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EDITED TRANSCRIPT

Full Year 2022 Vattenfall AB Earnings Call

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PRESENTATION

Andreas Regnell *Vattenfall AB (publ) - Senior VP & Head of Strategic Development*

Welcome to Vattenfall and this year-end report webcast.

I'm Andreas Regnell. And with me in the studio, I have as always our CEO, Anna Borg; and our CFO, Kerstin Ahlfont.

During this session, we will go through the main events and the financial performance of 2022. After the initial discussion, we will, as always, open up for questions. And as customary, we have the financial standard material available on the web. Let's start.

Anna, 2022 was quite an extraordinary year, wasn't it?

Anna Borg *Vattenfall AB (publ) - CEO & President*

Yes and in several different aspects, I would say: first of all, to manage the day-to-day business in this very volatile market situation; but also to support our customers. We see a huge increase of inflow to our customer service, both on telephone and on the web. And we are trying to support the best way we can, but we are having problems keeping up from time to time. We have seen huge price swings in the market. That has an impact on our customers, but it also has an impact on us from a liquidity perspective and when it comes to counterparty risks. We have had challenges supplying gas at competitive prices for our heating business in continental Europe. And these are just a few examples.

I think that energy is really on top of the agenda everywhere, also in the public debate. And I think that's good because it's needed in order to sort of get through this transition. So I'm happy about that. Then I'm also especially happy that nuclear is back on the agenda and is now seen as a natural part of the Swedish energy system. And we are working hard to bridge the gap between supply and demand of fossil-free electricity.

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Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Yes. So an exciting year. And what about the financials, Kerstin?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

Well, the business is doing well. The underlying operating profit grew by SEK 6 billion to SEK 37 billion. The balance sheet is strong. FFO over adjusted net debt is at 55%, and we have a good liquidity position. The reported net profit, however, is heavily impacted by temporary accounting effects related to our hedging business but also negative development in the Nuclear Waste Fund.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

We will get back to the financials in a bit, but let's start with a movie covering some of the key developments during 2022.

(presentation)

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

And all this in only 1 year. Anna, is there anything else you would like to mention?

Anna Borg Vattenfall AB (publ) - CEO & President

Well, I think that this shows that, even if the market is turbulent here and now, we are focusing on long-term solutions at the same time. I mean new fossil-free electricity production like we saw with Hollandse Kust Zuid here or lowering CO2 emissions like we do with the Carpe Futurum project, but we're also preparing to make sure we can add even more fossil-free capacity long term: for example, regarding this offshore project in Finland, wind power, but also when it comes to this pre-study of the small modular reactors at the Ringhals site. So I think that one thing that is very important that was maybe not mentioned in this film is the -- both expansion and maintenance of the electricity grid, which is very much needed in order for the entire energy system to work. And we see a clear increase in number of requests to connect to our grid, and that will continue.

Maybe one additional piece of positive news is that we also got the approval and the concession to build the power lines to Oxelösund, which is needed for SSAB in order to facilitate their electric arc furnace.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Yes, that's good news. And now let's get back to the numbers. Kerstin, in the beginning, you mentioned the strong underlying profit, a strong balance sheet and good liquidity but also large temporary negative effects impacting the net profit for the year. And let's start in that end, the net profit for the year. And I think it was expected, for it to be lower than 2021. That was an exceptional year with large positive one-off effects like the nuclear settlement, the sale of Stromnetz Berlin and SEK 10 billion of positive fair value adjustments, but this year, in the other direction, a very significant difference between underlying profit and profit for the year. Let's do some more explanations.

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

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Yes. And the answer actually lies in what you mentioned last there, the changes in fair values.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

So by fair values, you mean the market of futures and forward contracts, primarily in the electricity and gas market, but can you explain how this works?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

Absolutely. So Vattenfall use futures and forward contracts, meaning that we enter into agreements to buy or sell electricity or gas at a specific price and at a specific time in the future. And we call this, normally, hedging. And we do it in order to lock in our margin for both the generation portfolio but also for our end customer business. And if you take the example then on our electricity sales business on the continent -- and then you need to remember that on the continent Vattenfall produce less electricity compared to what we sell to customers, meaning we need to source electricity on the wholesale market. And we do that to a certain extent by using hedges.

So let's say that we have an agreement with an end customer where we sell 1 megawatt hour at a price of EUR 52 to be delivered in 2024. And then to cover for that, we enter into a futures contract where we buy 1 megawatt hour in 2024 for EUR 50. And that contract has a value that gets recorded in the balance sheet. And assume then that, 3 months later, the price for electricity in 2024, for whatever reason -- and that is the price that this future contract's value is based upon. Say that, that price has increased, but we still have the contract to buy for EUR 50. And obviously that contract has then become more valuable. And that is what we in accounting language call that it has a higher fair value. And that change in fair value needs to be recorded somewhere, and in most cases, we utilize something that is called hedge accounting. And then that change in fair value is recorded in the balance sheet only, but hedge accounting cannot be used for all contracts. For hedge accounting, you need, for example, certain documentation or certain credit quality on your counterpart. And if that is not there, then that change in fair value ends up in the profit and loss statement and impacts your EBIT, but for Vattenfall you need to remember that we have another side of the trade.

