation into account to a sufficient extent. One consequence of this, according to the reappraisal decision, has been that Vattenfall AB's opening balance sheet as a limited liability company has been corrected, meaning that the Group's deferred tax liability was reduced by SEK 2,443 million, with a corresponding increase in Retained earnings in the Group's equity.

Share capital:
As of 31 December 2006 the registered share capital comprised 131,700,000 shares with 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. Further, the translation reserve includes exchange rate differences arising in the reassessment of debts raised as hedges for net investments in non-Swedish operations.

Reserve for cash flow hedges:
The reserve for cash flow hedges includes mostly unrealised values of electricity derivatives used to hedge future sales.

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.

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Note 1 Company information

The consolidated accounts and year-end report for Vattenfall AB for 2006 were approved for publication in accordance with a decision by the Board of Directors on 7 February 2007. The Annual Report has been approved in accordance with a decision by the Board of Directors on 7 March 2007. 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 submitted at the Annual General Meeting (AGM).

The main activities of the Group are described in Note 6 to the consolidated accounts, Segmental information.

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 interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as approved by the European Commission for application within the EU. These also include the International Accounting Standards (IAS) issued by IASB's predecessor, the International Accounting Standards Committee (IASC), and the interpretations issued by IFRIC's predecessor, the Standing Interpretations Committee (SIC).

Further, the Swedish Financial Accounting Standards Council's recommendation RR 30:05 – Supplementary Accounting Principles for Groups of Companies, has been applied. RR 30:05 specifies the necessary additions to the IFRS disclosure requirements in accordance with the Swedish Annual Accounts Act.

Basis of measurement

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

Functional and presentation currencies

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

The Parent Company's functional currency is the 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 kronor (SEK). Unless otherwise stated, all figures are rounded off to the nearest million Swedish kronor (SEK million).

Estimations and assessments

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 to 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 on a regular basis. 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 material 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 49 to the consolidated accounts.

Changes in accounting principles and definitions

The accounting principles of the Group detailed below have been applied consistently to all periods presented in the consolidated financial statements. The Group's accounting principles have been applied consistently to the reporting and consolidation of subsidiaries and associated companies.

Starting in 2006, the Group's share of an associated company's reported profit after tax – where appropriate adjusted for any amortisation, impairment loss or dissolution of acquired surplus or deficit values – is reported as "Participations in the results of associated companies". Previously, the Group's share of associated companies' recorded tax expenses was included in the consolidated tax expense. All periods prior to 2006 have been restated to comply with this new principle.

In the 2006 year-end book-closing, the accounting principle for emission allowances has been changed in such way that purchased emission allowances are reported at cost as intangible assets under current assets, while emission allowances that have been received free of charge from the respective countries' authorities are stated at a value of SEK 0. As carbon dioxide is emitted, an obligation arises to deliver emission allowances to the authorities in the respective countries. An expense and a liability are booked only in cases where the emission allowances that were received free of charge do not cover this obligation. This liability is valued in the amount at which it is expected to be settled. In previous periods, emission allowances received free of charge were stated at the time of their acquisition at fair value among inventories and as a government grant on the balance sheet, while purchased emission allowances were reported at cost among inventories. The government grant was realised as income over the year, and as carbon dioxide was emitted, an expense and a liability for the obligation to provide emission allowances was recognised. The liability was valued on the basis of inventory assets. Effects in previous periods of the above-mentioned change in accounting principle for emission allowances entails that the balance sheet total for the Vattenfall Group decreased by SEK 5,353 million as per 31 December 2005, by SEK 27,782 million as per 31 March 2006, by SEK 20,437 million as per 30 June 2006, and by SEK 20,576 million as per 30 September 2006. Gross profit and operating profit are not affected by this new accounting principle.

Starting with 2006 and onwards, an average of equity over the period is applied when calculating the key ratio Return on equity. Previously this same key ratio was based on equity brought forward for the period. Previous periods have been restated to comply with this new principle.

New IFRSs and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations approved by the EU are effective as of the 2007 fiscal year, and have not been applied in preparing these consolidated financial statements.

IFRS 7 – Financial Instruments: Disclosures, and the Amendment to IAS 1 – Presentation of Financial Statements: Capital Disclosures, require increased disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and the related amendments to IAS 1, which become mandatory for the Group's 2007 financial statements, will require increased additional disclosures with respect to the Group's financial instruments.

IFRIC 7 – Applying the Restatement Approach under IAS 29 – Financial Reporting in Hyperinflationary Economies, addresses the application of IAS 29 when an economy first becomes hyperinflationary and in particular the accounting for deferred tax. IFRIC 7, which becomes mandatory for the Group's 2007 financial statements, is not expected to have any impact on the consolidated financial statements.

IFRIC 8 – Scope of IFRS 2 Share-based Payment, addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. IFRIC 8 will become mandatory for the Group's 2007 financial statements, with retrospective application required. At present, Vattenfall is not affected by IFRIC 8.

IFRIC 9 – Reassessment of Embedded Derivatives, requires that a reassessment of whether embedded derivatives should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9, which becomes mandatory for the Group's 2007 financial statements, is not expected to have any material impact on the consolidated financial statements.

IFRIC 10 – Interim Financial Reporting and Impairment, prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument,

or a financial asset carried at cost. IFRIC 10 will become mandatory for the Group's 2007 financial statements and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Group first applied the measurement criteria of IAS 36 and IAS 39, respectively (i.e., 1 January 2004 for goodwill and 1 January 2005 for financial instruments). Since no such reversals of impairment losses have taken place, IFRIC 10 will have no impact on the Group's financial statements.

Segmental information

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 (geographic area) that are exposed to risks and opportunities that distinguish it from other segments. Segmental information (see Note 6 to the consolidated accounts) is provided for the Group.

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 one for which the Group does not have an unconditional right to defer settlement of for a minimum of twelve months after the balance sheet date.

All other liabilities are classified as non-current liabilities.

Principles of consolidation

Subsidiaries

Subsidiaries are companies in which the Parent Company, Vattenfall AB, directly or indirectly holds more than 50% 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 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 cost 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 cost 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 discontinued operation is reported separately from continuing operations if the discontinued operation amounts to a significant value.

Associated companies

Associated companies are companies for which the Group has a significant – but not controlling – influence over 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 share of the associated companies' equity plus consolidated goodwill and any unamortised value of consolidated surplus and deficit values. Dividends received from an 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 investment 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 activities in which the Group has a joint controlling influence over the operational and financial management 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

Transactions in foreign currencies are translated to 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 to 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.

Financial reporting of foreign activities

Assets and liabilities of foreign activities, including goodwill and other consolidated surplus and deficit values, are translated to SEK at the exchange rate in effect on the balance sheet date. Income and expenses of foreign activities are translated to SEK using an average exchange rate. Translation differences arising from foreign currency translation of foreign activities are reported directly against equity under the heading Translation reserve.

For the Vattenfall Group, the more important exchange rates used in the accounts are provided in Note 4 to 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 excise taxes.

In the case of service and consulting assignments, the percentage of completion method is applied, i.e., revenues and expenses are reported in proportion 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 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

Grants are reported at fair value when it can reasonably be assumed

Continued on page 80

Note 2 continued

that the grant will be received and that the Group will meet the conditions of the grant.

A grant tied to a non-current asset reduces the book value of the asset.

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

Operating expenses

Operating leases

Payments concerning operating leases are reported in the income statement on a straight-line basis over the leasing period. For a definition of operating leases, see below under the heading Property, plant and equipment/Leasing.

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, and positive changes in values of 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, and negative changes in values of 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 non-current assets are not reported as financial costs but should be included in the cost of the non-current asset during the construction period.

Leasing fees pertaining to finance leases 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.

Financial assets and liabilities

General principles

Foreign exchange gains and losses concerning operating 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 set at the rate applicable when the market closes on the balance sheet date. The same rule applies for fixing the fair value of bilaterally traded financial instruments (OTC-trading). For unlisted financial instruments, fair value is set 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 point of acquisition.

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

Financial assets carried at fair value in 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 near 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 restated on an ongoing basis at fair value, with changes in value reported in the income statement.

This category includes cash and cash equivalents, 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 whose amounts can be determined. 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 stated 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 on 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 shares and participations

These are 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 date of original acquisition.

Financial liabilities stated at fair value in the income statement

Derivative instruments are 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 noninterest-bearing financial liabilities that are not held for commercial purposes are reported. A valuation is made at 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

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. In a situation where hedging is not applied, the 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.

Vattenfall has taken out embedded derivative contracts with a number of major customers, i.e., contracts that contain conditions that entail that the value of the contracts will be affected in the same way as

if a separate derivative had been contracted. These contracts stretch over long periods of time – considerably longer than available market quotations: the longest contract has a term extending until 2019.

In customer contracts, the price can be linked to the price trend for other commodities than electricity, and indirectly also to currency movements, since the current commodity prices are quoted in foreign currency. According to IAS 39, such contracts are considered to contain embedded derivatives. In view of the structure of these contracts in general and their duration in particular, plus the fact that reliable market quotations are only available for a period of 27 months ahead in time, Vattenfall has made the judgement that a reliable value cannot be established on the portion of these embedded derivatives that pertain to the period extending beyond April 2009.

Hedge accounting

Hedge accounting is adopted for derivative instruments that are included in a documented hedge relationship. For hedge accounting 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. The 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 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), the part of the change in value reported under equity is transferred to and included in the cost 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, hedge accounting is applied in cases where the hedge pertains to an item that is normally stated at amortised cost. In such cases, hedge accounting entails that the hedged risk in the hedged item is stated at fair value along with the change in value 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: non-current

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 cost 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 non-current intangible assets

Other non-current 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 non-current intangible assets are reported as an asset in the balance sheet only 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.

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 are unchanged compared with a year ago and are further described in Note 18 to the consolidated accounts, Intangible assets: non-current.

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.

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Note 2 continued

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

Leasing
Leases are classified as either finance or operating leases. A finance lease 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 an operating lease.

Leased assets
Assets leased under finance leases 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.

Operating leases normally entail 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 finance leases are not reported as property, plant and equipment, since 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 operating leases are reported as property, plant and equipment that are subject to depreciation.

Subsequent costs
Subsequent costs 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.

What is decisive for the assessment when a subsequent cost is added to cost is whether the cost concerns the replacement of identified components, or parts of them, whereby such costs are capitalised. Also in cases where new components are created, the cost is added to the cost of the asset. Any undepreciated reported values of replacement components, or parts of components, are retired and carried as an expense in connection with the replacement. Repairs are carried as an expense continuously.

Depreciation principles
Depreciation is reported on a straight-line basis in the income statement 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 are unchanged compared with a year ago for all property, plant and equipment except for the Group's Swedish nuclear power plants where the useful life, starting in 2006, has been extended from 25 years to 40 years. Estimated useful lives are further described in Note 19 to the consolidated accounts, Property, plant and equipment.

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 done on a straight-line basis, and an assessment of residual value and useful life of an asset is conducted annually.

Inventories
Nuclear fuel, fossil fuels, and materials and spare parts
These inventories are valued at the lower of their cost and net realisable value. 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.

Intangible assets: 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.

Purchased emission allowances are reported at cost as intangible assets under current assets, while emission allowances that have been received free of charge from the respective countries' authorities are stated at a value of SEK 0. As carbon dioxide is emitted, an obligation arises to deliver emission allowances to the authorities in the respective countries. An expense and a liability are booked only in cases where the emission allowances that were received free of charge do not cover this obligation. This liability is valued in the amount at which it is expected to be settled.

Impairment losses
Assessments are made throughout the year for any indication that an asset 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 an 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 for an individual asset cannot be established for the 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. Any 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 higher of fair value less selling expenses and value in use. When calculating 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 made.

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 made.

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

Defined benefit pension plans
Defined benefit pension plans consist of other post-employment benefit

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

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

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

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 the money's time value and the risks associated with the liability. The discount rate does not reflect such risks that 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, whereby 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 established or, established in practice 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 initial reporting of goodwill, initial 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 that have been established or have been established in practice by the balance sheet date.

Deferred tax assets concerning non-deductible temporary differences and tax-loss carryforwards are only reported to the extent 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 Acquired and divested operations

As per 1 July 2006, assets, liabilities and staff, etc., were transferred between Vattenfall and the Danish company DONG A/S. Assets, primarily in the form of combined heat and power plants and wind power plants, were transferred to Vattenfall from Elsam A/S and Energi E2 A/S (subsidiaries of DONG A/S) in exchange for Vattenfall's shares in Elsam A/S and Vattenfall's participation in I/S Avedöre 2.

The main parts of the new plants were acquired directly by Vattenfall A/S in Denmark (the company is 100%-owned by Vattenfall AB), whereby plants, shareholdings, working capital and financing were taken over. At the same time, shares were acquired in Kentish Flats Ltd (100%), Vattenfall Vindkraft Sverige AB (100%) and Vattenfall Wolin-North Sp.z.o.o (100%) (present names).

The acquisition of the subsidiaries has been reported using the acquisition method of accounting, as defined in IFRS 3 – Business Combinations. As prescribed under this method, Vattenfall has allocated the total acquisition price, both for acquired assets and companies, to assets acquired and liabilities assumed based on their fair values. The fair values have been determined by applying generally accepted principles and procedures.

The value of transferred net assets amounted to SEK 13,307 million. After divestments (mainly Vattenfall's shareholding in Elsam A/S and its participation in I/S Avedöre 2) valued at SEK 12,621 million, the net investment amounts to SEK 686 million. The valuation of assets acquired and liabilities is preliminary pending a final review of the acquisition.

Operating profit of the acquired operations amounted to SEK 430 million for the second half of 2006. Vattenfall does not have access to information on operating profit for the full year 2006. The same applies for reported values of assets and liabilities taken over from the selling companies engaged.

The table below shows assets and liabilities taken over as stated in the consolidated accounts at the acquisition date (SEK million).

Assets and liabilities acquired	
Intangible assets: non-current	2,046
Property, plant and equipment	13,917
Other non-current assets	586
Inventories	1,174
Cash and cash equivalents	39
Other current assets	1,249
Total assets	**19,011**
Provisions	1,203
Interest-bearing non-current liabilities	1,434
Other non-current liabilities	1,170
Interest-bearing current liabilities	1,460
Other current liabilities	437
Total liabilities	**5,704**
Net assets acquired	**13,307**
Cash flow effects	
Net assets acquired	13,307
Value of assets divested	12,621
Net investment	**686**
Cash and cash equivalents acquired	39
Net cash outflow at time for acquisition	**647**

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Note 3 continued

Other companies than the above-mentioned, that have been subject to divestment (major divestments).

	Month	Company	Change, %	New ownership %	Transfer amount, SEK million
Nordic countries	March	Ringhals AB, Sweden	– 4	70	91
	December	Bodens Energi AB, Sweden	–40	–	110
Germany	March	Enoplan GmbH	–62	–	19
	April	Energie Südwest AG	–51	–	342
	June	Compania Electricia de Sochagota S.A.E.S.P, Colombia	–25	–	180
	August	AVG Abfall und Verwertungs GmbH	–20	–	79
	August	TVF Thyssen VEAG Flächenrecycling GmbH	–50	–	13

Note 4 Exchange rates

Key exchange rates applied in the accounts of the Vattenfall Group:

		Average rate		Balance sheet date rate	
Country	Currency	2006	2005	31 Dec 2006	31 Dec 2005
Euro	EUR	9.2617	9.2812	9.0500	9.4300
Denmark	DKK	1.2418	1.2456	1.2135	1.2640
Norway	NOK	1.1516	1.1559	1.0945	1.1760
Poland	PLN	2.3769	2.3062	2.3600	2.4400
USA	USD	7.3794	7.4455	6.8700	7.9530

Note 5 Net sales

	2006	2005
Sales including excise taxes		
sale of goods (electricity, heat, gas etc.)	145,313	129,866
rendering of services	5,130	4,825
Excise taxes	–4,628	–5,533
Net sales	**145,815**	**129,158**

Note 6 Segmental information

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, the Netherlands and the UK. The primary segments consist of areas based on the locations of assets. Operating profit of the primary segment Other includes changes in market values for electricity trading. These are reported in Energy Trading until the amounts are realised. When the amounts are realised, other segments are affected.

The Group's activities are also divided into business segments (secondary segments), namely Electricity Generation, Electricity Markets (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. Operating profit of the secondary segment Electricity Markets includes changes in market values for electricity trading. These are reported in Energy Trading until the amounts are realised. When the amounts are realised the segment Electricity Generation is the main segment affected.

