

Speech at Annual General Meeting on 24 April 2013

President and CEO Øystein Løseth

Looking back on 12 quarters

Thank you for giving me the floor, Mr Chairman.

In February, I presented the quarterly financial report for the twelfth time as President and CEO of Vattenfall. Today the Annual General Meeting is discussing the third annual report that I have signed. So I have had good reason to look back over the last three years before this AGM.

I was appointed CEO in April 2010. Then, in my first quarterly report, I presented my assessment of the situation that we would in future have to endure tough market conditions with low demand for electricity. At the Annual General Meeting on the same day I developed this theme further in my speech: "We will not reach the owner's profitability requirement. Vattenfall has made major acquisitions which are putting pressure on the balance sheet. Demand for electricity is declining."

Strategy 2010

Together with my colleagues in Executive Group Management and on the Board, it was important for me to draw direct conclusions from this harsh picture of reality. The strategy which we set out included an efficiency-boosting programme of SEK 6 billion, a more streamlined organisation, pruned investment plans, divestments and a focus on Vattenfall's main markets of Sweden, Germany and the Netherlands.

The new normal

In summing up 2012, I note that this introductory analysis has proved correct.

Prices on the electricity market have fallen to low levels. Last year's serious consequences of the international economic recession were accompanied by political initiatives with subsidies for new production capacity and decisions that radically changed the preconditions for the energy sector in other ways. We can also see a change in attitude as regards energy use, which contributes to reduced demand. Previous market forecasts have been overturned, and what used to be regarded as "normal" no longer applies. This is the new normal.

It's against this background that Vattenfall, like other energy companies, is forced to rationalise, boost the efficiency of its operations and cut back on its investment plans.

The measures that we planned in 2010 have been successful but don't go far enough. Vattenfall will now reduce the number of employees in the whole Group by 2,500. Other energy companies which operate on the same market as us have announced layoffs of over 10,000 employees in each case. The cost-cutting programme that we are currently implementing is not unique to Vattenfall, but is rather a symptom of the challenges faced by the whole industry.

The macroeconomic situation continues to look bleak. The OECD estimates that the eurozone's economies shrank by 0.4 per cent in 2012. The forecast for 2013 sees the economy continuing to contract, at a rate of 0.1 per cent. Growth is not expected to resume until next year, and then at a modest 1.4 per cent.

Strategy yields results

Thanks to the measures that we have taken in line with our strategy, we were able to report an underlying operating profit for comparable units in 2012 of about the same level as the previous year. Excluding divested companies, we achieved SEK 27.5 billion in 2012, compared with SEK 28.2 billion in 2011.

We reached our target to cut our annual costs by SEK 6 billion one year ahead of schedule. These savings correspond to about 11 per cent of our cost base. We are reducing our costs by another SEK 3 billion in 2013, and in a further step, by SEK 1.5 billion in 2014.

The divestments that we carried out have greatly strengthened Vattenfall's liquidity, and our net debt has been reduced. We have also continued to cut back on our investment programme.

Vattenfall produced 178.9 terawatt hours of electricity in 2012. That was 7 per cent more than in 2011.

Our target to improve the availability of our nuclear power plants was largely reached in 2012. Their total availability rose from 72 per cent to 83 per cent – the highest average level in five years.

Vattenfall's Swedish hydro power plants reached their highest volume ever in 2012 thanks to good water supplies, especially in the spring months. This high output of both nuclear and hydro power meant that we could largely compensate low electricity prices with higher production volumes.

111 per cent more wind power

In this context, I would also point out that Vattenfall's production of electricity from wind power in 2012 beat all earlier records. The year before my appointment as CEO, Vattenfall produced 1.7 terawatt hours of electricity from wind power. In 2012 we produced 3.6 terawatt hours. That is an increase of 111 per cent.

Vattenfall now has more than 900 wind turbines in operation in Sweden, Denmark, Germany, the Netherlands and Great Britain. And their numbers are growing.

Last autumn, I inaugurated the offshore wind farm at Ormonde, our most advanced facility. It consists of 30 wind turbines off Barrow-in-Furness in the Irish Sea. Our wind farm at Swinford in Great Britain went into full operation in September.

Installation of the onshore wind farm at Zuidlob, to the east of Zeewolde in the Netherlands, will be concluded this spring.

The DanTysk offshore wind farm with 80 turbines in the North Sea, 70 kilometres from the island of Sylt, is a joint venture between Vattenfall and Stadtwerke München. It is planned to start operation in early 2014.

Earlier this month, we began the groundwork for the wind farm of Hjuleberg in Falkenberg municipality. When it is ready for operation at the end of 2013, it will be Vattenfall's largest onshore wind farm in southern Sweden.