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

2006	Nordic countries	Germany	Poland	Other	Eliminations	Total
External net sales	48,235	69,905	8,981	18,694	–	**145,815**
Sales between segments	970	42,065	468	44,218	–87,721	**–**
Total	**49,205**	**111,970**	**9,449**	**62,912**	**–87,721**	145,815
Operating profit (EBIT)	13,287	13,059	1,072	–413	44	**27,049**
Operating profit (EBIT) excl. items affecting comparability	13,217	12,886	942	–413	44	**26,676**
Assets	154,005	165,596	18,127	122,823	–137,385	**323,166**
Liabilities	130,413	98,672	11,859	111,929	–137,381	**215,492**
Net assets	81,687	61,818	8,812	–4,405	2,053	**149,965**
Investments	11,744	6,305	845	14	–1,688	**17,220**
Depreciation and amortisation	4,372	9,423	728	51	–	**14,574**
Impairment losses	196	1,368	4	–	–	**1,568**
Reversed impairment losses	–	25	–	–	–	**25**
Participations in the results of associated companies	550	771	–	13	–	**1,334**

2005[1]	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	**–**
Total	**42,021**	**104,995**	**8,850**	**44,563**	**–71,271**	129,158
Operating profit (EBIT)	16,794	10,113	842	–178	–	**27,571**
Operating profit (EBIT) excl. items affecting comparability	13,704	10,251	808	–178	–	**24,585**
Assets	137,671	173,982	17,302	106,427	–110,314	**325,068**
Liabilities	108,204	113,004	11,540	111,689	–110,278	**234,159**
Net assets	77,190	68,717	9,295	–2,034	2,069	**155,237**
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	350	80	–	–	**1,029**
Reversed impairment losses	–	237	6	–	–	**243**
Participations in the results of associated companies	189	347	–	–2	–	**534**

Secondary segments

2006	Electricity Generation	Electricity Markets	Electricity Networks	Heat	Other	Eliminations	Total
External net sales	34,169	73,992	36,571	14,833	1,598	–15,348	**145,815**
Sales between segments	41,096	19,774	15,003	8,429	5,701	–90,003	**–**
Total	**75,265**	**93,766**	**51,574**	**23,262**	**7,299**	**–105,351**	145,815
Operating profit (EBIT)	19,762	355	3,947	4,130	–1,145	–	**27,049**
Operating profit (EBIT) excl. items affecting comparability	19,776	169	3,985	4,251	–1,505	–	**26,676**
Assets	210,100	29,993	83,104	43,443	136,635	–180,109	**323,166**
Investments	20,532	94	6,001	2,138	6,499	–18,044	**17,220**

2005[1]	Electricity Generation	Electricity Markets	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	**–**
Total	**57,414**	**73,262**	**50,813**	**20,925**	**7,278**	**–80,534**	129,158
Operating profit (EBIT)	19,751	1,172	5,288	3,494	–2,134	–	**27,571**
Operating profit (EBIT) excl. items affecting comparability	16,742	1,171	5,373	3,540	–2,241	–	**24,585**
Assets	196,836	32,899	80,448	47,191	124,248	–156,554	**325,068**
Investments	5,818	269	4,776	2,605	13,178	–2,149	**24,497**

1) Certain figures are adjusted compared to previously published information in Vattenfall's 2005 Annual Report. See Note 2 to the consolidated accounts, Accounting principles.

Note 7 Cost of products sold

Direct costs include production taxes and duties of SEK 5,341 million (4,198) and property taxes of SEK 1,152 million (597). The costs also include SEK 461 million (498) in interest components related to annual pension costs, net after deductions for expected returns on plan assets.

Note 8 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 has received for the closing of the Barsebäck 2.

Note 9 Selling expenses, administrative expenses and research & development costs

The costs include SEK 311 million (295) in interest components related to annual pension costs, net after deductions for expected returns on plan assets.

Note 10 Other operating expenses

Other operating expenses primarily comprise capital losses from the sale of non-current assets, operationally derived exchange rate losses and closure and restructuring expenses.

Note 11 Depreciation and amortisation

Depreciation of property, plant and equipment and of investment property and amortisation of non-current intangible assets in the income statement are broken down as follows:

	2006	2005
Cost of products sold	13,843	13,496
Selling expenses	303	167
Administrative expenses	405	343
Research and development costs	4	1
Other operating expenses (investment property)	19	19
Total	**14,574**	**14,026**

Amortisation of non-current intangible assets is included in Cost of products sold above in the amount of SEK 415 million (521), Selling expenses in the amount of SEK 137 million (0) and Administrative expenses in the amount of SEK 194 million (141).

Note 12 Impairment losses and reversed impairment losses

Impairment losses of non-current intangible assets, property, plant and equipment and investment property in the income statement are broken down as follows:

	2006	2005
Cost of products sold	1,191	992
Selling expenses	193	–
Administrative expenses	2	11
Other operating expenses (investment property)	182	26
Total	**1,568**	**1,029**

Major impairment losses above include:

Costs for sold products

In 2006 Vattenfall was handed a decision from the German network regulator, Bundesnetzagentur, regarding tariff reductions for its transmission and distribution operations. The future loss of income that will result from this decision gave strong indications of a need to test the reported values of the assets involved. An impairment test has been performed for the respective cash-generating units.

The reported value of the cash-generating units has been compared with an estimated net present value based on future, sustainable cash flows. This has resulted in impairment losses totalling SEK 1,019 million for the distribution operations.

The discount rate for the networks amounts to 4% after tax, given the special risk situation for regulated operations.

Selling expenses

The development of a new customer handling system has resulted in higher outlays than originally estimated. The future gains that the new system was to generate do not match the higher cost. Consequently, operating profit has been changed with an impairment loss of SEK 192 million.

Investment properties

Each investment property, consisting of land and buildings, has been compared with an estimated market value less selling expenses. This

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Note 12 continued

has give rise to impairment losses of investment properties in eastern Germany and for individual investment properties in Berlin, in the amount of SEK 182 million.

Reversed impairment losses of non-current intangible assets, property, plant and equipment and investment property in the income statement are broken down as follows:

	2006	2005
Cost of products sold	23	198
Selling expenses	–	43
Administrative expenses	2	–
Other operating expenses (investment property)	–	2
Total	**25**	**243**

Note 13 Operating costs according to type

	2006	2005
Personnel costs	19,249	18,664
Depreciation and amortisation	14,574	14,026
Impairment losses of non-current assets	1,568	1,029
Reversed impairment losses of non-current assets	–25	–243
Other operating costs incl. input commodities	87,053	74,042
Total	**122,419**	**107,518**

Note 14 Financial income

	2006	2005
Dividends	73	66
Interest income attributable to investments, etc.	1,341	980
Returns from the Swedish Nuclear Waste Fund	2,106	2,089
Net change in value from reassessment of derivatives	272	545
Net change in value from reassessment of other financial assets	35	117
Capital gains from divestments of shares and participations	12	13
Total	**3,839**	**3,810**

Note 15 Financial expenses

	2006	2005
Interest expenses attributable to loans, etc.	3,317	2,967
Discounting effects attributable to provisions	2,012	2,060
Exchange rate differences, net	25	171
Impairment losses on shares and participations	7	17
Capital losses from divestments of shares and participations	2	6
Total	**5,363**	**5,221**

See also Notes 9 and 11 to the consolidated accounts concerning interest components attributable to pension provisions.

Note 16 Income tax expense

Profit before tax excluding participations in the results of associated companies amounted to:

	2006	2005
Sweden	10,443	15,298
Other countries	13,748	10,328
Total	**24,191**	**25,626**

The reported income tax expense breaks down as follows:

	2006	2005
Current tax		
Current taxes related to the period:		
Sweden	1,668	2,248
Other countries	5,578	4,421
Adjustment of current taxes for prior periods:		
Sweden	–103	392
Other countries	–1,127	–900
Deferred tax		
Sweden	1,251	819
Other countries	–1,600	–1,338
Total	**5,667**	**5,642**

The difference between the nominal Swedish tax rate and the effective tax rate is explained as follows:

%	2006	2005
Swedish income tax rate	28.0	28.0
Difference in tax rate in foreign operations	4.8	3.3
Tax adjustment for previous periods, new tax law	–5.0	–
Tax adjustment for previous periods, other	0.3	–1.9
Amended tax rates	–	0.7
Non-deductible expenses and non-taxable income, net	–5.4	–8.5
Impairment losses on goodwill	–	0.3
Other	–0.5	0.1
Effective tax rate[1]	**22.2**	**22.0**
Tax rate, current tax[2]	24.9	24.0

1) Income tax expense according to the consolidated income statement in relation to profit before tax excluding participations in the results of associated companies.

2) Income tax expense according to the consolidated income statement excluding deferred tax in relation to profit before tax excluding participations in the results of associated companies.

Accumulated tax-loss carryforwards are broken down as follows:

	2006	2005
Sweden	13	19
Other countries	627	2,205
Total	**640**	**2,224**

The decrease in the reported amount is explained by the tax-loss carryforwards utilised in 2006.

The tax-loss carryforwards fall due as follows:

	2006
2007	182
No time limit	458
Total	**640**

A non-current tax asset for current tax has arisen following changed legislation in Germany (December 2006) which entails that a tax credit received during the years 2002–2005 pertaining to previously abolished rules regulating tax on dividends, can now be recovered without conditions for further distribution. The relaxed tax credit will be paid out during the years 2008–2017 and is represented in the balance sheet by a discounted value. As an effect of changed legislation, the income statement for 2006 has been credited in the amount of SEK 1,241 million as an adjustment of current taxes pertaining to previous periods.

Deferred tax assets and deferred tax liabilities are attributable to balance sheet items as follows:

Deferred tax assets	2006	2005
Non-current assets	3,208	3,016
Current assets	1,096	530
Equity	–	5,704
Non-current liabilities	6,296	5,274
Current liabilities	1,609	–171
Tax-loss carryforwards	66	216
Offsetting of deferred tax liabilities	–10,468	–
Total	**1,807**	**14,569**

Deferred tax liabilities	2006	2005
Non-current assets	32,436	32,533
Current assets	2,235	52
Equity	–	141
Non-current liabilities	4,309	4,664
Current liabilities	1,363	2,537
Offsetting of deferred tax assets	–10,468	–
Total	**29,875**	**39,927**

Deferred tax assets (changes in 2006)	
Balance brought forward	14,569
Acquired companies	403
Additions/dissolutions for the period, net	–2,383
Divested companies	–2
Translation differences	–312
Offsetting of deferred tax liabilities	–10,468
Balance carried forward	**1,807**

Deferred tax liabilities (changes in 2006)	
Balance brought forward	39,927
Acquired companies	734
Additions/dissolutions for the period, net	622
Divested companies	–18
Translation differences	–922
Offsetting of deferred tax assets	–10,468
Balance carried forward	**29,875**

Note 17 Minority interests

	2006	2005
Minority interests in profit before tax	1,503	1,422
Minority interests in income tax expense	–374	–139
Total	**1,129**	**1,283**

Note 18 Intangible assets: non-current

	Capitalised development costs		Goodwill		Concessions and similar rights with finite useful lives		Renting rights, mining rights and similar rights with finite useful lives		Total	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Cost										
Cost brought forward	1,307	814	451	243	3,250	2,931	4,428	4,212	**9,436**	**8,200**
Acquired companies	–	–	–	180	–	135	–	–	**–**	**315**
Investments	110	426	–	–	122	159	354	17	**586**	**602**
Divestments/Disposals	–	–	–	–	–205	–43	–1	–4	**–206**	**–47**
Reclassifications	–	31	–	–	–135	–22	–	38	**–135**	**47**
Divested companies	–	–	–	–	–71	–3	–	–	**–71**	**–3**
Translation differences	–36	36	–16	28	–72	93	–157	165	**–281**	**322**
Accumulated cost carried forward	**1,381**	**1,307**	**435**	**451**	**2,889**	**3,250**	**4,624**	**4,428**	**9,329**	**9,436**
Accumulated amortisation according to plan[1]										
Amortisation brought forward	–484	–274	–	–	–2,125	–1,885	–1,174	–892	**–3,783**	**–3,051**
Amortisation for the year	–277	–197	–	–	–245	–238	–224	–227	**–746**	**–662**
Divestments/Disposals	–	–	–	–	199	40	1	–	**200**	**40**
Reclassifications	–59	3	–	–	67	15	–	–17	**8**	**1**
Divested companies	–	–	–	–	44	3	–	–	**44**	**3**
Translation differences	25	–16	–	–	50	–60	45	–38	**120**	**–114**
Accumulated amortisation carried forward	**–795**	**–484**	**–**	**–**	**–2,010**	**–2,125**	**–1,352**	**–1,174**	**–4,157**	**–3,783**
Impairment losses										
Impairment losses brought forward	–	–	–183	–	–19	–17	–525	–317	**–727**	**–334**
Impairment losses for the year	–193	–	–	–180	–3	–	–	–205	**–196**	**–385**
Reclassifications	–	–	–	–	2	–	–	–	**2**	**–**
Divested companies	–	–	–	–	–	–1	–	–	**–**	**–1**
Translation differences	–	–	7	–3	1	–1	1	–3	**9**	**–7**
Accumulated impairment losses carried forward	**–193**	**–**	**–176**	**–183**	**–19**	**–19**	**–524**	**–525**	**–912**	**–727**
Residual value according to plan carried forward	**393**	**823**	**259**	**268**	**860**	**1,106**	**2,748**	**2,729**	**4,260**	**4,926**
Advance payment to suppliers									**–**	**341**
Total									**4,260**	**5,267**

1) Estimated useful lives are for Capitalised development costs 3–4 years, for Concessions etc., 3–30 years and for Renting rights, mining rights, etc., 3–50 years.

At 31 December 2006, contractual commitments for the acquisition of non-current intangible assets amounted to SEK 7 million.

Note 19 Property, plant and equipment

	Land and buildings[1]		Plants and other technical installations		Equipment, tools, and fixtures and fittings		Construction in progress[2]		Total	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Cost										
Cost brought forward[3]	68,306	65,378	353,960	333,986	9,019	8,784	7,366	7,081	**438,651**	**415,229**
Acquired companies	–	28	4,306	185	–	19	85	–	**4,391**	**232**
Investments[4]	2,607	431	13,236	2,476	776	530	11,365	8,727	**27,984**	**12,164**
Capitalised/Reversed future expenses for decommissioning, restoration, etc.	723	1,298	366	1,596	–	–	–1	–	**1,088**	**2,894**
Transfer from construction in progress	649	1,088	6,578	7,133	105	67	–7,332	–8,288	**–**	**–**
Divestments/Disposals	–1,151	–1,918	–5,608	–3,857	–498	–683	–121	–156	**–7,378**	**–6,614**
Other reclassifications	35	46	–7	80	–14	11	128	–124	**142**	**13**
Divested companies	–99	–119	–788	–140	–59	–28	–1	–1	**–947**	**–288**
Translation differences	–1,727	2,074	–10,675	12,501	–282	319	–122	127	**–12,806**	**15,021**
Accumulated cost carried forward	**69,343**	**68,306**	**361,368**	**353,960**	**9,047**	**9,019**	**11,367**	**7,366**	451,125	438,651
Accumulated depreciation according to plan[5]										
Depreciation brought forward	–31,338	–30,378	–208,346	–193,758	–7,472	–7,274	–	–	**–247,156**	**–231,410**
Acquired companies	–	–6	–189	–26	–	–15	–	–	**–189**	**–47**
Depreciation for the year	–1,686	–1,638	–11,548	–11,135	–575	–571	–	–	**–13,809**	**–13,344**
Divestments/Disposals	875	1,674	5,290	3,558	473	662	–	–	**6,638**	**5,894**
Other reclassifications	50	–20	–5	30	6	–18	–	–	**51**	**–8**
Divested companies	76	29	534	95	46	7	–	–	**656**	**131**
Translation differences	795	–999	6,195	–7,110	234	–263	–	–	**7,224**	**–8,372**
Accumulated depreciation carried forward	**–31,228**	**–31,338**	**–208,069**	**–208,346**	**–7,288**	**–7,472**	–	–	–246,585	–247,156
Impairment losses										
Impairment losses brought forward	–943	–877	–2,030	–1,604	–61	–51	–10	–9	**–3,044**	**–2,541**
Acquired companies	–	–10	–	–37	–	–	–	–	**–**	**–47**
Impairment losses for the year	–99	–167	–1,090	–443	–1	–8	–	–	**–1,190**	**–618**
Reversed impairment losses for the year	24	146	1	95	–	–	–	–	**25**	**241**
Transfer from construction in progress	–2	–	–	–	–	–	2	–	**–**	**–**
Divestments/Disposals	33	116	16	28	–	–	–	–	**49**	**144**
Other reclassifications	–38	–106	–	5	–	–	–	–	**–38**	**–101**
Translation differences	39	–45	90	–74	2	–2	–	–1	**131**	**–122**
Accumulated impairment losses carried forward	**–986**	**–943**	**–3,013**	**–2,030**	**–60**	**–61**	**–8**	**–10**	–4,067	–3,044
Residual value according to plan carried forward	**37,129**	**36,025**	**150,286**	**143,584**	**1,699**	**1,486**	**11,359**	**7,356**	200,473	188,451
Advance payment to suppliers									**855**	**565**
Total									201,328	189,016

1) Cost for land and buildings includes cost of land and water rights amounting to SEK 13,961 million (14,247), which are not subject to depreciation.

2) Interest during the construction period has been reported as an asset in the amount of SEK 75 million (7) for the year. The average fixed rate term for 2006 was 4.3 %.

3) Government grants received, balance brought forward, amount to SEK 4,760 million (4,409). Accumulated interest reported as an asset totalling SEK 648 million (573) is included in cost of buildings.

4) Government grants received during the year amounted to SEK 76 million (66)

5) Estimated useful lives are for Hydro power installations 5–40 years, for Combined heat and power installations 5–40 years, for Electricity distribution and transmission lines 5–35 years, for Mining operations 5–20 years, for Office equipment 5–10 years and for Office and warehouse buildings and workshops 25–50 years.

The extended useful life for the Group's Swedish nuclear power plants has resulted in lower depreciation of SEK 505 million compared to earlier estimations made.

Tax assessment values (for Swedish real estate)

	2006	2005
Buildings	86,505	92,579
Land	25,382	25,501
Total	111,887	118,080

Distribution lines and transformer stations are not subject to tax assessment values.

At 31 December 2006, contractual commitments for the acquisition of property, plant and equipment amounted to SEK 8,532 million.

Note 20 Investment property

	2006	2005
Cost		
Cost brought forward	2,505	2,499
Investments	4	3
Divestments/Disposals	–178	–59
Reclassifications	–12	–53
Translation differences	–94	115
Accumulated cost carried forward	**2,225**	**2,505**
Accumulated depreciation according to plan[1]		
Depreciation brought forward	–564	–540
Depreciation for the year	–19	–20
Divestments/Disposals	66	18
Reclassifications	–56	3
Translation differences	24	–25
Accumulated depreciation carried forward	**–549**	**–564**
Impairment losses		
Impairment losses brought forward	–685	–679
Impairment losses for the year	–182	–26
Reversed impairment losses for the year	–	2
Divestments/Disposals	61	24
Reclassifications	37	26
Translation differences	29	–32
Accumulated impairment losses carried forward	**–740**	**–685**
Residual value according to plan carried forward	**936**	**1,256**
Estimated fair value	**1,156**	**1,594**

1) The estimated useful life for investment property ranges from 25–50 years.

Investment property encompasses 156 (180) properties located in Berlin, Hamburg and eastern 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 110 million in (114). Direct costs for the concerned properties amounted to SEK 355 million (248), of which SEK 176 million (82) is related to properties that did not generate rental income.