2012 profits in relation to our financial targets

Let me now present Vattenfall's results for 2012.

I will start with the new financial targets for Vattenfall that the extraordinary Annual General Meeting set at the end of November last year.

- Return on capital employed was 8.4 per cent, which should be compared with the target to reach 9 per cent over a business cycle.
- Our debt/equity ratio was 72.3 per cent, which is within the target interval of 50 to 90 per cent.
- Funds from operations (FFO)/adjusted net debt amounted to 22.4 per cent, which is within the target interval of 22 to 30 per cent.
- The Annual General Meeting will comment today on the dividend payout of SEK 6.8 billion proposed by the Board. This corresponds to 40 per cent of net income, and is thus within the target interval of 40 to 60 per cent.

Continuous improvements

Part of our work to make Vattenfall better equipped to meet the demands of a changing world centres on Operational Excellence, a term which describes our ambition to create a culture of striving for continuous improvements. We want to ensure that we work at all times to add value as well as challenge inefficient routines and ways of working.

We are reinforcing our work on Operational Excellence with an overall Group function designed to lead, support and coordinate all our business units. They will for instance create a shared method platform for working with necessary improvements. Indeed, we will continuously seek out improvements – not because we have to but because we can. We are involving all employees and leaders in this work.

It's my ambition that Vattenfall will become the leading company and an example in the energy sector as regards productivity and efficiency, indeed as regards everything covered by the term Operational Excellence.

A key aspect of Operational Excellence is safety.

Vattenfall applies zero tolerance to both workplace-related accidents and absences due to work-related illness. All employees should have a safe, healthy and motivating work environment. We are working to develop management systems and to improve our safety culture to get there. Our target for 2012, namely that absences due to work-related illness should drop by at least 15 per cent, was exceeded by a wide margin, declining by over 30 per cent. Fewer than 150 accidents occurred compared with 2010. Vattenfall is now among the companies in the sector with the lowest level of absences due to work-related illness. Among

the seven largest electricity producers in Europe, Vattenfall has the second lowest incidence of injury. We will continue our efforts to reduce the number of injuries further.

Changes in the energy landscape

I would now like to develop the theme raised earlier by myself and the Chairman of the Board Lars G Nordström about the changes in the energy landscape.

The price of carbon dioxide in the European emissions trade has fallen sharply since 2008 and is now approaching zero. One consequence of this is that lignite is still one of Vattenfall's most profitable sources of energy. In contrast, the profitability of gas power, which plays an important role in balancing weather-dependent power from wind and sun, has greatly declined.

Vattenfall's impairment losses on the value of its assets in the Netherlands are a consequence of the greatly worsened margins in gas power. This development will in time lead to an energy system that is unable to satisfy the demands for flexibility and climate-efficiency. It can in the worst case lead to problems in electricity supply during certain periods.

At the same time, many of Europe's support systems for renewable energy are failing. The Spanish government has been unable to pay its promised subsidies, and the German government has indicated that its system of guaranteed revenues for producers of renewable energy, known as feed-in-tariffs, cannot be allowed to expand further. The countries simply cannot afford it.

We consider that the European emission trading system for carbon dioxide is the right one, but if Europe is to reach its target for reduced carbon dioxide emissions, the current surplus in emissions rights must be limited so that the energy producers can pick up clear price signals that make it profitable for them to change over to production with low carbon dioxide emissions. The turnaround of the energy system will become cost-effective and thus possible only by means of well-functioning emissions trading, and not of extended and more expensive subsidies.

Europe stands at a crossroads: the trend toward increased regulation of the energy markets and detailed political control of the energy sources and products permitted on the market may continue. Alternatively, the EU could restore well-functioning emissions trading and trust that the price signals on the market will lead to optimal investments. Europe is now moving towards increased regulation and low carbon dioxide prices. The climate, Europe's citizens as well as Vattenfall would benefit from a change of course.

Implementation of sustainability targets

As you have heard, I have certain views on how Europe's framework policy designed to reduce carbon dioxide emissions is working. Irrespective of that, we at Vattenfall have our own clear targets to live up to.

At the same time as responding to these challenging market conditions, Vattenfall must build up a sustainable portfolio of production and products. We shall both "generate a market rate of return" and be a "leader in developing environmentally sustainable energy production", to quote the terms used in our owner's assignment.

Vattenfall's Board has set sustainability targets for the company's operations. One starting point for these is the EU's 2020 goal that prescribes 20 per cent lower carbon dioxide

emissions and 20 per cent renewable production as well as a 20 per cent rise in energy efficiency. Vattenfall has consequently set sustainability targets within the same areas as the EU.