At 31 December 2006, contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements amounted to SEK 9 million.

Note 21 Shares and participations held by the Parent Company Vattenfall AB and other Group companies

Shares and participations held by Parent Company Vattenfall AB

Group companies	Corporate Identity Number	Registered office	Number of shares 2006	Participation in % 2006	Book value 2006
Nordic countries					
Bergeforsens Kraft AB	556044-8887	Sundsvall	3,240	60	3
Energibolaget Botkyrka-Salem Försäljn. AB	556014-7406	Botkyrka	23,988	100	35
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
Produktionsbalans PBA AB	556425-8134	Stockholm	4,800	100	5
Ringhals AB	556558-7036	Varberg	248,572	70	379
Svensk Kärnbränslehantering AB[1]	556175-2014	Stockholm	360	36	0
Svenska Kraftbyggarna Entreprenad AB	556333-2468	Luleå	38,000	100	46
Säffle Årjäng Energi AB	556499-8689	Säffle	8,000	100	22
Vattenfall Bränsle AB	556440-2609	Stockholm	100	100	96
Vattenfall A/S	21 311 332	Copenhagen	10,040,000	100	12,878
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	Jokkmokk	3,000	100	4
Vattenfall Oy	1071366-1	Helsinki	10,000	100	1,483
Vattenfall Power Consultant AB	556383-5619	Stockholm	12,500	100	15
Vattenfall Power Management AB	556573-5940	Stockholm	6,570	100	6
Vattenfall Eldistribution AB	556417-0800	Stockholm	8,000	100	11
Vattenfall Research & Development AB	556390-5891	Älvkarleby	14,000	100	17
Vattenfall Service Nord AB	556242-0959	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 Vindkraft Sverige AB	556581-4273	Stockholm	2,500	100	71
Vattenfall Vindkraft Kriegers Flak AB	556622-5941	Stockholm	1,000	100	129
Vattenfall Vindkraft Lillgrund AB	556550-1292	Malmö	219,919	100	125
Vattenfall Vindkraft Trolleboda AB	556644-2595	Malmö	1,000	100	5
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

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Note 21 continued

Group companies	Corporate Identity Number	Registered office	Number of shares 2006	Participation in % 2006	Book value 2006
Germany					
Vattenfall Deutschland GmbH	(HRB) 62659	Hamburg	2	100	18,868
Vattenfall Europe AG[2]	HRB 86854	Berlin	77,456,046	38	10,828
Poland					
Vattenfall Heat Poland SA	38 440	Warsaw	18,377,346	75	3,240
Vattenfall Distribution Poland SA	RHB 9861	Gliwice	936,184	75	5,271
Vattenfall Poland Sp.z.o.o	270 893	Warsaw	10,000	100	5
Vattenfall Trading Services Sp.z.o.o	969-1406-317	Rejonowy	80,000	100	9
Other countries					
Kentish Flats Ltd	4 130 301	London	25,000,000	100	1,196
Vattenfall Estonia OÜ	10142764	Tallinn	100	100	6
Vattenfall Reinsurance S.A.	(B) 49528	Luxembourg	13,000	100	13
Other companies					9
Total					**55,715**

1) Group companies own a further 20% through Forsmarks Kraftgrupp AB.

2) Vattenfall AB and other Group companies own a total of approx. 97% (97%) through Vattenfall Deutschland GmbH's holding.

Larger shareholdings held by other Group companies than the Parent Company Vattenfall AB
When calculating the participation percentages, consideration is made of the minority ownership in each owner company respectively.

	Registered office	Participation in % 2006
Nordic countries		
Barsebäck Kraft AB, Sweden	Malmö	70
Pamilo Oy, Finland	Uimaharju	100
Vattenfall Indalsälven AB, Sweden	Bispgården	74
Vattenfall Sähköntuotanto Oy, Finland	Helsinki	100
Vattenfall Verkko Oy, Finland	Helsinki	100
Germany		
Fernheizwerk Märkisches Viertel GmbH	Berlin	97
Fernheizwerk Neukölln AG	Berlin	73
Kernkraftwerk Brunsbüttel GmbH & Co. oHG	Hamburg	65
Koros GmbH & Co. KG	Cologne	95
Kraftwerke Schwarze Pumpe GmbH	Spremberg	97
Müllverwertung Borsigstrasse GmbH	Hamburg	83
MVR Müllverwertung Rugenberger Damm GmbH & Co. KG	Hamburg	53
Vattenfall Europe AG	Berlin	97
Vattenfall Europe Berlin AG & Co. KG (former Bewag AG & Co. KG)	Berlin	97
Vattenfall Europe Distribution Berlin GmbH	Berlin	97
Vattenfall Europe Distribution Hamburg GmbH	Hamburg	97
Vattenfall Europe Generation AG & Co. KG	Cottbus	97
Vattenfall Europe Hamburg AG (former Hamburgische Electricitäts-Werke AG)	Hamburg	97
Vattenfall Europe Mining AG	Cottbus	97
Vattenfall Europe Nuclear Energy GmbH	Hamburg	97
Vattenfall Europe Sales GmbH	Hamburg	97
Vattenfall Europe Transmission GmbH	Berlin	97
Vattenfall Europe Waste to Energy GmbH	Hamburg	97
Vattenfall Trading Services GmbH	Hamburg	97
WEMAG AG	Schwerin	78
Poland		
Nieruchomosci EWSA Grupa Vattenfall	Warsaw	75
Vattenfall Wolin-North Sp.z.o.o	Szczecin	75

Note 22 Participations in associated companies

	2006	2005
Balance brought forward	23,421	12,286
Investments	–	10,325
New share issues and shareholders' contributions	13	18
Divestments	–11,315	–2
Reclassifications	–	–4
Profit participations and dividends	666	–38
Translation differences	–659	836
Balance carried forward	**12,126**	**23,421**

Shares and participations owned by the Parent Company Vattenfall AB or by other Group companies.

	Corporate Identity Number	Registered office	Number of shares 2006	Participation in % 2006	Book value Group 2006	Book value Parent Company 2006
Associated companies held by the Parent Company Vattenfall AB						
Nordic countries						
Gulsele AB, Sweden	556001-1800	Sollefteå	84,000	35	338	332
Luleå Energi AB, Sweden	556139-8255	Luleå	54,000	30	217	3
PiteEnergi AB, Sweden	556330-9227	Piteå	70,000	50	200	7
Plusenergi AB, Sweden	556572-4696	Gothenburg	50,000	50	178	171
Preem Gas AB, Sweden	556037-2970	Stockholm	750	30	8	6
SwePol Link AB, Sweden	556530-9829	Stockholm	96,000	16	15	1
Associated companies held by other Group companies than the Parent Company Vattenfall AB						
Germany						
ENSO Strom AG	HRB 965	Dresden	436,926	29	979	–
GASAG Berliner Gaswerke AG	HRB 44343	Berlin	8,100,000	32	3,187	–
Kernkraftwerk Krümmel GmbH & Co. oHG	HRB 15033	Hamburg		50	3,916	–
Kernkraftwerk Stade GmbH & Co. oHG	HRB 12163	Hamburg		33	932	–
Kernkraftwerk Brokdorf GmbH & Co. oHG	HRB 17623	Hamburg		20	1,742	–
Städtische Werke AG	HRB 2150	Kassel	121,148	25	390	–
Other companies					24	–
Total					**12,126**	**520**

Amounts relating to held participation of associated companies' revenues, profit, assets and liabilities:

	Revenues 2006	Profit 2006	Assets 31 Dec. 2006	Liabilities 31 Dec. 2006
Associated companies held by the Parent Company Vattenfall AB				
Gulsele AB, Luleå Energi AB, PiteEnergi AB, Plusenergi AB, Preem Gas AB and SwePol Link AB	2,128	49	1,680	1,083
Associated companies held by other Group companies than the Parent Company Vattenfall AB				
GASAG Berliner Gaswerke AG	3,456	223	7,091	5,240
Kernkraftwerk Krümmel GmbH & Co. oHG, Kernkraftwerk Stade GmbH & Co. oHG and Kernkraftwerk Brokdorf GmbH & Co. oHG	1,755	371	17,403	10,567
Other companies	2,388	165	3,187	1,834
Total	**9,727**	**808**	**29,361**	**18,724**

Note 23 Other shares and participations

	2006	2005
Balance brought forward	747	2,448
Investments	581	8
New share issues and shareholders' contributions	–	1
Divestments	–32	–61
Reclassifications	–1	–51
Reclassifications to subsidiaries	–	–1,667
Impairment losses	–4	–13
Translation differences	–37	82
Balance carried forward	**1,254**	**747**

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Note 23 continued

	Participation in % 2006	Book value Group 2006	Book value Parent Company 2006
Shares and participations held by the Parent Company Vattenfall AB			
Nordic countries			
Jämtkraft AB, Sweden	20[1]	23	23
Metrima AB, Sweden	4	6	6
Solibro AB, Sweden	18	3	3
Other companies		3	3
Other countries			
Eutilia, Netherlands	8	3	3
Shares and participations held by other Group companies than the Parent Company Vattenfall AB			
Germany			
EHA Energie Handels Gesellschaft mbH & Co KG	50	13	–
GNS Gesellschaft für Nuklear-Service GmbH	6	23	–
Stadtwerke Eilenburg GmbH	49	51	–
Stadtwerke Parchim GmbH	15	27	–
Stadtwerke Rostock AG	12	363	–
Stadtwerke Wittenberge GmbH	23	25	–
Other companies		92	–
Other countries/companies			
Asikkalan Voima Oy, Finland	50	9	–
Ensteds Havn I/S, Denmark	50	564	–
Terki Oy, Finland	20	12	–
Åtvidabergs Fjärrvärme AB, Sweden	50	10	–
ELINI, Netherlands	22[2]	27	–
Total		**1,254**	**38**

1) The share of voting rights is 16%.

2) The share of voting rights is 14%.

Note 24 Share in the Swedish Nuclear Waste Fund

	2006	2005
Balance brought forward	21,403	19,447
Payments	501	528
Disbursements	–689	–661
Returns	2,106	2,089
Balance carried forward	**23,321**	**21,403**

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 reimburses the owner of the reactor for expenses as the owner's obligations pursuant to the 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 23,981 million (23,889).

As stated in Note 35 to the consolidated accounts, provisions for future expenses for decommissioning, etc. within Swedish nuclear power operations amount to SEK 18,668 million (18,149).

Contingent liabilities attributable to the Swedish Nuclear Waste Fund are described in Note 42 to the consolidated accounts.

Note 25 Other non-current receivables

	Receivables from associated companies		Other receivables	
	2006	2005	2006	2005
Balance brought forward	2,249	1,860	2,036	5,896
New receivables	46	2	8,194	185
Payments received	–1,791	–52	–4,979	–3,962
Impairment losses	–	–	–4	–5
Divested companies	–36	–3	–21	–
Reclassifications	–	380	–42	–233
Translation differences	–	62	–32	155
Balance carried forward	**468**	**2,249**	**5,152**	**2,036**

Breakdown of receivables:	2006	2005	2006	2005
Non-current interest-bearing receivables	60	2,152	3,680	473
Non-current noninterest-bearing receivables	408	97	1,472	1,563
Total	**468**	**2,249**	**5,152**	**2,036**

Note 26 Inventories

	2006	2005
Nuclear fuel	3,710	3,683
Materials and spare parts	2,263	1,982
Fossil fuel	2,231	1,148
Other	1,180	501
Total	**9,384**	**7,314**

Inventories recognised as an expense during 2006 amount to SEK 20,019 million. Inventory impairment losses amounted to SEK 200 million during the year.

Note 27 Intangible assets: emission allowances

Attributable to emission allowances purchased. See Note 2 to the consolidates accounts, Accounting principles.

	2006
Balance brought forward	–
Emission allowances purchased during the year	950
Impairment losses	–204
Balance carried forward	**746**

Note 28 Trade receivables and other receivables

	2006	2005
Accounts receivable - trade	18,084	16,758
Receivables from associated companies	1,622	478
Other receivables	7,423	11,244
	27,129	**28,480**
Derivatives with positive fair values	5,370	9,467
Total	**32,499**	**37,947**

Note 29 Prepaid expenses and accrued income

	2006	2005
Prepaid insurance premiums	9	37
Prepaid expenses, other	919	501
Prepaid expenses and accrued income, electricity	1,623	2,132
Accrued income, other	1,787	1,789
Total	**4,338**	**4,459**

Note 30 Short-term investments

	2006	2005
Interest-bearing investments	6,670	7,243
Shares	864	782
Total	**7,534**	**8,025**

Note 31 Cash and cash equivalents

	2 006	2 005
Cash and cash equivalents	3,343	4,850
Interest-bearing investments	11,291	1,199
Total	**14,634**	**6,049**

Note 32 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.

	2006	2005
Balance brought forward	9,268	–
Original amount	–	9,248
Discount allocation	16	9
Translation differences	–373	11
Balance carried forward	**8,911**	**9,268**

The Interest Coverage Trigger Ratio key ratio is calculated as follows:

	2006	2005
Funds from operations (FFO)	35,673	31,386
Interest paid	2,927	2,230
FFO plus interest paid (a)	**38,600**	**33,616**
Interest expenses (b)	3,317	2,967
Interest Coverage Trigger Ratio (a/b)	**11.64**	**11.33**

Note 33 Other interest-bearing liabilities (non-current)

	2006	2005
Bond loans	30,908	38,808
Liabilities to credit institutions	7,416	7,300
Liabilities to minority owners	4,644	4,003
Liabilities to associated companies	2,973	9,052
Other liabilities	927	702
Total	**46,868**	**59,865**

Of the above liabilities, the following amounts are due after more than five years: Bond loans SEK 13,049 million (15,572), Liabilities to credit institutions SEK 3,477 million (3,579), Liabilities to minority owners SEK 4,494 million (3,827) and Other liabilities SEK 147 million (138).

Note 34 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.

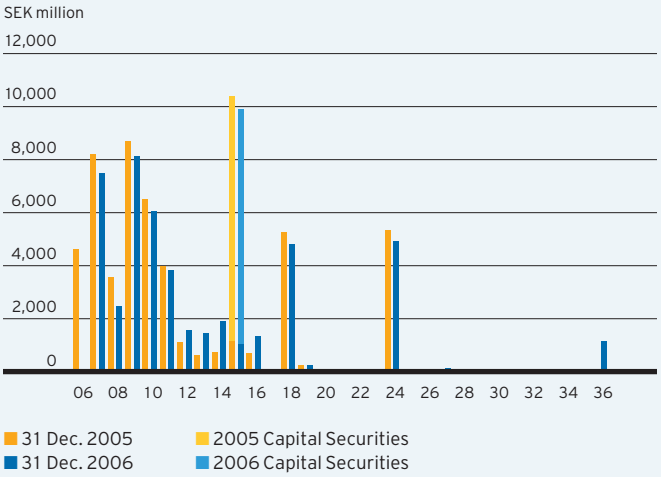
Financing risk

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 6.2 years (6.0) excluding Capital Securities and loans from minority owners and associated companies. 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 programmes. 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 9.4 billion (17.8) in committed credit facilities.

The Group's target for short-term liquidity is always to have no less than 10% 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. Vattenfall's goal with regard to credit rating is to retain a rating in the Single A category.

Maturity profile in debt portfolio[1]



1) Excluding loans from minority owners and associated companies.

Borrowing programmes and credit facilities

	Maximum aggregate amount	Currency	Maturity	Used portion,%	Reported external liability
Programmes					
Commercial Paper	15,000	SEK		–	–
Euro Commercial Paper	2,000	USD		40	–
Medium Term Note	10,000	SEK		8	849
Euro Medium Term Note	6,000	USD		69	36,472
Polish Commercial Paper	1,000	PLN		–	–
Committed credit facilities					
Revolving Credit Facility[1]	1,000	EUR	2013	–	–
Bank overdraft facilities	371	SEK		–	–
Other credit facilities					
Bank overdraft facilities and other lines of credit	10,216	SEK		2	–
Total					**37,321**

1) Back-up facility for short-term borrowing.

Continued on page 94

Note 34 continued

Benchmark bonds

Type	Currency	Amount	Coupon, %	Maturity
Euro Medium Term Note	EUR	500	6.125	2007
Euro Medium Term Note	EUR	650	6.000	2009
Euro Medium Term Note	EUR	500	6.000	2010
Euro Medium Term Note	EUR	500	5.000	2018
Euro Medium Term Note	EUR	500	5.375	2024

Interest rate risk

Interest rate risk in the Group's debt portfolio is measured as the duration, which at year-end was 2.6 years (2.5) excluding Capital Securities and loans from minority owners and associated companies. 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.

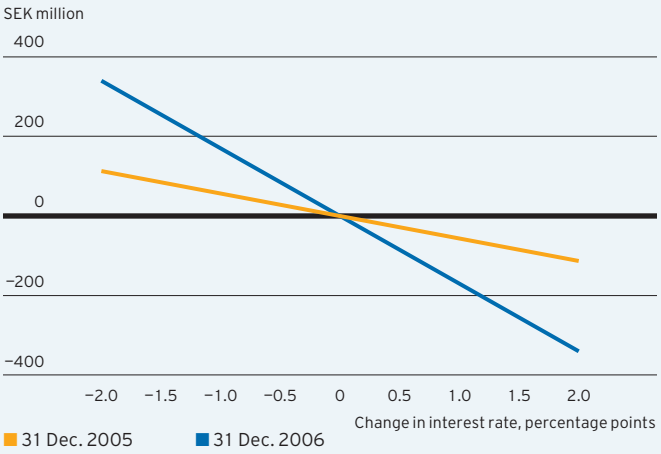
	SEK	EUR	Other	Total
< 3 months	−17,197	−7,539	166	**−24,570**
3 months–1 year	8,365	1,377	–	**9,742**
1 year–5 years	31,632	25,542	1,227	**58,401**
> 5 years	2,050	1,639	–	**3,689**
Total	**24,850**	**21,019**	**1,393**	**47,262**
Average financing rate, %	4.4	3.5	4.3	4.0

Remaining fixed rate term in loan portfolio

Excluding Capital Securities and loans from minority owners and associated companies. Nominal amount.

	Debt	Derivatives	Total
< 3 months	6,056	−30,626	**−24,570**
3 months–1 year	7,180	2,562	**9,742**
1 year–5 years	19,694	38,707	**58,401**
> 5 years	13,511	−9,822	**3,689**
Total	**46,441**	**821**	**47,262**

Interest rate sensitivity, excluding Capital Securities and loans from minority owners and associated companies



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.

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 excluding Capital Securities. Nominal amount.

Original currency	Debt	Derivatives	Total
DKK	1,388	–	**1,388**
CZK	164	−164	**–**
EUR	46,951	−14,929	**32,022**
HKD	679	−679	**–**
JPY	3,440	−3,440	**–**
NOK	383	−383	**–**
PLN	6	–	**6**
SEK	7,627	22,134	**29,761**
USD	1,718	−1,718	**–**
Total	**62,356**	**821**	**63,177**

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 the Nordic operations, most transaction exposure is in 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	63	67
SEK	29	23
PLN	6	7
DKK	2	2
USD	–	1
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% would affect consolidated equity by approximately SEK 2,390 million (1,570). Translation exposure is managed as described under the headings Derivative instruments and Hedging, respectively, in Note 2 to the consolidated accounts, Accounting Principles.

Translation exposure

Currency	Equity	Hedging after tax	Net exposure after tax
EUR	62,462	37,581	24,881
PLN	15,118	–	15,118
DKK	12,892	5,365	7,527
Other	393	194	199
Total	**90,865**	**43,140**	**47,725**

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% of the assets. As of 31 December, the proportion of shares was 23% (20%). The average interest rate was 3.9% (3.4%) while the average duration was 3.3 years (2.8).

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 risks

Type of instrument	Exposure
Electricity derivatives, positive fair values	2,229
Electricity derivatives, settlement risk	1,775
Interest and currency derivatives, positive fair values	1,912
Interest-bearing investments including large bank balances	18,524
Shares	864
Total	**25,304**

Exposure in interest and currency derivatives adjusted for ISDA agreements or equivalents amounts to SEK 1,912 million (2,724). Without adjustment, exposure is SEK 3,649 million (5,196).

Note 35 Interest-bearing provisions

	Non-current portion		Current portion		Total	
	2006	2005	2006	2005	2006	2005
Provisions for future expenses of nuclear operations	26,078	25,919	280	154	**26,358**	**26,073**
Provisions for future expenses of mining operations and other environmental measures/undertakings	9,452	8,074	843	962	**10,295**	**9,036**
Personnel-related provisions for non-pension purposes	3,642	3,980	1,045	1,293	**4,687**	**5,273**
Provisions for tax and legal disputes	5,014	3,437	1,488	2,062	**6,502**	**5,499**
Other provisions	1,178	1,566	197	244	**1,375**	**1,810**
Total	**45,364**	**42,976**	**3,853**	**4,715**	**49,217**	**47,691**

A discount rate of 5.0% (5.0%) has been used for interest-bearing provisions. See also Note 49 to 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 87% of the provisions will result in disbursements after 2016. The remaining 13% is estimated to result in relatively evenly distributed disbursements over the years 2007–2016. Existing plans for the decommissioning of the German nuclear power operations entail about 92% of the provisions resulting in cash flows after 2008. For 2007 and 2008, respectively, disbursements are estimated at about 4% per year of the provisions.

Provisions for future expenses of nuclear operations (changes in 2006)

	Sweden	Germany	Total
Balance brought forward	18,149	7,924	**26,073**
Provisions for the period	433	40	**473**
Discounting effects	888	360	**1,248**
Provisions used	–802	–301	**–1,103**
Reversed provisions	–	–5	**–5**
Translation differences	–	–328	**–328**
Balance carried forward	**18,668**	**7,690**	**26,358**

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 79% of the provisions will result in cash outflows later than 2009. For 2007, disbursements are estimated at about 8% of the provisions, while disbursements corresponding to the remaining approx. 13% are estimated to be relatively evenly distributed over the years 2008–2009.

Provisions for mining operations, etc. (changes in 2006)

Balance brought forward	9,036
Acquired companies	696
Provisions for the period	1,317
Discounting effects	395
Provisions used	–387
Reversed provisions	–368
Translation differences	–394
Balance carried forward	**10,295**

Personnel-related provisions for non-pension purposes:
Provisions are made for future costs relating to redundancy in the form of severance pay and other costs for giving notice to personnel. Approximately 22% of the provisions that have been made are expected to result in disbursements in 2007 while about 35% is expected to be disbursed in 2008 and 2009. Thereafter, approximately 43% will be relatively evenly distributed over the years 2010–2021.

Personnel-related provisions for non-pension purposes (changes in 2006)

Balance brought forward	5,273
Provisions for the period	817
Discounting effects	203
Provisions used	–1,070
Reversed provisions	–299
Divested companies	–17
Translation differences	–220
Balance carried forward	**4,687**

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Note 35 continued

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 eastern Germany.

Approximately 33% of the provisions for tax and legal disputes are expected to result in disbursements in 2007–2008. The remaining provisions are estimated to result in cash flows during the years 2009–2011 (59%) and 8% thereafter.

Provisions for tax and legal disputes (changes in 2006)

Balance brought forward	5,499
Provisions for the period	1,744
Discounting effects	–5
Provisions used	–302
Reclassified provisions	–4
Reversed provisions	–171
Divested companies	–3
Translation differences	–256
Balance carried forward	**6,502**

Other provisions
Other provisions include, among others, those for losses on contracts, restructuring and guarantee commitments.

Approximately 14% of these provisions are expected to result in disbursements in 2007, while the remaining approximately 66% is expected to result in disbursements during 2008–2010 and 20% thereafter.

Other provisions (changes in 2006)

Balance brought forward	1,810
Acquired companies	73
Provisions for the period	161
Discounting effects	19
Provisions used	–288
Reversed provisions	–335
Divested companies	–3
Translation differences	–62
Balance carried forward	**1,375**

Note 36 Pension provisions

General
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 plan assets, are reported at fair value. There are also pension plans in these and other countries that are defined contribution plans.

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 are evenly distributed over the employees' remaining service periods to the extent that the total gain or loss for a particular pension plan falls outside a corridor equal to 10% of the greater of the pension obligation and the fair value of the plan assets for each individual plan.

Swedish pension plans
The Swedish pension plans supplement the Swedish social insurance system and are the result of agreements between employer and employee organisations. Almost all of Vattenfall's 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 obligations for retirement pensions and family pensions for salaried 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 multi-employer defined benefit plan. As in previous years, 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 136 million (130). Alecta's surplus can be distributed between the policyholders and/or the insured parties. At the end of 2006, Alecta's surplus in the form of its so-called collective funding amounted to 144% (128%). Collective funding comprises the fair value of Alecta's assets as a percentage of the insurance obligations calculated in accordance with Alecta's insurance calculation principles and assumptions, which are not in agreement with IAS 19.

German pension plans
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 Vattenfall Europe Berlin (former Bewag) and Vattenfall Europe Hamburg (former HEW).

Vattenfall Europe Berlin has two pension plans, both financed through Pensionskasse der Bewag, a mutual insurance company. This plan is financed through funds from Vattenfall Europe Berlin and its employees. One plan has been assessed as a defined contribution plan and is reported as such since 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% 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. Vattenfall Europe Berlin's obligations encompass the entire pension commitment. The plan assets attributable to personnel employed since before 1 January 1984 are reported as plan assets at fair value. Pension obligations for Vattenfall Europe Hamburg employees mainly comprise of the company's obligations 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% of the salary on which the pension is based.

Defined benefit obligations

	2006	2005
Present value of unfunded obligations	17,028	19,049
Present value of fully or partly funded obligations	18,619	18,566
Present value of obligations	**35,647**	**37,615**
Fair value of plan assets	15,977	16,248
Present value of net obligations	**19,670**	**21,367**
Unrecognised actuarial gains (+)/ losses (–) of the obligations	–3,128	–4,474
Unrecognised actuarial gains (+)/ losses (–) of plan assets	335	539
Pension provisions	**16,877**	**17,432**

Changes in obligations

	2006	2005
Balance brought forward	37,615	32,313
Benefits paid by the plan	–1,681	–1,592
Service costs	612	550
Difference between expected and actual return (actuarial gain (+) or loss (–))	–1,201	3,392
Current interest expense	1,523	1,639
Translation differences	–1,221	1,313
Balance carried forward	**35,647**	**37,615**

Changes in plan assets

	2006	2005
Balance brought forward	16,248	14,972
Benefits paid by the plan	–400	–388
Expected return on plan assets	751	847
Difference between expected and actual return (actuarial gain (+) or loss (–))	–205	349
Translation differences	–417	468
Balance carried forward	**15,977**	**16,248**

Plan assets consist of the following

	2006	2005
Equity securities	4,586	3,992
Debt instruments	9,579	10,524
Property	559	600
Other	1,253	1,132
Total	**15,977**	**16,248**

Historical information

	2006	2005	2004
Present value of obligations	35,647	37,615	32,313
Fair value of plan assets	15,977	16,248	14,972
Present value of net obligations	**19,670**	**21,367**	**17,341**

The Group expects to pay SEK 1,241 million in contributions to defined benefit plans in 2007.

Pension costs

	2006	2005
Defined benefit plans:		
Current service cost	547	470
Interest expense	1,523	1,639
Expected return on plan assets	–751	–846
Past service cost	60	73
Other	57	60
Total cost for defined benefit plans	**1,436**	**1,396**
Cost for defined contribution plans	444	294
Total pension costs	**1,880**	**1,690**

Pension costs are reported in the following rows in the income statement:

	2006	2005
Cost of products sold	1,123	1,063
Selling expenses	153	152
Administrative expenses	559	447
Research and development costs	45	28
Total pension costs	**1,880**	**1,690**

In calculating pension obligations, the following actuarial assumptions have been made (%):

	2006	2005
Discount rate	3.75–4.50	3.75–4.25
Expected return on plan assets	4.35–5.25	4.35–5.25
Future annual salary increases	2.5–3.5	2.5–3.5
Future annual pension increases	1.0–2.5	2.0

Note 37 Other noninterest-bearing liabilities (non-current)

Of the total liabilities of SEK 2,320 million (2,425), SEK 1,411 million (1,256) falls due after more than five years.

Note 38 Trade payables and other liabilities

	2006	2005
Advance payments from customers	225	1 335
Accounts payable – trade	10,189	9,393
Liabilities to associated companies	1,051	982
Other liabilities	3,388	3,210
	14,853	**14,920**
Derivatives with negative fair values	12,823	18,986
Total	**27,676**	**33,906**

Note 39 Accrued expenses and deferred income

	2006	2005
Accrued personnel-related costs	3,263	3,199
Accrued expenses, carbon dioxide emissions	442	302
Accrued expenses, connection fees	455	254
Accrued nuclear power-related fees and taxes	61	62
Accrued interest expense	1,619	1,560
Other accrued expenses	2,982	1,968
Deferred income and accrued expenses, electricity	3,919	3,220
Other deferred income	1,626	1,475
Total	**14,367**	**12,040**

Note 40 Interest-bearing liabilities (current)

	2006	2005
Bond loans	6,412	3,008
Liabilities to credit institutions	831	1,028
Liabilities to minority owners	312	635
Liabilities to associated companies	7,985	4,679
Other liabilities	256	180
Total	**15,796**	**9,530**

Note 41 Pledged assets

	2006	2005
For own liabilities and provisions		
Liabilities to credit institutions:		
Real estate mortgages	1,173	6
Blocked bank funds as security for trading on energy exchanges	40	2,246
Blocked bank funds as security for redemption of minority shares	2,913	2,629
Other	3	2
Total	**4,129**	**4,877**

Note 42 Contingent liabilities

	2006	2005
Guarantees	6,539	1,256
Other contingent liabilities	11,071	9,738
Swedish Nuclear Waste Fund	5,643	5,377
Total	**23,253**	**16,371**
Other contingent liabilities		
Compensatory and free power deliveries:		
Wholesale power deliveries		
Number of commitments	13	13
Power MW	223	223
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 damage 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 7,000 million for these types of claims.

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.

Vattenfall AB has issued guarantees amounting to SEK 4,978 million for certain associated companies' deposits of funds with Vattenfall Treasury AB.

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 coun-

Continued on page 98

Note 42 continued

terparts 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 lessees or the underlying customers fail to meet their obligations during the leasing period, this will incur termination costs for Vattenfall. On the closing date, these obligations amounted to a maximum of SEK 1,329 million (1,392), 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 give rise to costs for Vattenfall. On the balance sheet date, these costs amounted to a maximum of SEK 92 million (97).

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 2007, EUR 170 million (170) per claim and entails an obligation to keep available liquid assets corresponding to twice this amount, that is, EUR 340 million (340).

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 967 million (852). On the balance sheet date, guarantees totalling EUR 380 million (390), equal to SEK 3,436 million (3,679), 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.

As security for the subsidiaries Forsmarks Kraftgrupp AB and Ringhals AB, Vattenfall AB has made guarantee commitments for a combined value of SEK 5,643 million (5,377) to cover the risk that the existing funds in the Swedish Nuclear Waste Fund should, over time, prove to be insufficient. Two types of guarantee commitments have been made. The one guarantee commitment is intended to cover the requisite need for fees that has been decided on for the fees that have not yet been paid in during the so-called earnings period (25 years of operation). The other guarantee commitment pertains to future cost increases stemming from unforeseen events. Both amounts are determined from a probability-based risk analysis, where the former amount has been determined as such that there is a 50% probability that it, together with currently funded amounts (median value), will provide full cost coverage. The latter amount consists in principle of the supplement that would be required if the corresponding probability was 90%.

Note 43 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 jointventure'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 44 Average number of employees and personnel costs

	2006			2005		
Average number employees	Men	Women	Total	Men	Women	Total
Sweden	6,588	1,970	**8,558**	6,459	1,891	**8,350**
Denmark[1]	271	48	**319**	5	–	**5**
Finland	352	202	**554**	341	205	**546**
Germany	15,269	4,667	**19,936**	15,532	4,667	**20,199**
Poland	2,169	682	**2,851**	2,297	734	**3,031**
Other countries	74	16	**90**	80	20	**100**
Total	**24,723**	**7,585**	**32,308**	**24,714**	**7,517**	**32,231**

Personnel costs	2006	2005
Salaries and other remuneration	13,799	13,371
Social security costs	5,450	5,293
(of which pension costs)[2]	(2,136)	(2,115)
Total	**19,249**	**18,664**

1) Vattenfall Denmark is a new Group company as of 1 July 2006.

2) SEK 77 million (80) 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 463 million (423).

	2006			2005		
Salaries and other compensation	Board members and senior executives[1]	Other employees	Total	Board members and senior executives[1]	Other employees	Total
Sweden	48	3,633	**3,681**	66	3,397	**3,463**
Denmark	–	162	**162**	–	4	**4**
Finland	5	223	**228**	4	213	**217**
Germany	89	9,132	**9,221**	81	9,135	**9,216**
Poland	21	478	**499**	19	443	**462**
Other countries	–	8	**8**	–	9	**9**
Total[2]	**163**	**13,636**	**13,799**	**170**	**13,201**	**13,371**

Social security costs

	2006	2006
Sweden	1,975	1,838
Denmark	15	1
Finland	58	52
Germany	3,297	3,304
Poland	102	96
Other countries	3	2
Total	**5,450**	**5,293**

1) Board members and senior executives also include deputy board members and vice presidents and former board members, deputy board members, presidents and vice presidents.

2) Total salaries and other compensation to board members and presidents include bonuses of SEK 32 million (41).

Benefits to board members and senior executives of Vattenfall AB

SEK thousands	Directors' fees and base salary 2006 including vacation pay	Company car and other benefits 2006	Pension costs 2006	Estimated variable compensation for 2006 to be paid 2007
Dag Klackenberg, Chairman of the Board	431	–	–	–
Maarit Aarni, Director	215	–	–	–
Carl-Gustaf Angelin, Director	43	–	–	–
Johnny Bernhardsson, Director	43	–	–	–
Christer Bådholm, Director	267	–	–	–
Ronny Ekwall, Director	43	–	–	–
Greta Fossum, Director (from 27 April 2006)	145	–	–	–
Peter Lindell, Director	267	–	–	–
Hans-Olov Olsson, Director	215	–	–	–
Lone Fønss Schrøder, Director	267	–	–	–
Anders Sundström, Director	215	–	–	–
Lars Carlsson, Deputy director	43	–	–	–
Stig Lindberg, Deputy director	43	–	–	–
Per-Ove Lööv, Deputy director	56	–	–	–
Lars G. Josefsson, President and CEO	7,802	109	5,731	–
Matts Ekman, First Senior Executive Vice President and CFO	3,862	75	2,075	636
Jan Erik Back (from 14 December 2006), First Senior Executive Vice President and CFO from 1 January 2007	154	–	–	–
Hans von Uthmann, Senior Executive Vice President	4,207	68	670	696
Klaus Rauscher, Senior Executive Vice President	8,104	49	5,354	3,473
Tuomo Hatakka, Senior Executive Vice President	2,329	109	699	775
Alf Lindfors, Executive Vice President (until 31 July 2006)	2,746	53	3,868	–
Mats Fagerlund, Executive Vice President	4,075	1,263	1,958	4,075
Lennart Billfalk, Executive Vice President	2,765	63	602	452
Ann-Charlotte Dahlström, Senior Vice President Personnel	2,779	78	2,029	456
Knut Leman, Senior Vice President Communications	2,340	94	2,044	384
Total	**43,456**	**1,961**	**25,030**	**10,947**

Board of Directors

In 2006, the Chairman of the Board received a fee of SEK 431 thousand (413) while other directors received combined fees of SEK 1,693 thousand (1,576) (breakdown shown in the table above).

The four directors serving on the Board's Audit Committee also received fees as follows: SEK 52 thousand (50) each for those not employed by Vattenfall and SEK 13 thousand (13) for the employee representative serving on this assignment in 2006. These amounts are included in the table above under the heading Directors' fees.