The Board has set very clear objectives – To reduce the company's CO₂ emissions to 65 million tonnes of absolute emissions by 2020, to have a higher growth rate than the market within renewable energy production and to contribute to energy efficiency.

I observe that we have already started on the journey towards reduced carbon dioxide emissions. Our carbon dioxide exposure has been reduced – Vattenfall's emissions have declined every year since 2010.

The reduction from 2011, when emissions were 89 million tonnes, can be explained mainly by the divestment of our Polish operations. However, emissions are expected to rise in 2013 and 2014 due to the completion of coal and gas-fired plants, including the hard coal power plant at Moorburg outside Hamburg and the lignite-fired power plant in Boxberg in eastern Germany. But I would like to stress that no decision on new investments in coal-fired power plants has been taken since 2006.

Further measures are needed to reduce emissions to 65 million tonnes, and Vattenfall is looking into alternatives to ensure that this target is reached by 2020.

CCS, the technology of capturing and storing carbon dioxide, is a way of reducing these emissions further, but the official permits required for this storage has not yet been granted in Germany. So further measures are needed to reduce emissions all the way down to 65 million tonnes. Possible alternatives that we have mentioned are the divestment of our Danish heat and power operations and of our share in the lignite-fired combined heat and power plant at Lippendorf in Germany.

Investment plans

To reach our target of outpacing the market in renewable electricity production, we must prioritise wind power in our budget for new investments. In order to sustain such extensive investments, we must at the same time maintain the positive cash flow from our existing plants.

The strategy that we decided on in 2010 was split into two phases, a consolidation phase up to 2013 followed by a growth phase. This division is no longer valid in view of changed market conditions. Instead of planning for growth in general terms, Vattenfall must for the foreseeable future focus on its existing assets and on growth in the sector of renewable energy.

The whole investment plan for the years 2013 to 2017 means a reduction compared with the previous five-year period, namely the years 2012 to 2016, of just over SEK 20 billion. The main part of the total investment sum is allocated to the production of electricity and heat. The remainder is mainly accounted for by investment in the electricity and heat grids and in IT. Allocation for new capacity, known as growth investments, represents just over a quarter of the total sum.

The main part of our growth investments are in turn allocated to technologies with low carbon dioxide emissions (wind, hydro and nuclear power as well as biomass). Wind power is the largest single category in these investments. In the next five years, Vattenfall plans to invest

some SEK 20 billion in new capacity, distributed about equally between onshore and offshore wind power.

This investment plan remains extensive even after adjusting for the new circumstances. Let me summarise this part of my presentation with a single sentence: in the next five years, the main part of our growth investments will go to wind power.

Smart energy solutions

Part of our green strategy is to go further in supporting consumers to simplify their lives and act in a more ecological and energy-efficient way. That's why we are working hard on improving and broadening our customer offer. Vattenfall intends to enable smart energy solutions. This concerns everything from package deals comprising heat pumps and energy, electric cars and solutions for boosting energy efficiency in small homes to offering our customers energy advice.

Vattenfall can contribute to a more sustainable energy supply

Vattenfall has much to contribute to making all of Europe's energy supply more sustainable in the future. If the transfer capacity between and within the Nordic and continental north European electricity markets increases, we can contribute to ironing out the fluctuations in German electricity supply that is becoming increasingly dependent on weather and wind. Our Nordic energy looks like an attractive alternative to fossil-fired power on the continent, gas from Russia or from unconventional sources, such as fracking – both from an environmental perspective and as regards security of supply.

In this context, I would also stress the importance of nurturing the production capacity of Swedish hydro power. It would be bad climate policy to introduce restrictions that would force hydro power to be replaced by other sources of energy.

Conclusion

In my presentation I have described the great challenges facing Vattenfall. At the same time, I would like to say that Vattenfall enjoys relatively good preconditions compared with the rest of the European energy sector for tackling the circumstances prevailing in the new energy landscape. We have a well balanced production portfolio as regards geographical spread, energy sources and carbon dioxide exposure. Half of our production generates little or no carbon dioxide emissions. This is a real strength whenever we encounter tough conditions in the future.

Let me now conclude my presentation with a summary.

- The bleak forecasts that I made three years ago have proved to be true.
- We in the Executive Group Management feel that the markets will be characterised for the next few years by continued low demand for electricity, high supply capacities and low prices.
- This means that Vattenfall will continue to face great challenges. We must consequently make our operations even more efficient and strengthen our financial position so that we can meet the targets that our owner and we ourselves have set.

- And we will also have to increase our flexibility by creating a culture in which continuous improvements, in the sense of operational excellence, are a natural part of our day-to-day activities.

Thank you for your attention.