President and Chief Executive Officer

In 2006, Lars G. Josefsson, who is President and Chief Executive Officer of Vattenfall AB, received a salary and other remuneration, including the value of a company car, amounting to SEK 7,911 thousand (7,313). As of 2005, the CEO no longer receives any variable salary.

Lars G. Josefsson, who was born in 1950, is entitled to retire at the age of 60. A retirement pension of 65% 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% of the portion of his salary in excess of 30 times the Base Amount (the Base 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 one fifth for each subsequent year and ceases completely at the age of 80. The pension obligation is covered by premiums paid to an insurance company on a regular basis. The benefits are vested, i.e., they are not conditional on future employment. In the event Vattenfall serves notice, 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 amount of the severance pay will be calculated on the basis of his base salary at the time notice was served. 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 senior executives

For other senior executives who have been part of Executive Group Management, a total of 10 individuals (10), the total sum of salaries and other compensation, including the value of company cars, was SEK 35,213 thousand (30,162).

The First Senior Executive Vice President, Matts Ekman, was entitled to a defined contribution pension solution with a retirement age of 60.

Starting in 2006, Dr Klaus Rauscher is entitled to pension benefits corresponding to 3.34% of his base salary, which is earned on a yearly basis.

Tuomo Hatakka is entitled to a defined contribution pension solution.

For other members of Executive Group Management, the retirement

Continued on page 100

Note 44 continued

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% of the base salary is paid. Variable salary is not pensionable for pension benefits payable 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% of pensionable salary in excess of 20 times the Base Amount. Pensionable salary consists of the executives' salary and annual variable salary, in accordance with ITP. Occupational pension from the age 65 is between 44% and 49% of base salary.

In cases where the pension applies from the age 62 (two individuals), ITP applies with an extension equivalent to 32.5% of the part of salary in excess of 30 times the Base Amount. In addition, the average of the past five years' fixed salaries is pensionable, while variable salary is not pensionable. The pension from age 62 is approximately 40% of base salary.

A defined contribution solution applies in the other case. All pension benefits are vested, i.e., they are not conditional on future employment. For these other members of Executive Group Management, premiums were paid to Alecta for 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 consisting 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 is secured through Vattenfall's Pension Foundation.

In two cases, alternative ITP applies (a so-called high-earner solution), whereby premiums are paid instead of the equivalent amount being posted as a liability. The extension over and above ITP, as described above, is also applied.

For these executives, if the Company serves notice, they are entitled to their salary during the contractual notice period (6 months), plus severance pay equivalent to 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.

Drafting and decision processes

In 2006 the Board established a compensation committee for preparation of ongoing matters regarding the compensation of senior executives. The committee handles matters pertaining to annual salary reviews and other terms of employment for the CEO. In addition, the committee drafts principles regarding the salary and remuneration of the members of the Executive Group Management. The committee reports on its work to the Board, whereby the committee chair, who is the Chairman of the Board, informs the Board about the committee's decisions. However, the Board as a whole must decide on matters concerning the CEO's employment and decide on the CEO's terms of employment. (See also page 54.)

Incentive programme

In light of the Swedish government's guidelines on executive compensation 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 CEO no longer receives any variable salary. Regarding other executives and employees, variable salary may not exceed the equivalent of two months' salary per year, or 16.7% of the normal base salary. Also, for certain executives, the normal base salary can be reduced by 16.7%, depending on outcome. The maximum level for most employees averages about SEK 17 thousand per year.

As previously, the basis of the incentive programmes continues to be the Group's long-term value creation[1]. The Group target is uniform for all employees. Further, the result of each unit and individual is measured.

In other countries the same Group value creation target is used in agreements on variable salary for senior executives 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%.

Note 45 Gender distribution among senior executives

	Women, %		Men, %	
	2006	2005	2006	2005
Gender distribution among Company directors	10	10	90	90
Gender distribution among other senior executives	13	11	87	89

Note 46 Leasing

Leasing expenses

Equipment leased by the Group through finance leases and reported as property, plant and equipment are reported as follows:

	2006	2005
Machinery/equipment		
Cost	157	256
Accumulated depreciation according to plan	–38	–61
Impairment losses	–	–37
Residual value according to plan	**119**	**158**

Future payment commitments, as of 31 December 2006, for leasing contracts and rental contracts are broken down as follows:

	Finance leases, nominal	Finance leases, present value	Operating leases
2007	37	34	530
2008	27	25	459
2009	27	23	420
2010	27	21	391
2011	41	31	367
2012 and beyond	480	414	1,616
Total	**639**	**548**	**3,783**

The current year's leasing expenses for Group assets amounted to SEK 534 million (630).

Certain, major leasing undertakings are described further in Note 42 to the consolidated accounts, Contingent liabilities.

Leasing revenues

Certain Group companies own and operate power facilities on behalf of customers. Revenues from customers are broken 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 2006, cost of assets reported under Operating leasing amounted to SEK 2,047 million (2,049). Accumulated depreciation amounted to SEK 841 million (762) and accumulated impairment losses amounted to SEK 30 million (30).

Future payments for this type of facility are broken down as follows:

	Financial leasing	Operating leasing
2007	11	171
2008	11	161
2009	11	147
2010	10	123
2011	10	102
2012 and beyond	81	371
Less: Financial income	–45	–159
Total	**89**	**916**

Note 47 Auditors' fees, etc.

	2006	2005
Statutory audit		
Ernst & Young[1]	29	23
PricewaterhouseCoopers[2]	11	10
BDO[2]	8	12
Swedish National Audit Office	1	1
Other	1	1
Total	**50**	**47**
Other fees		
Ernst & Young[3]	19	15
PricewaterhouseCoopers[4]	10	13
BDO (Germany)	9	5
Other	2	–
Total	**40**	**33**

1) In addition to the Parent Company's auditing costs of SEK 8 million (7), these costs are attributable to audits of Swedish, Danish, Finnish, German and Polish companies.

2) These amounts are primarily attributable to audits in German companies.

3) SEK 11 million (8) of the Group's auditing cost is attributable to operations in Germany and Poland.

4) SEK 8 million (11) of the Group's auditing cost is attributable to operations in Germany.

Note 48 Related party disclosures

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, purchases or profits is attributable to the Swedish state or any of its authorities and companies.

Information on transactions with key persons in executive positions in the Company is provided in Note 44 to the consolidated accounts, Average number of employees and personnel costs.

Disclosures on transactions with associated companies in 2006 and associated receivables and liabilities as per 31 December 2006 are described below.

SwePol Link AB
SwePol Link AB handles the electricity cable that links together the Nordic and Polish electricity systems in the aim of achieving higher delivery reliability and more effective utilisation of generation plants. Vattenfall's sales revenue from the company amounted to SEK 2 million, while interest income totalled SEK 30 million. Purchases from the company amounted to SEK 130 million. Trade receivables as per 31 December amounted to SEK 386 million, while financial receivables totalled SEK 1,350 million. Trade liabilities to the company amounted to SEK 15 million.

PiteEnergi AB
PiteEnergi sells electricity, heat, broadband internet access and other services in the Piteå area. Electricity is generated by the company's own hydro power plants. Vattenfall's sales revenue from the company amounted to SEK 2 million.

Plusenergi AB
The main product consists of electricity sales to both private and corporate customers. The company focuses on the market in Sweden's Västra Götaland region. Vattenfall's sales revenue from the company amounted to SEK 39 million. Trade receivables as per 31 December totalled SEK 8 million, while trade liabilities to the company amounted to SEK 2 million.

Luleå Energi AB
Luleå Energi's business areas include electricity trading operations, generation and distribution of district heating and optical network activities. Vattenfall's sales revenue from the company amounted to SEK 257 million, while purchases from the company amounted to SEK 1 million. Trade receivables as per 31 December amounted to SEK 13 million, while trade liabilities to the company amounted to SEK 2 million.

Gulsele AB
Gulsele sells electricity generated by its own hydro power plants. Vattenfall received SEK 2 million in sales revenue from the company and interest income of SEK 2 million.

Kernkraftwerk Brokdorf GmbH & Co. oHG
This is a nuclear power plant from which Vattenfall purchases electricity. Purchases amounted to SEK 496 million. Sales revenue from the company amounted to SEK 1 million. Vattenfall paid SEK 33 million in interest to the company. Trade liabilities and loan liabilities as per 31 December amounted to SEK 118 million and SEK 3,200 million, respectively.

Kernkraftwerk Krümmel GmbH & Co. oHG
This is a nuclear power plant from which Vattenfall purchases electricity. Purchases amounted to SEK 1,183 million. Sales revenue from the company amounted to SEK 363 million. Vattenfall paid SEK 78 million in interest to the company. Trade receivables amounted to SEK 25 million as per 31 December. Trade liabilities and loan liabilities as per 31 December amounted to SEK 280 million and SEK 5,435 million, respectively.

Kernkraftwerk Stade GmbH & Co. oHG
This is a nuclear power plant from which Vattenfall purchases electricity. Purchases amounted to SEK 240 million. Vattenfall paid SEK 29 million in interest to the company. Trade receivables amounted to SEK 27 million as per 31 December. Trade liabilities and loan liabilities as per 31 December amounted to SEK 155 million and SEK 2,316 million, respectively

GASAG Berliner Gaswerke AG
GASAG Berliner Gaswerke sells, distributes and stores natural gas in the Berlin area. Vattenfall received SEK 81 million in sales revenue from the company, and purchases from the company totalled SEK 2,805 million. Trade receivables amounted to SEK 5 million, while trade liabilities amounted to SEK 439 million.

ENSO Strom AG
ENSO Strom generates and distributes electricity and heat. The company also provides services in gas, water, telecommunications and waste collection. Vattenfall received SEK 1,226 million in sales revenue from the company, while purchases amounted to SEK 438 million. Trade receivables and liabilities as per 31 December amounted to SEK 79 million and SEK 9 million, respectively.

Städtische Werke AG
This company provides electricity, heat, gas, water and waste collection services. Vattenfall's sales revenue from the company amounted to SEK 20 million, while purchases from the company amounted to SEK 18 million.

Other associated companies
These companies are primarily active in design, consulting and purchasing in the energy sector. Vattenfall's combined sales revenue from these companies amounted to SEK 21 million, while purchases also amounted to SEK 21 million. Liabilities to these companies amounted to SEK 3 million.

Note 49 Important estimations and assessments

The various provisions made in Vattenfall's consolidated balance sheet are reviewed on an annual basis. The review of 2006 has led to changes in earlier assumptions about discount rates in the calculation of provisions for pensions in Germany. The discount rate was adjusted from 4.25% to 4.50% for pension plans in Germany. For provisions for pensions in Sweden, the discount rate is unchanged at 3.75% compared with a year ago.

The discount rate for other provisions than provisions for pensions is also unchanged compared with a year ago, at 5.0%

Note 50 Events after the balance sheet date

In the Company's opinion, no significant events have taken place after the balance sheet date up until the date of this report's publication that require disclosure under this heading.

PARENT COMPANY

Parent Company income statement

Amounts in SEK million, 1 January–31 December	Note	2006	2005
Net sales	4, 5	33,049	26,843
Cost of products sold	6	–22,335	–16,415
Gross profit		**10,714**	**10,428**
Selling expenses		–947	–872
Administrative expenses		–1,485	–1,320
Research and development costs		–183	–165
Other operating income	7	688	162
Other operating expenses	8	–462	–90
Operating profit	9, 10	**8,325**	**8,143**
Result from participations in Group companies	11	4,829	414
Result from participations in associated companies	12	160	26
Result from other shares and participations	13	11	–3
Interest income and similar profit/loss items	14	3,752	1,853
Interest expenses and similar profit/loss items	15	–3,029	–6,037
Group contributions		2,068	1,771
Profit before appropriations and tax		**16,106**	**6,167**
Appropriations	16	–2,071	–709
Profit before tax		**14,035**	**5,458**
Income tax expense	17	–2,486	–1,873
Profit for the year		**11,549**	**3,585**

Parent Company balance sheet

Amounts in SEK million	Note	31 Dec. 2006	31 Dec. 2005
Assets			
Non-current assets			
Intangible assets: non-current	18		
Capitalised development costs		120	237
Concessions and similar rights		10	10
Renting and similar rights		23	23
Total intangible assets: non-current		**153**	**270**
Property, plant and equipment	19		
Buildings and land		11,234	11,009
Plants and machinery and other technical installations		7,197	7,147
Equipment, tools, and fixtures and fittings		28	33
Construction in progress		1,360	1,224
Total property, plant and equipment		**19,819**	**19,413**
Other non-current assets			
Participations in Group companies	20, 21	55,715	41,742
Receivables from Group companies	22	5,195	4,316
Participations in associated companies	20, 21	520	10,860
Receivables from associated companies	22	392	2,183
Other shares and participations	20, 21	38	37
Deferred tax assets	17	395	937[1]
Other non-current receivables	22	3,433	261
Total other non-current assets		**65,688**	**60,336**
Total non-current assets		**85,660**	**80,019**
Current assets			
Inventories	23	770	276[1]
Intangible assets: emission allowances	24	5	–
Current receivables	25	50,215	43,488
Cash and cash equivalents	26	181	2,360
Total current assets		**51,171**	**46,124**
Total assets		**136,831**	**126,143**
Equity, provisions and liabilities			
Equity			
Restricted equity			
Share capital (131,700,000 shares with a par value of SEK 50)		6,585	6,585
Statutory reserve		1,286	1,286
Non-restricted equity			
Retained earnings		16,295	18,974[1]
Profit for the year		11,549	3,585
Total equity		**35,715**	**30,430**
Untaxed reserves	16	**11,445**	**9,374**[1]
Provisions	27	**115**	**120**
Non-current interest-bearing liabilities	28	63,904	58,700
Non-current noninterest-bearing liabilities	29	2,661	2,826
Total non-current liabilities		**66,565**	**61,526**
Current interest-bearing liabilities	30	8,763	10,383
Current tax liabilities	17	663	156
Other current noninterest-bearing liabilities	31	13,565	14,154[1]
Total current liabilities		**22,991**	**24,693**
Total equity, provisions and liabilities		**136,831**	**126,143**
Pledged assets	32	2,953	4,875
Contingent liabilities	33	107,544	95,122
Commitments under consortium agreements	34		

1) These figures are adjusted compared to previously published information in Vattenfall's 2005 Annual Report. See page 103, Parent Company statement of changes in equity and Note 2 to the consolidated accounts, Accounting principles.

Parent Company statement of changes in equity

Amounts in SEK million	Share capital	Statutory reserve	Non-restricted equity	Total
Balance carried forward 2004	6,585	1,286	17,078	**24,949**
Adjustment of profit carried forward[1]	–	–	6,478	**6,478**
Dividend to shareholders	–	–	–5,600	**–5,600**
Group contribution	–	–	–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**	**22,559**	**30,430**
Dividend to shareholders	–	–	–5,800	**–5,800**
Group contribution	–	–	–647	**–647**
Tax effect of Group contributions	–	–	181	**181**
Result from mergers	–	–	2	**2**
Profit for the year	–	–	11,549	**11,549**
Balance carried forward 2006	**6,585**	**1,286**	**27,844**	**35,715**

As of 31 December 2006 the registered share capital comprised 131,700,000 shares with a par value of SEK 50 each.

1) Reappraisal decision by the Swedish Tax Agency

Vattenfall AB has previously been the subject of an extensive tax audit which dealt with Vattenfall's transition from a public utility (affärsverk) to a limited liability company in 1992. The County Administrative Court and Administrative Court of Appeal, after appeals on verdicts, have established that the Swedish Parliament's decision at the time of the conversion of Vattenfall into a limited liability company did not take applicable tax legislation into account to a sufficient extent. One consequence of this, according to the reappraisal decision, has been that Vattenfall AB's opening balance sheet as a limited liability company has been corrected, entailing that an adjustment has been made of untaxed reserves in the amount of SEK 5,604 million, with a corresponding increase in the Parent Company's profit carried forward in equity. The adjustment of profit carried forward includes (also related to the reappraisal decision) SEK 397 million pertaining to an extra provision for depreciation, and SEK 477 million pertaining to a reduction of the Company's tax for the 2000 tax year.

Parent Company cash flow statement

Amounts in SEK million, 1 January–31 December	2006	2005
Operating activities		
Funds from operations (FFO)		
Profit for the year	11,549	3,585
Adjustments for the effect of items not included in cash flow:		
Income tax expense	2,486	1,873
Appropriations	2,071	709
Depreciation and amortisation	926	731
Dividend-contingent Group contributions	–2,068	–1,771
Taxes paid	–1,437	–1,142
Unrealised exchange rate effects	–1,743	1,852
Increase in provisions	–5	34
Other	–180	–150
Cash flow from changes in operating assets and operating liabilities	–8,352	–11,827
Cash flow from operating activities	**3,247**	**–6,106**
Investing activities		
Investments in Group companies, associated companies and other shares and participations	–1,045	–11,607
Investments in property, plant and equipment and intangible assets: non-current	–1,308	–1,445
New share issue/shareholder contribution rendered	–13,140	–
Divestments of property, plant and equipment and intangible assets: non-current	93	1,166
Divestments of shares and participations	10,419	157
Cash flow from investing activities	**–4,981**	**–11,729**
Cash flow before financing activities	**–1,734**	**–17,835**
Financing activities		
Loans raised	3,584	23,133
Group contribution received	1,771	2,520
Dividend paid to shareholders	–5,800	–5,600
Cash flow from financing activities	**–445**	**20,053**
Cash flow for the year	**–2,179**	**2,218**
Cash and cash equivalents		
Cash and cash equivalents at the beginning of the year	2,360	142
Cash flow for the year	–2,179	2,218
Cash and cash equivalents at the end of the year	**181**	**2,360**

Interest paid totalled SEK 3,040 million (2,519) and interest received totalled SEK 1,181 million (806). Dividends received totalled SEK 4,833 million (373).

PARENT COMPANY NOTES

(Amounts in SEK million unless stated otherwise.)

Note 1 Company information

Vattenfall AB's 2006 Annual Report was approved in accordance with a decision by the Board of Directors of 7 March 2007. 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 submitted at the Annual General Meeting (AGM).

Note 2 Accounting principles

General

The Parent Company Vattenfall AB's accounts are prepared according to Swedish GAAP, i.e., in accordance with the Swedish Annual Accounts Act and Recommendation RR32:05 of the Swedish Financial Accounting Standards Council on accounting for legal entities. Vattenfall AB has adopted the exemption rule regarding IAS 39 according to RR32:06.

The accounting principles applied are stated in the applicable parts of Note 2 to the consolidated accounts with the following amendments for the Parent Company Vattenfall AB.

Financial instruments are reported at cost.

Depreciation and amortisation

As in the consolidated accounts, depreciation and amortisation are based on cost and are applied on a straight-line basis over the estimated useful life of the asset in question. 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 plan assets of 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 4 to the consolidated accounts.

Note 4 Net sales

	2006	2005
Sales including excise taxes		
sale of goods (electricity, heat, etc.)	34,182	28,176
rendering of services	993	929
Excise taxes	−2,126	−2,262
Net sales	**33,049**	**26,843**

Net sales per geographic area

	2006	2005
Nordic countries	32,278	25,723
Germany	639	739
Poland	132	321
Other	–	60
Total	**33,049**	**26,843**

Net sales per segment

	2006	2005
Electricity Generation	9,594	6,834
Electricity Market	21,046	17,656
Heat	2,244	2,253
Other	165	100
Total	**33,049**	**26,843**

Note 5 Intra-Group transactions

Of the Parent Company's total income from sales and total purchase costs, transactions with Group companies account for 12% (9%) of sales and 41% (52%) of purchase costs.

Note 6 Cost of products sold

Direct costs include production taxes and duties of SEK 199 million (191) and property taxes of SEK 837 million (260).

Note 7 Other operating income

Other operating income consists primarily of 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 consist primarily of capital losses on divestments of non-current assets and operationally derived exchange rate losses.

Note 9 Depreciation and amortisation

Amortisation of non-current intangible assets and depreciation of property, plant and equipment in the income statement are broken down as follows:

	2006	2005
Cost of products sold	736	721
Selling expenses	75	8
Administrative expenses	1	2
Total	**812**	**731**

Amortisation of non-current intangible assets is included in Cost of products sold above in the amount of 2 SEK million (9) and in Selling expenses in the amount of 73 SEK million (0).

Note 10 Impairment losses

Impairment losses of non-current intangible assets, property, plant and equipment in the income statement are broken down as follows:

	2006	2005
Selling expenses	114	–
Total	**114**	**–**

Impairment losses of non-current intangible assets are included above in Selling expenses in the amount of SEK 114 million (0).

The development of a new customer handling system has resulted in higher outlays than originally estimated. The future gains that the new system was to generate do not match the higher cost. Consequently, operating profit has been charged with impairment losses of SEK 114 million.

Note 11 Result from participations in Group companies

	2006	2005
Dividends	4,817	351
Impairment losses	–2	–11
Capital gains/losses on divestments	14	74
Total	**4,829**	**414**

Note 12 Result from participations in associated companies

Attributable to dividends from associated companies, totalling SEK 16 million (26), and a capital gain from the sale of associated companies, in the amount of SEK 144 million (0).

Note 13 Result from other shares and participations

	2006	2005
Dividends	2	2
Impairment losses	–	–1
Capital gains/losses on divestments	9	–4
Total	**11**	**–3**

Note 14 Interest income and similar profit/loss items

	2006	2005
Interest income from subsidiaries	717	362
Other interest income	464	444
Foreign exchange gains	2,271	1,047
Total	**3,752**	**1,853**

Note 15 Interest expenses and similar profit/loss items

	2006	2005
Interest expenses to subsidiaries	3,017	2,494
Other interest expenses	22	25
Foreign exchange losses	–	3,518
Total	**3,039**	**6,037**

Note 16 Appropriations and untaxed reserves

	Balance brought forward	Provision/Dissolution (–)	Balance carried forward
Accelerated depreciation	6,412	–261	**6,151**
2001 Tax allocation reserve	464	–464	**–**
2002 Tax allocation reserve	1,371	–	**1,371**
2003 Tax allocation reserve	966	–	**966**
2004 Tax allocation reserve	1,295	–	**1,295**
2005 Tax allocation reserve	2,733	–	**2,733**
2006 Tax allocation reserve	1,737	–	**1,737**
2007 Tax allocation reserve	–	2,796	**2,796**
Other untaxed reserves	–5,604	–	**–5,604**
Total	**9,374**	**2,071**	**11,445**

Note 17 Income tax expense

The reported income tax expense is broken down as follows:

	2006	2005
Current tax	2,420	1,855
Deferred tax	66	18
Total	**2,486**	**1,873**

The income tax expense for the year attributable to previous years amounts to SEK 110 million (–396). Deferred tax assets according to the balance sheet amount to SEK 395 million (937). Current tax liabilities amount to SEK 663 million (156). The tax effect of the standard tax interest on tax allocation reserves amounts to SEK 56 million (61).

The difference between the nominal Swedish tax rate and the effective tax rate is explained as follows:

%	2006	2005
Swedish income tax rate	28.0	28.0
Appropriations	–3.6	–3.2
Tax adjustment for previous periods	–0.7	6.4
Non-taxable income	–9.2	–2.6
Non-deductible expenses	0.7	1.1
Other	0.2	0.7
Effective tax rate[1]	**15.4**	**30.4**
Tax rate, current tax[2]	15.0	30.1

1) Tax expense according to the Parent Company income statement in relation to profit before appropriations and tax.

2) Tax expense according to the Parent Company income statement excluding reported deferred tax in relation to profit before appropriations and tax.

Note 18 Intangible assets: non-current

	Capitalised development costs		Goodwill		Concessions and similar rights		Renting and similar rights		Total	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Cost										
Cost brought forward	237	–	13	13	344	340	61	61	**655**	**414**
Investments	64	161	–	–	6	–	3	–	**73**	**161**
Divestments/Disposals	–	–	–	–	–	–	–1	–	**–1**	**–**
Reclassifications	–	76	–	–	–	4	–	–	**–**	**80**
Accumulated cost carried forward	**301**	**237**	**13**	**13**	**350**	**344**	**63**	**61**	**727**	**655**
Accumulated amortisation according to plan										
Amortisation brought forward	–	–	–13	–13	–334	–327	–38	–36	**–385**	**–376**
Amortisation for the year	–67	–	–	–	–6	–7	–2	–2	**–75**	**–9**
Accumulated amortisation carried forward	**–67**	**–**	**–13**	**–13**	**–340**	**–334**	**–40**	**–38**	**–460**	**–385**
Impairment losses										
Impairment losses for the year	–114	–	–	–	–	–	–	–	**–114**	**–**
Accumulated impairment losses carried forward	**–114**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–114**	**–**
Residual value according to plan carried forward	**120**	**237**	**–**	**–**	**10**	**10**	**23**	**23**	**153**	**270**
Accumulated excess amortisation	–36	–71	–	–	–3	–10	–7	–23	**–46**	**–104**
Book value	**84**	**166**	**–**	**–**	**7**	**–**	**16**	**–**	**107**	**166**

At 31 December 2006, there are no contractual commitments for the acquisition of non-current intangible assets.

Note 19 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	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Cost										
Cost brought forward	16,612	16,422	15,112	14,867	166	176	1,224	1,919	**33,114**	**33,384**
Investments	–	–	–	2	11	12	1,235	1,270	**1,246**	**1,284**
Grants received	–	–	–	–	–	–	–11	–	**–11**	**–**
Transfer from construction in progress	458	684	630	953	–	1	–1,088	–1,896	**–**	**–258**
Divestments/Disposals	–14	–485	–237	–946	–48	–23	–	–4	**–299**	**–1,458**
Reclassifications	10	–9	–7	236	–	–	–	–65	**3**	**162**
Accumulated cost carried forward	**17,066**	**16,612**	**15,498**	**15,112**	**129**	**166**	**1,360**	**1,224**	**34,053**	**33,114**
Accumulated depreciation according to plan										
Depreciation brought forward	–5,603	–5,449	–7,965	–7,633	–133	–141	–	–	**–13,701**	**–13,223**
Depreciation for the year	–239	–239	–489	–470	–9	–13	–	–	**–737**	**–722**
Divestments/Disposals	10	83	156	138	41	21	–	–	**207**	**242**
Reclassifications	–	2	–3	–	–	–	–	–	**–3**	**2**
Accumulated depreciation carried forward	**–5,832**	**–5,603**	**–8,301**	**–7,965**	**–101**	**–133**	**–**	**–**	**–14,234**	**–13,701**
Residual value according to plan carried forward	**11,234**	**11,009**	**7,197**	**7,147**	**28**	**33**	**1,360**	**1,224**	**19,819**	**19,413**
Accumulated excess depreciation	–	–	–6,077	–6,275	–28	–33	–	–	**–6,105**	**–6,308**
Book value	**11,234**	**11,009**	**1,120**	**872**	**–**	**–**	**1,360**	**1,224**	**13,714**	**13,105**

1) Cost for land and buildings includes cost for land and water rights amounting to SEK 6,617 million (6,618), which are not subject to depreciation.

Tax assessment values (for Swedish real estate)

	2006	2005
Buildings	33,947	34,389
Land	20,743	20,970
Total	**54,690**	**55,359**

Distribution lines and transformer stations are not subject to tax assessment values.

At 31 December 2006, there are no contractual commitments for the acquisition of property, plant and equipment.

Note 20 Participations in Group companies, associated companies and other shares and participations

	Participations in Group companies		Participations in associated companies		Other shares and participations	
	2006	2005	2006	2005	2006	2005
Balance brought forward	41,742	40,533	10,860	540	37	55
Investments/acquisitions	1,044	1,276	–	10,331	1	–
Shareholder contributions[1]	2	–	–	–	–	–
Divestments[1]	–78	–56	–10,340	–4	–	–23
New share issue	13,139	–	–	–	–	–
Reclassifications	–	–	–	–7	–	7
Merged shareholdings	–133	–	–	–	–	–
Impairment losses	–1	–11	–	–	–	–2
Balance carried forward	**55,715**	**41,742**	**520**	**10,860**	**38**	**37**

1) Shareholder contributions and divestments are mainly attributable to restructuring in the Group.

Note 21 Shares and participations

For a breakdown of the Parent Company's shares and participations in Group companies, associated companies and other shares and participations, see Notes 21–23 to the consolidated accounts.

Note 22 Receivables from Group companies, associated companies and other non-current receivables

	Receivables from Group companies		Receivables from associated companies		Other non-current receivables	
	2006	2005	2006	2005	2006	2005
Balance brought forward	4,316	4,335	2,183	1,790	261	148
New receivables	902	260	–	1	3,347	122
Payments received	–23	–	–1791	–49	–175	–2
Reclassifications	–	–279	–	441	–	–7
Balance carried forward	**5,195**	**4,316**	**392**	**2,183**	**3,433**	**261**

Note 23 Inventories

	2006	2005
Biofuels	62	28
Fossil fuels	242	212
Materials and spare parts	21	20
Other	445	16
Total	**770**	**276**

The amount of inventories recognised as an expense in 2006 totalled SEK 803 million. No impairment losses of inventories or reversal of impairment losses were recognised during the year.

Note 24 Intangible assets: emission allowances

Relates to emission allowances purchased during 2006. See Note 2 to the consolidated accounts, Accounting principles.

Note 25 Current receivables

	2006	2005
Accounts receivable - trade	3,255	2,717
Receivables from Group companies	39,915	34,421
Receivables from associated companies	1,442	55
Other receivables	3,015	4,209
Prepaid expenses and accrued income	2,588	2,086
Total	**50,215**	**43,488**

Breakdown of prepaid expenses and accrued income:

	2006	2005
Prepaid insurance premiums	35	9
Prepaid expenses, other	552	163
Prepaid expenses and accrued income, electricity	1,786	1,839
Accrued income, other	215	75
Total	**2,588**	**2,086**

Note 26 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 30,965 million (30,892) 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 181 million (2,360).

Note 27 Provisions

	2006	2005
Personnel-related provisions for non-pension purposes	115	120
Total	**115**	**120**

	2006	2005
Pension obligations[1,2]	2,647	2,617
Less: Plan assets	–2,647	–2,617
Total pension provisions at year-end	**–**	**–**
1) Information registered by PRI	1,603	1,530
2) Of which, covered by credit insurance with FPG/PRI	2,336	2,326

The Parent Company's pension obligations are subject in their entirety to the Pension Obligations Vesting Act.

	2006	2005
Fair value of plan assets at the beginning of the year	2,617	2,606
Return on plan assets	30	11
Fair value of plan assets at the end of the year	**2,647**	**2,617**

	2006	2005
Plan assets consist of the following:		
Equity securities	1,319	1,109
Debt instruments	1,072	1,169
Other	256	339
Total	**2,647**	**2,617**

Note 28 Non-current interest-bearing liabilities

Fully attributable to liabilities to Group companies in the amount of SEK 63,904 million (58,700), of which SEK 17,886 million (18,615) falls due after more than five years.

Liabilities to Group companies are mainly attributable to long-term borrowings from Vattenfall Treasury AB.

Note 29 Non-current noninterest-bearing liabilities

	2006	2005
Liabilities to Group companies	2,164	2,134
Other liabilities	497	692
Total	**2,661**	**2,826**

Liabilities to Group companies are mainly attributable to long-term liabilities to Forsmarks Kraftgrupp AB for power charges. For this liability there shall be, in accordance with an agreement between the co-owners, no interest payable on the debt. Of other liabilities, SEK 289 million (333) falls due after more than five years.

Note 30 Current interest-bearing liabilities

Fully attributable to liabilities to Group companies, totalling SEK 8,763 million (10,383).

Note 31 Other current noninterest-bearing liabilities

	2006	2005
Advance payments from customers	29	37
Accounts payable - trade	711	629
Liabilities to Group companies	11,127	12,013
Liabilities to associated companies	26	29
Other liabilities	607	606
Accrued expenses and deferred income	1,065	840
Total	**13,565**	**14,154**

Breakdown of accrued expenses and deferred income:

	2006	2005
Accrued personnel – related costs	150	215
Other accrued expenses	253	352
Deferred income and accrued expenses, electricity	599	267
Other deferred income	63	6
Total	**1,065**	**840**

Note 32 Pledged assets

	2006	2005
Blocked bank funds as security for trading on Nord Pool	40	2246
Blocked bank funds as security for redemption of minority shares	2,913	2,629
Total	**2,953**	**4,875**

Note 33 Contingent liabilities

	2006	2005
Guarantees		
of which:		
for Vattenfall Treasury's:		
lending to subsidiaries	23,178	20,797
lending to associated companies	36	36
external borrowing for subsidiaries	46,259	54,223
borrowing from Group companies	10,209	–
borrowing from associated companies	4,978	–
for lending by:		
other than Group companies	9	14
Group companies	5,504	4,768
associated companies	2	–
Swedish Nuclear Waste Fund	5,643	5,377
Contract guarantees	255	677
Other guarantees	11,471	9,230
Total	**107,544**	**95,122**
Other contingent liabilities		
Compensatory and free power deliveries:		
Wholesale power deliveries		
Number of commitments	13	13
Power MW	223	223
Energy deliveries, TWh/year	0.9	0.9

SEK 102,406 million (91,088) 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 at a total value of EUR 713 million (525), equivalent to SEK 6,451 million (4,951). On the balance sheet date, utilised guarantees totalling EUR 280 million (271), equivalent to SEK 2,537 million (2,558), were included in the reported contingent liabilities.

As security for the subsidiaries Forsmarks Kraftgrupp AB and Ringhals AB, Vattenfall AB has made guarantee commitments for a combined value of SEK 5,643 million (5,377) to cover the risk that the existing funds in the Swedish Nuclear Waste Fund should, over time, prove to be insufficient. Two types of guarantee commitments have been made. The one guarantee commitment is intended to cover the requisite need for fees that has been decided on for the fees that have not yet been paid in during the so-called earnings period (25 years of operation). The other guarantee commitment pertains to future cost increases stemming from unforeseen events. Both amounts are determined from a probability-based risk analysis, where the former amount has been determined as such that there is a 50% probability that it, together with currently funded amounts (median value), will provide full cost coverage. The latter amount consists in principle of the supplement that would be required if the corresponding probability was 90%. See also Note 42 to the consolidated accounts.

Note 34 Commitments under consortium agreements

See Note 43 to the consolidated accounts.

Note 35 Average number of employees and personnel costs

	2006			2005		
Average number employees	Men	Women	Total	Men	Women	Total
Sweden	805	285	1,090	844	360	1,204
Other countries	4	–	4	2	1	3
Total	**809**	**285**	**1,094**	**846**	**361**	**1,207**

Personnel costs	2006	2005
Salaries and other remuneration	615	501
Social security charges	465	426
(of which pension costs)[1]	(212)	(194)
Total	**1,080**	**927**

1) SEK 8 million (8) of the pension costs are attributable to the group of individuals comprising current senior executives and former senior executives. The Company's outstanding pension obligations attributable to these executives total SEK 51 million (44).

None of the Company directors receives any pension benefits in connection with board duties.

	2006			2005		
Salaries and other remuneration	Board members and senior executives[1]	Other employees	Total	Board members and senior executives[1]	Other employees	Total
Sweden	19	593	612	24	476	500
Other countries	–	3	3	–	1	1
Total[2]	**19**	**596**	**615**	**24**	**477**	**501**

1) Board members and senior executives also include deputy board members and vice presidents, and former presidents and vice presidents.

2) Total salaries and other remuneration to board members and presidents include bonuses of SEK 1 million (8).

For benefits to senior executives at Vattenfall, see Note 44 to the consolidated accounts.

Note 36 Sickness-related absence

Sickness-related absence as a percentage of normal working hours during the year

	Parent Company Vattenfall AB		Vattenfall Group, Swedish operations	
	2006	2005	2006	2005
Total sickness-related absence	2.8	3.5	3.5	4.1
Total sickness-related absences:				
–for women	5.0	6.2	5.5	6.3
–for men	2.0	2.2	2.8	3.4
–for employees aged 29 and younger	1.4	4.5	3.1	3.4
–for employees aged 30–49 years	2.7	3.4	3.3	3.6
–for employees aged 50 and above	2.7	2.9	4.2	5.3
Percentage of sickness-related absence lasting 60 days or more	38.9	38.6	48.5	43.8

Note 37 Gender distribution among senior executives

	Women, %		Men, %	
	2006	2005	2006	2005
Gender distribution among board members	20	15	80	85
Gender distribution among other senior executives	11	10	89	90

Note 38 Leasing

Leasing expenses

Future payment commitments, as of 31 December 2006, for leasing contracts and rental contracts break down as follows:

	Finance leases	Operating leases
2007	–	19
2008	–	22
2009	–	3
Total	**–**	**44**

Leasing expenses for the year attributable to the Parent Company amounted to SEK 6 million (11).

Leasing revenues

Vattenfall AB owns and operates energy facilities on behalf of customers. Revenues from customers are broken 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 2006, the cost of assets reported under Operating leases amounted to SEK 979 million (1,016). Accumulated depreciation amounted to SEK 334 million (341) and accumulated impairment losses to SEK 30 million (30).

Future payments for this type of facility are broken down as follows:

	Finance leases	Operating leases
2007	–	42
2008	–	41
2009	–	39
2010	–	34
2011	–	33
2012 and beyond	–	205
Less: Financial income	–	–150
Total	**–**	**244**

Note 39 Auditors' fees, etc.

	2006	2005
Statutory audit		
Ernst & Young	8	7
Swedish National Audit Office	1	1
Total	**9**	**8**
Other fees		
Ernst & Young[1]	6	5
PricewaterhouseCoopers	–	1
Total	**6**	**6**

1) SEK 3 million (3) is attributable to consultations for personnel based outside Sweden.

Note 40 Related party disclosures

See Note 48 to the consolidated accounts.

PROPOSED DISTRIBUTION OF PROFITS

The Annual General Meeting has at its disposal profits totalling SEK 27,844,113,050.

The Board of Directors and President propose that the profits be distributed as follows:

To be distributed to the shareholders, SEK	7,500,000,000
To be carried forward, SEK	20,344,113,050
	27,844,113,050

The proposed distribution is equivalent to a dividend of SEK 56.95 per share.

Statement by the Board of Directors pursuant to the Swedish Companies Act, Chapter 18, Section 4:
Based on the Company's and Group's strong financial position, favourable earnings and strong cash position, the Board of Directors is of the opinion that the proposed distribution of profits will not lead to any material limitation of the Company's or Group's ability to make any necessary investments or to meet their obligations in the short and long term.

Nor does the proposed dividend have any material impact on the Company's key ratios.

In view of the above, the Board finds the proposed distribution of profits, totalling SEK 7,500,000,000, to be carefully considered and justified. Further, the Board finds that proposed distribution of profits adheres to the principles of the adopted dividend policy (page 3).

The Board of Directors and President's affirmation upon signing the annual accounts for 2006
We affirm that the annual accounts, to the best of our knowledge, have been prepared in accordance with generally accepted accounting principles, that the information provided reflects the actual state of affairs, and that nothing of material importance has been omitted which could affect the view of the Company presented by the annual accounts.

Stockholm, 7 March 2007

Dag Klackenberg
Chairman of the Board

Maarit Aarni-Sirviö, Carl-Gustaf Angelin, Johnny Bernhardsson, Christer Bådholm

Ronny Ekwall, Peter Lindell, Hans-Olov Olsson

Lone Fønss Schrøder, Anders Sundström, Greta Fossum

Lars G. Josefsson
President and Chief Executive Officer

AUDIT REPORT

To the Annual General Meeting 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 President of Vattenfall AB for the year 2006. The Board of Directors and the President 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 60–110 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 President and significant estimates made by the Board of Directors and the President when preparing the annual accounts and consolidated accounts as well as evaluating the overall presentation of information 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 President. We also examined whether any board member or the President 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 General 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 President be discharged from liability for the financial year.

Stockholm, 7 March 2007

Ernst & Young AB
Lars Träff
Auktoriserad revisor
(Authorised Public Accountant)

Per Redemo
Auktoriserad revisor
(Authorised Public Accountant)
appointed by the
Swedish National Audit Office

DEFINITIONS AND CALCULATIONS OF KEY RATIOS

Figures for the Group in 2006. Amounts in SEK million unless stated otherwise.

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. For 2005, the compensation received from the Swedish state for the closure of Barsebäck 2 and relevant costs for the impairment losses of the assets are also reported as items affecting comparability.

Free cash flow Cash flow from operating activities less maintenance investments

Net assets Balance sheet total less noninterest-bearing liabilities, provisions, interest-bearing receivables, funds in the Swedish Nuclear Waste Fund, cash and cash equivalents, short-term investments.

Net debt Interest-bearing liabilities less long-term loans to minority owners in foreign subsidiaries, cash and cash equivalents and short-term investments.

Operating margin, %

$$100 \times \frac{\text{Operating profit (EBIT)}}{\text{Net sales}} = \frac{27{,}049}{145{,}815} = 18.6$$

Operating margin excl. items affecting comparability, %

$$100 \times \frac{\text{Operating margin excl. items affecting comparability}}{\text{Net sales}} = \frac{26{,}676}{145{,}815} = 18.3$$

Pre-tax profit margin, %

$$100 \times \frac{\text{Profit before tax}}{\text{Net sales}} = \frac{25{,}525}{145{,}815} = 17.5$$

Pre-tax profit margin excl. items affecting comparability, %

$$100 \times \frac{\text{Profit before tax excl. items affecting comparability}}{\text{Net sales}} = \frac{25{,}141}{145{,}815} = 17.2$$

Return on equity, %

$$100 \times \frac{\text{Profit for the period attributable to equity holders of the Parent Company}}{\text{Average equity for the period attributable to equity holders of the Parent Company excl. the Reserve for cash flow hedges}} = \frac{18{,}729}{97{,}951} = 19.1$$

Return on equity excl. items affecting comparability, %

$$100 \times \frac{\text{Profit for the period attributable to equity holders of the Parent Company excl. items affecting comparability}}{\text{Average equity for the period attributable to equity holders of the Parent Company excl. the Reserve for cash flow hedges}} = \frac{18{,}343}{97{,}951} = 18.7$$

Return on net assets, %

$$100 \times \frac{\text{Operating profit (EBIT) plus discounting effects attributable to provisions}}{\text{Weighted average of net assets for the period}} = \frac{25{,}037}{151{,}155} = 16.6$$

Return on net assets excl. items affecting comparability, %

$$100 \times \frac{\text{Operating profit (EBIT) excl. items affecting comparability plus discounting effects attributable to provisions}}{\text{Weighted average of net assets for the period}} = \frac{24{,}664}{151{,}155} = 16.3$$

Interest coverage ratio, times

$$\frac{\text{Operating profit (EBIT) + financial income excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund}}{\text{Financial expenses excl. discounting effects attributable to provisions}} = \frac{28{,}782}{3{,}351} = 8.6$$

Interest coverage ratio excl. items affecting comparability, times

$$\frac{\text{Operating profit (EBIT) excl. items affecting comparability + financial income excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund}}{\text{Financial expenses excl. discounting effects attributable to provisions}} = \frac{28{,}409}{3{,}351} = 8.5$$

FFO interest coverage ratio, times

$$\frac{\text{Funds from operations (FFO) + financial expenses excl. discounting effects attributable to provisions}}{\text{Financial expenses excl. discounting effects attributable to provisions}} = \frac{39{,}024}{3{,}351} = 11.6$$

FFO interest coverage ratio, net, times

$$\frac{\text{Funds from operations (FFO) + net financial items excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund}}{\text{Financial items excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund}} = \frac{37{,}291}{1{,}618} = 23.0$$

Cash flow interest coverage ratio after maintenance investments, times

$$\frac{\text{Cash flow from operating activities less maintenance investments + financial expenses excl. discounting effects attributable to provisions}}{\text{Financial expenses excl. discounting effects attributable to provisions}} = \frac{26{,}529}{3{,}351} = 7.9$$

Equity/assets ratio, %

$$100 \times \frac{\text{Equity}}{\text{Balance sheet total}} = \frac{107{,}674}{323{,}166} = 33.3$$

Net debt/equity ratio, times

$$\frac{\text{Net debt}}{\text{Equity}} = \frac{49{,}407}{107{,}674} = 0.46$$

Net debt/net debt plus equity, %

$$100 \times \frac{\text{Net debt}}{\text{Net debt + equity}} = \frac{49{,}407}{157{,}081} = 31.5$$

Interest-bearing liabilities/interest-bearing liabilities + equity, %

$$100 \times \frac{\text{Interest-bearing liabilities}}{\text{Interest-bearing liabilities + equity}} = \frac{71{,}575}{179{,}249} = 39.9$$

FFO/interest-bearing liabilities, %

$$100 \times \frac{\text{Funds from operations (FFO)}}{\text{Interest-bearing liabilities}} = \frac{35{,}673}{71{,}575} = 49.8$$

FFO/net debt, %

$$100 \times \frac{\text{Funds from operations (FFO)}}{\text{Net debt}} = \frac{35{,}673}{49{,}407} = 72.2$$

EBITDA/net financial items, times

$$\frac{\text{Operating profit before depreciation and amortisation (EBITDA)}}{\text{Financial items excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund}} = \frac{43{,}166}{1{,}618} = 26.7$$

EBITDA excl. items affecting comparability/net financial items, times

$$\frac{\text{Operating profit before depreciation and amortisation (EBITDA) excl. items affecting comparability}}{\text{Financial items excl. discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund}} = \frac{42{,}793}{1{,}618} = 26.4$$

NINE–YEAR REVIEW

	Swedish GAAP							IFRS		
Amounts in SEK million	1998[3]	1999[3]	2000[3]	2001[3]	2002[3]	2003[3]	2004[3]	2004[3]	2005[3]	2006
Income statement items										
Net sales	27,957	27,754	31,695	69,003	101,025	111,935	113,366	113,366	129,158	145,815
EBITDA	9,821	9,834	11,670	18,207	25,489	24,450	31,347	32,331	42,383	43,166
Operating profit (EBIT)	6,028	5,483	6,193	9,916	13,997	14,868	19,501	17,057	27,571	27,049
Operating profit (EBIT)[1]	6,028	5,483	4,474	8,779	13,550	14,605	18,682	19,272	24,585	26,676
Financial income	288	542	1,037	2,232	3,010	2,267	1,772	2,969	3,810	3,839
Financial expenses	–1,907	–1,760	–2,536	–4,737	–6,386	–5,203	–4,020	–5,467	–5,221	–5,363
Profit before tax	4,409	4,265	4,694	7,411	10,621	11,932	17,253	14,559	26,160	25,525
Profit for the year	2,632	2,897	3,432	5,287	8,224	9,529	12,348	9,604	20,518	19,858
– of which, attributable to equity holders of the Parent Company	2,664	2,538	2,970	4,190	7,566	9,123	11,776	8,944	19,235	18,729
– of which, attributable to minority interests	–32	359	462	1,097	658	406	572	660	1,283	1,129
Cash flow items										
Funds from operations (FFO)	6,758	6,224	5,830	13,148	17,106	18,804	24,159	24,302	31,386	35,673
Free cash flow	4,047	–1,660	3,050	5,478	10,820	11,606	15,684	15,684	14,341	23,178
Balance sheet items										
Cash and cash equivalents and short-term investments	4,439	4,860	7,543	10,340	15,473	14,647	13,616	13,616	14,074	22,168
Equity	36,981	38,262	42,802	61,101	57,532	64,328	73,947	85,551	90,909	107,674
– of which, attributable to equity holders of the Parent Company	34,768	35,790	37,817	42,021	47,572	54,949	64,759	75,437	80,565	96,589
– of which, attributable to equity minority interests	2,213	2,472	4,985	19,080	9,960	9,379	9,188	10,114	10,344	11,085
Interest-bearing liabilities	27,876	32,275	50,854	88,723	94,838	85,631	73,013	73,013	78,663	71,575
Net debt	23,437	27,415	43,311	55,736	75,207	66,890	55,411	55,411	64,343	49,407
Interest-bearing provisions	–	–	–	–	–	–	–	45,491	47,691	49,217
Noninterest-bearing liabilities and provisions	18,499	16,126	21,603	109,219	123,906	115,006	109,955	81,150	107,805	94,700
Net assets, weighted average value	57,253	60,395	74,968	100,701	127,479	124,229	123,423	134,125	143,001	151,155
Balance sheet total	83,356	86,663	115,259	259,043	276,276	264,965	256,915	285,205	325,068	323,166
Key ratios (% unless stated otherwise)										
Operating margin	21.6	19.8	19.5	14.4	13.9	13.3	17.2	15.0	21.3	18.6
Operating margin[1]	21.6	19.8	14.1	12.7	13.4	13.0	16.5	17.0	19.0	18.3
Pre-tax profit margin	15.8	15.4	14.8	10.7	10.5	10.7	15.2	12.8	20.3	17.5
Pre-tax profit margin[1]	15.8	15.3	9.0	9.1	10.1	10.4	14.5	14.8	17.9	17.2
Return on equity	7.9	7.3	8.3	11.1	18.0	19.2	21.4	12.2	23.2	19.1
Return on equity[1]	7.9	7.2	4.0	9.7	17.3	18.8	20.4	13.9	19.4	18.7
Return on net assets	10.5	9.1	8.3	9.8	11.0	12.0	15.8	11.6	17.8	16.6
Return on net assets[1]	10.5	9.1	6.0	8.7	10.6	11.8	15.1	13.2	15.8	16.3
Interest coverage ratio, times	3.3	3.4	2.9	2.6	2.7	3.3	5.3	5.3	9.3	8.6
Interest coverage ratio, times[1]	3.3	3.4	2.2	2.3	2.6	3.2	5.1	5.9	8.3	8.5
FFO interest coverage ratio, times	4.5	4.5	3.3	3.8	3.7	4.6	7.0	8.0	10.9	11.6
FFO interest coverage ratio, net, times	5.2	6.1	4.9	6.2	6.1	7.4	11.7	11.8	22.8	23.0
Cash flow interest coverage ratio after maintenance investments, times	3.1	0.1	2.2	2.2	2.7	3.2	4.9	5.5	5.5	7.9
Equity/assets ratio	45.5	45.2	37.6	23.7	20.9	24.4	28.8	30.0	28.0	33.3
Net debt/equity ratio, times	0.63	0.72	1.01	0.91	1.31	1.04	0.75	0.65	0.71	0.46
Net debt/net debt plus equity	38.8	41.7	50.3	47.7	56.7	51.0	42.8	39.3	41.4	31.5
Interest-bearing liabilities/interest-bearing liabilities plus equity	39.3	44.8	54.2	59.2	62.2	57.1	49.7	46.0	46.4	39.9
FFO/interest-bearing liabilities	24.2	19.3	11.5	14.8	18.0	22.0	33.1	33.3	39.9	49.8
FFO/net debt	28.8	22.7	13.5	23.6	22.7	28.1	43.6	43.9	48.8	72.2
EBITDA/net financial items, times	6.1	8.1	7.8	7.3	7.6	8.3	13.9	14.4	29.4	26.7
EBITDA/net financial items, times[1]	6.1	7.9	6.1	6.8	7.4	8.2	13.6	15.4	27.4	26.4
Other information										
Dividend to equity holders of the Parent Company	1,500	1,500	990	1,030	1,675	2,400	5,600	5,600	5,800	7,500[2]
Investments	4,528	7,916	23,840	43,443	39,932	11,356	12,601	12,731	24,497	17,220
Electricity sales, TWh	83.8	86.9	83.1	149.9	188.3	184.2	186.4	186.4	200.3	194.8
Average number employees	7,996	7,991	13,123	23,814	34,248	35,296	33,017	33,017	32,231	32,308

1) Excl. items affecting comparability.

2) Proposed dividend.

3) Certain figures are adjusted compared to previously published information in Vattenfall's 2005 Annual Report. See Note 2 to the consolidated accounts, Accounting principles.

Comments

Vattenfall's sales have more than quadrupled since 2000 – a result of the acquisitions of the large German energy companies HEW, Bewag, Veag and Laubag, and the Polish companies EW and GZE. Assets nearly tripled during the same period of time. Operating profit increased from SEK 6.2 billion in 2000 to SEK 27.0 billion in 2006 due to very successful integration and consolidation work, but also to higher generation volumes and higher wholesale prices for electricity. Net debt, which after the major acquisitions had increased by more than SEK 75 billion, have decreased to SEK 49.2 billion due to the Company's strong cash flow. The return on equity has increased from 8.3% to 19.1%.

QUARTERLY REVIEW

	2005[3]				2006			
Amounts in SEK million	Q 1	Q 2	Q 3	Q 4	Q 1	Q 2	Q 3	Q 4
Income statement items								
Net sales	35,036	29,292	27,550	37,280	40,432	33,644	30,875	40,864
EBITDA	12,519	8,868	6,567	14,429	16,115	9,245	7,960	9,846
Operating profit (EBIT)	9,092	4,906	3,063	10,510	12,689	5,834	3,304	5,222
Operating profit (EBIT)[1]	9,069	4,933	3,073	7,510	12,435	5,697	3,286	5,258
Financial income	544	592	771	1,903	797	681	841	1,520
Financial,expenses	−1,134	−1,375	−1,218	−1,494	−1,276	−1,240	−1,184	−1,663
Profit before tax	8,502	4,123	2,616	10,919	12,210	5,275	2,961	5,079
Profit for the period	5,569	2,917	1,857	10,175	7,979	3,399	1,871	6,609
– of which, attributable to equity holders of the Parent Company	5,184	2,793	1,814	9,444	7,502	3,183	1,726	6,318
– of which, attributable to minority interests	385	124	43	731	477	216	145	291
Cash flow items								
Funds from operations (FFO)	8,771	6,020	3,921	12,674	13,281	7,240	5,625	9,527
Free cash flow	6,014	2,809	5,129	389	7,013	6,729	3,722	5,714
Balance sheet items								
Cash and cash equivalents and short-term investments	15,950	14,953	16,815	14,074	17,926	14,705	16,738	22,168
Equity	88,987	82,041	82,940	90,909	93,386	92,865	94,118	107,674
– of which, attributable to equity holders of the Parent Company	78,449	71,398	73,331	80,565	82,722	82,430	83,480	96,589
– of which, attributable to minority interests	10,538	10,643	9,609	10,344	10,664	10,435	10,638	11,085
Interest-bearing liabilities	71,389	87,358	80,921	78,663	74,637	69,042	72,222	71,575
Net debt	51,395	68,307	63,800	64,343	56,474	54,179	55,380	49,407
Interest-bearing provisions	45,372	45,787	45,466	47,691	47,479	46,899	48,412	49,217
Noninterest-bearing liabilities and provisions	98,220	109,850	113,393	107,805	146,404	130,481	133,609	94,700
Net assets, weighted average value	133,391	134,767	138,307	143,001	148,512	150,875	151,247	151,155
Balance sheet total	303,968	325,036	322,720	325,068	361,906	339,287	348,361	323,166
Key ratios (% unless stated otherwise)								
Operating margin	26.0	16.7	11.1	28.2	31.4	15.3	10.7	12.8
Operating margin[1]	25.9	16.8	11.2	20.1	30.8	15.0	10.6	12.9
Pre-tax profit margin	24.3	14.1	9.5	29.3	30.2	13.9	9.6	12.4
Pre-tax profit margin[1]	24.2	14.1	9.5	21.2	29.6	13.5	9.5	12.5
Return on equity[2]	12.7	14.1	14.8	23.2	24.7	24.1	23.0	19.1
Return on equity[1, 2]	14.2	15.5	15.7	19.4	20.9	20.2	19.3	18.7
Return on net assets[2]	12.6	13.5	13.9	17.8	19.6	19.9	20.0	16.6
Return on net assets[1, 2]	14.1	14.8	14.8	15.8	17.4	17.7	17.7	16.3
Interest coverage ratio, times	15.2	6.2	5.1	11.0	17.5	8.5	5.3	4.9
Interest coverage ratio, times[1]	15.2	6.2	5.1	8.1	17.2	8.3	5.3	4.9
FFO interest coverage ratio, times	15.3	8.2	6.8	13.3	18.6	10.9	9.9	8.7
FFO interest coverage ratio, net, times	23.9	11.8	16.0	54.7	52.9	21.8	11.3	21.3
Cash flow interest coverage ratio after maintenance investments, times	10.8	4.3	8.5	1.4	10.3	10.2	6.9	5.6
Equity/assets ratio	29.8	25.7	26.2	28.0	27.9	29.1	28.7	33.3
Net debt/equity ratio, times	0.58	0.83	0.77	0.71	0.60	0.58	0.59	0.46
Net debt/net debt plus equity	36.6	45.4	43.5	41.4	37.7	36.8	37.0	31.5
Interest-bearing liabilities/interest-bearing liabilities plus equity	44.5	51.6	49.4	46.4	44.4	42.6	43.4	39.9
FFO/interest-bearing liabilities[2]	33.7	27.9	31.5	39.9	48.1	53.8	53.8	49.8
FFO/net debt[2]	46.8	35.7	40.0	48.8	63.6	68.5	70.1	72.2
EBITDA/net financial items, times	32.7	15.9	25.1	61.1	62.9	26.6	14.6	20.9
EBITDA/net financial items, times[1]	32.6	15.9	25.1	48.4	62.0	26.2	14.6	21.0
Other information								
Investments	1,821	13,515	4,432	4,729	2,436	3,233	5,435	6,116
Electricity sales, TWh	55.4	45.6	56.5	90.1	51.6	58.6	31.5	53.1
Average number employees	32,170	32,113	32,428	32,231	31,829	31,823	32,811	32,308

1) Excl. items affecting comparability.

2) Last 12-month values.

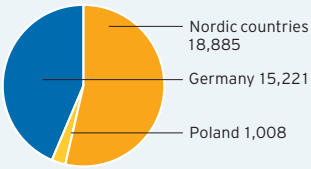
3) Certain figures are adjusted compared to previously published information in Vattenfall´s 2005 Annual Report. See Note 2 to the consolidated accounts, Accounting principles.

Comments

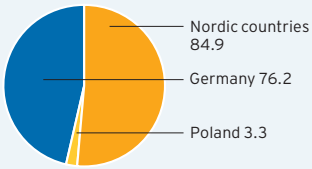
Vattenfall's earnings vary sharply during the year. Normally, the large part of annual profit is generated during the first and fourth quarters, when demand for electricity and heat is at its highest.

FACTS ABOUT VATTENFALL'S MARKETS

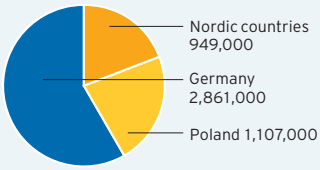
Generation capacity, electricity, MW (2006)



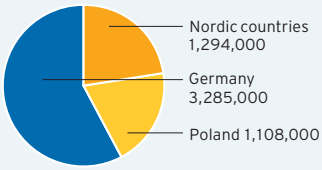
Generated electricity, TWh (2006)



Number of electricity customers (2006)



Number of network customers (2006)



	Nordic countries		Germany		Poland		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
Generation capacity, electricity & heat, MW								
Hydro power	8,399	8,399	2,894	2,894	–	–	**11,293**	**11,293**
Nuclear power	6,736	6,697	771	771	–	–	**7,507**	**7,468**
Fossil-based power	2,967	1,068	11,412	11,371	978	981	**15,357**	**13,420**
Wind power	522	31	12	41	30	–	**564**	**72**
Biofuels, waste	261	160	132	35	–	–	**393**	**195**
Total electricity	**18,885**	**16,355**	**15,221**	**15,112**	**1,008**	**981**	**35,114**	**32,448**
Total heat	**5,351**	**3,440**	**8,727**	**8,697**	**4,986**	**4,996**	**19,064**	**15,964**
Generated electricity, TWh								
Hydro power	30.9	36.4	3.4	3.5	–	–	34.3	**39.8**
Nuclear power	49.2	52.9	6.0	6.0	–	–	55.2	**58.9**
Fossil-based power	3.9	–	66.5	66.4	3.2	3.4	73.6	**69.9**
Wind power	0.5	0.1		–	0.1	–	0.6	**0.1**
Biofuels, waste	0.4	0.4	0.3	–	–	–	0.7	**0.4**
Total electricity	**84.9**	**89.8**	**76.2**	**75.9**	**3.3**	**3.4**	**164.5**	**169.1**
Produced heat , TWh								
Fossil-based power	3.4	1.5	14.3	14.3	11.2	11.4	**28.9**	**27.2**
Biofuels, waste	5.1	5.5	1.2	1.1	–	–	**6.3**	**6.6**
Other	–	0.3	–	–	–	–	–	**0.3**
Total heat	**8.5**	**7.3**	**15.5**	**15.4**	**11.2**	**11.4**	**35.8**	**34.1**
Number of electricity customers	**949,000**	**953,000**	**2,861,000**	**2,916,000**	**1,107,000**	**1,104,000**	**4,917,000**	**4,973,000**
Number of network customers	**1,294,000**	**1,291,000**	**3,285,000**	**3,287,000**	**1,108,000**	**1,104,000**	**5,687,000**	**5,682,000**
Electricity networks								
Transited volume, TWh	81.9[1]	83.5[1]	27.2[2]	28.2[2]	10.4	10.4	**119.5**	**122.1**
Transmission grid, km	–	–	10,000	10,000	–	–	**10,000**	**10 000**
Distribution network, km	187,800	187,700	77,000	76,000	26,600	26,200	**291,400**	**289,500**
Number of employees (full-year basis)								
Business Groups	9,158	8,788	19,821	20,096	2,836	3,029	**31,815**	**31,913**
Group total[3]	–	–	–	–	–	–	**32,308**	**32,231**

1) Excl. generation transiting
2) Excl. transmission grid
3) There are 493 (317) employees in Energy Trading, the Finance activities and other Group Shared Services, and Group staffs.

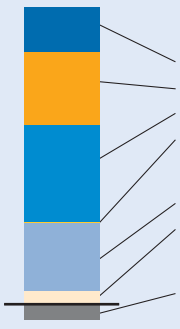
	2006	2005
External electricity trading volume, TWh[4]:	815	1,100

4) OTC and electricity exchange

Pro rata – Generation data corresponding to Vattenfall's ownership in the respective facilities

	Nordic countries 2006	Nordic countries 2005	Germany 2006	Germany 2005	Poland 2006	Poland 2005	Total 2006	Total 2005
Generation capacity, electricity & heat, MW								
Hydro power	8,155	8,155	2,894	2,894	–	–	**11,049**	**11,049**
Nuclear power	4,605	4,577	1,409	1,409	–	–	**6,014**	**5,986**
Fossil-based power	2,953	1,054	11,412	11,371	729	732	**15,094**	**13,157**
Wind power	457	30	12	41	23	–	**492**	**71**
Biofuels, waste	261	160	128	35	–	–	**389**	**195**
Total electricity	**16,431**	**13,976**	**15,855**	**15,750**	**752**	**732**	**33,038**	**30,458**
Total heat	**5,211**	**3,300**	**8,682**	**8,652**	**3,719**	**3,727**	**17,612**	**15,679**
Generated electricity, TWh								
Hydro power	29.8	35.0	3.4	3.5	–	–	**33.2**	**38.5**
Nuclear power	33.7	36.6	11.3	10.8	–	–	**45.0**	**47.4**
Fossil-based power	3.9	–	66.5	66.4	2.5	2.6	**72.9**	**69.0**
Wind power	0.5	0.1		–	–	–	**0.5**	**0.1**
Biofuels, waste	0.4	0.5	0.3	–	–	–	**0.7**	**0.5**
Total electricity	**68.3**	**72.2**	**81.5**	**80.7**	**2.5**	**2.6**	**152.3**	**155.5**
Produced heat, TWh								
Fossil-based power	3.3	1.4	14.2	14.3	8.3	8.6	**25.8**	**24.3**
Biofuels, waste	5.0	5.3	1.2	1.1	–	–	**6.2**	**6.4**
Other	–	0.3	–	–	–	–	**–**	**0.3**
Total heat	**8.3**	**7.0**	**15.4**	**15.4**	**–**	**8.6**	**32.0**	**31.0**

Vattenfall's electricity balance[1]



Own generation and electricity purchases

TWh	2006	2005
Hydro power	34.3	39.8
Nuclear power	55.2	58.9
Fossil-based power	73.6	69.9
Wind power, biofuels and waste	1.3	0.5
Total own generation	**164.5**	**169.1**
Purchased power	52.1	56.9
Spot market	9.2	7.5
Total electricity purchases	**225.8**	**233.5**
Use within the Group	–11.5	–12.5
Summa	**214.3**	**221.0**

Comment:
The total 2.7% decrease in generation is attributable to a sharp drop in hydro power due to very low water supply during most of the year and the loss of nuclear power generation. Nuclear power generation decreased due to a number of prolonged operational disruptions, mainly caused by the incident at Forsmark, but also by a fire at Ringhals and the closure of Barsebäck 2 on 31 May 2005. Fossil-based power increased by 5.3%, mainly due to the acquisition of combined heat and power assets in Denmark. Wind power and power derived from biofuels and waste rose 160%, mainly due to the acquisition of wind power plants in Denmark.

Sales

TWh	2006	2005
Nordic countries	56.4	60.6
Germany	71.2	80.5
Poland	11.5	13.1
Other countries	3.9	5.1
Spot market	51.8	41.0
Total	**194.8**	**200.3**
Deliveries to minority owners	18.7	19.7
Other	0.8	1.0
Total electricity sales	**214.3**	**221.0**

Comment:
The total 3.0% decline in sales for the year is attributable to a drop in sales directly to end customers; however, much of this was compensated by higher sales via the electricity exchanges, mainly Nord Pool and EEX. During the fourth quarter, sales directly to customers in Germany and Poland increased, while in the Nordic countries they showed a decrease.

1) Rounding differences of 0.1 TWh on certain items.

GLOSSARY

Availability Actual electricity generation capability in relation to the maximum possible generation.

Brownfield site Land or premises which has previously been used or developed and where certain infrastructure may exist.

CHP Combined heat and power plant. A plant that generates heat and electricity in the same process.

CSR Corporate Social Responsibility – a concept whereby companies integrate economic, social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

Deep repository Underground facility for the final disposal of spent nuclear fuel. See also SKB's website http://www.skb.se.

Deregulation Abolishing monopoly rights and obligations to open up for competition. Used here as a synonym for liberalisation.

Derivative instruments Financial instruments where the value or change in value is derived from an underlying instrument. Examples of derivative instruments include options, forwards and swaps. Derivative instruments are often used in risk management.

DSO Distribution System Operator. Responsible for operating, ensuring the maintenance of and developing the distribution system in a given area (compare with TSO).

EEX European Energy Exchange, the German electricity exchange. Head office in Leipzig.

Electricity spot market Short-term physical trading in electricity on an exchange.

EPD Environmental Product Declaration. A system based on Type III declarations.

EU 27 The 27 Member States constituting the European Union following the latest enlargement on 1 January 2007.

Ex-ante tariff regulation The approval of tariffs prior to implementation.

Ex-post tariff regulation Tariffs are examined by the regulator after implementation.

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.)

Green Certificates/electricity certificates Tradeable certificates issued for renewable energy. Called electricity certificates in Sweden.

Greenfield site A site or project location where no infrastructure exists.

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.

Kyoto Protocol 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.

Major disruption Extensive disruptions in electricity network operations which result in many customers lacking electricity.

Merit order The order in which capacity is put into use.

Nord Pool The Nordic electricity exchange.

NO_x A general term for various oxides of nitrogen.

NTPA 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.

PSE Polskie Sieci Elektroenergetyczne – Polish Power Grid Company.

Regional network An electricity network in Sweden within the 40–130 kV range.

Regulator The legal authority that supervises the market to ensure effective competition and fair pricing.

Renewable energy sources Non-finite energy sources such as hydro power, biofuel, wind, solar power, tidal power, wave power, geothermal power.

Replacement power Replacement delivery, in accordance with a riparian court decision, to the owner of another power station on the same river.

RTPA Regulated Third Party Access. Access to the network is provided based on published and regulated tariffs for the use of the network.

Retailer Firm at the end of the distribution chain, which normally buys a product from a wholesaler in order to sell it to the end consumer.

Shared power Several parties have the right to electricity from a particular power plant.

SKB Svensk Kärnbränslehantering AB, the party responsible for managing radioactive waste in Sweden.

SO_2 Sulphur dioxide.

Spot market A market where trade is conducted with immediate delivery.

Swap A financial instrument that is a combination of spot and forward transactions, a type of financial exchange agreement.

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).

TSO 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.

Value chain Process for creating value. Within the electricity sector this includes the generation, transmission, distribution, trading and selling of electricity.

Volatility A measure of the extent to which the price of a commodity varies over a particular period.

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)

Vattenfall's history

MILESTONES IN VATTENFALL'S HISTORY

1909 The restructuring of the Trollhättan canal and hydro power plant to the Swedish State Power Board marks the birth of Vattenfall. The Swedish state had bought the water rights in Trollhättan a few years earlier and was now taking an active involvement in this emerging electricity generation technology.

1909–1916 The first large hydro power plants – Olidan, Porjus and Älvkarleby – are built.

1951 Inauguration of the Harsprånget hydro power plant, the world's largest hydro power plant in many respects. During the same year, the world's first 400 kilovolt transmission line is put in operation, stretching from northern Norrland to Hallsberg in Central Sweden.

1952 The entire Swedish national electricity grid is hooked together.

1954 Vattenfall commissions the world's first commercial high-voltage direct current line – between the mainland and the island of Gotland.

1975–1976 Vattenfall's first two nuclear power reactors, Ringhals 1 and 2, are commissioned. During the 1970s and '80s, 12 reactors were built across Sweden, of which seven are owned by Vattenfall.

1992 Vattenfall is transformed from a state enterprise to the limited liability company Vattenfall AB. Responsibility for the national grid – the Swedish high-voltage network – is transferred to the newly formed state authority Svenska Kraftnät.

1995 Vattenfall's board charts out an international growth strategy for Vattenfall.

European expansion 1996–2006

1996 The Swedish electricity market is deregulated. The electricity network operations are legally separated from electricity generation and sales. Vattenfall's international expansion is initiated in 1996 through the acquisition of Hämeen Sähkö, a Finnish electricity distribution company. A representative office is opened in Hamburg, and Vattenfall begins working in the German market through the joint venture company VASA Energy.

1998 The German electricity market is deregulated in April.

1999 Vattenfall agrees to acquire 25.1% of the shares in HEW from the City of Hamburg, with an option for the city to sell another 25.1% to Vattenfall. The Barsebäck 1 nuclear reactor is decommissioned following a decision by Swedish parliament.

2000 In January, 55% of the Polish heat production company EW is acquired in Warsaw, Poland. In August HEW signs an agreement with E.ON to acquire a majority shareholding in Berlin's energy company, Bewag. However, the deal is blocked by the US company Southern Energy (now Mirant).

2002 In January Vattenfall acquires all of Mirant's shares in Bewag. Vattenfall's various acquisitions in Germany are gathered under the name Vattenfall Europe AG, which is formally established in August through the merger between HEW and VEAG, including LAUBAG. Vattenfall thereby becomes Germany's third-largest electricity generator.

2003 In January/February, Bewag is merged with Vattenfall Europe AG. Vattenfall increases its stake in the Polish company EW to 70% and in GZE to 54%.

2005 In April, 35.3% of the shares in the Danish company Elsam A/S are acquired. The nuclear reactor Barsebäck 2 is closed 31 May. In August, Vattenfall announces that it has gained possession of more than 95% of the shares in Vattenfall Europe AG and initiates compulsory redemption of the minority owners' shares.

2006 On 1 January the German brands HEW and Bewag, and the Polish brands EW and GZE, are replaced with the Vattenfall brand. Vattenfall increases its ownership in the Polish companies to 75%. On 1 July a number of Danish wind power and combined heat and power assets are acquired from the Danish company DONG in exchange for ownership stakes in Elsam A/S and I/S Avedöre 2.

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