We have this contract where we have sold 1 megawatt hour for EUR 52 in 2024, but that contract is only recognized in the P&L when we deliver that electricity. And this means that we have a certain imbalance in the profit and loss statement until both contracts are actually realized because then they both come into the underlying EBIT and there they will net themselves out. And what remains over time in the underlying EBIT is your underlying margin. And in this, then, specific example, that is then EUR 2. And of course, this is just one example. And this can go in different directions, but even if it would be sort of a negative fair value, these are the principles that apply.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Important to understand, clearly. I mean, how does this connect to the market price developments in Vattenfall during '22?

Anna Borg Vattenfall AB (publ) - CEO & President

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Well, in order to answer that, I would like to set the scene a bit by saying a few words on the market development over the last 1.5 years. I mean, even prior to Russia's invasion of Ukraine, we saw prices increasing dramatically; and that is what you see on the right-hand side of this graph. That was due to increased gas prices and due to unfavorable weather conditions. And at that time, we thought that this was a dramatic market development. And now if you look at it in the context of '21 and '22, you can see that those movements were, although big, relatively small to the movements we've seen in 2022. And the reason for that is that, in the beginning of '22, the general belief was that prices would go down after the heating season when you use less fuel. That is usually what happens, but instead, the prices continued to go up, mainly due to the fact that gas prices was increasing after Russia's invasion and starting the war in Ukraine; and because we saw lower nuclear availability, especially in France. So instead, the prices continued up. And they actually peaked during the summer, which is very, very unusual. Then we move into the winter season, where we are now. It's unusually warm, which means that there are less fuels being used for heating. The gas storages are relatively well filled. And this has led to a steep price decrease in the fourth quarter.

So connecting this back to the fair value logic that Kerstin just described, this means in practice that, during the last half of 2021, we had increased prices and Vattenfall had increased fair values. So we had plus SEK 10 billion of fair values when we ended 2021. Some of these were realized in 2022, going into the underlying EBIT, as Kerstin described, and then out of fair values, but when the prices dropped in Q4, we can see that the fair values of the contracts we now have for future deliveries have gone down. So the swings have been very, very big, but the business is doing well because the margins are locked in. This is accounting effects. They are temporary. It's not money in or out of Vattenfall, so the result is good. The cash flow is good. The liquidity is good and the balance sheet is doing fine.

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

And maybe just to add to that. I mean this is only a portion of our contracts. For the majority of the contracts, we apply hedge accounting. And historically this has not had a large impact on our profit and loss statement, but the reason why it has it now is these large price fluctuations that we see.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

So clearly a very important thing to understand to interpret our results for this year, but let's move out of that and go into the underlying results for the different businesses.

Anna Borg Vattenfall AB (publ) - CEO & President

Yes. And the underlying EBIT actually shows how the business is performing. And when it comes to our Wind business, we have more than doubled the result in '22 compared to '21. That is mainly due to 2 things. It's increased prices for the wind power that we actually produce, but it's also more production. We have more wind farms up and spinning. So for example, Danish Kriegers Flak was up all year of 2022, while it was only partially there in 2021.

In our Customers & Solutions business, we're also doing better compared to the year before. That increased result is mainly due to 2 things. The first one is a sourcing effect and the second one is that

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more customers are choosing Vattenfall. We have increased our customer base with more than 400,000 customers in Germany during the year. And it seems like the customers are appreciating the sort of stability that an established player like Vattenfall can provide. And despite this increase in customer service calls and the fact that we're not always able to sort of respond within the time that we would like, we still see an increase in customer satisfaction.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

And that's very good, and we'll get back to that when we discuss the strategic targets.

Anna Borg Vattenfall AB (publ) - CEO & President

Yes.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Okay, so a higher result from Wind and Customers & Solutions. How about the other segments, Kerstin?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

Well, if we start with Distribution: There we have a lower result. And the main effect there in the year-over-year comparison is because we divested our grid operations in Germany last year, but we also see increased costs for the transmission networks, mainly then in Sweden.

If you look at the Heat business. There we also see a lower result, which is due to unfavorable clean spark spreads. And they have actually been, on average, negative due to the high gas prices. The fuel prices, however, we adjust for those in our heat price to the end customer, but that comes with a time delay. And we also hedge parts of our spread exposure on the continent, but the result from the hedges are reported in the Power Generation segment.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

So let's go to the Power Generation segment, Anna.

Anna Borg Vattenfall AB (publ) - CEO & President

Yes. Here we have a lower result compared to 2021. That's mainly due to lower achieved prices in the Nordics due to price area differences. And although we have covered this in our earlier quarterly reports, maybe it's good to remind ourselves on why this is. We hedge our Nordic production in the so-called system price, the SYS. But we have our hydro production, mainly in the northern part of Sweden, where the prices have been lower, so that means that the system price is not an effective hedge for our production the same way it used to be historically. And this has caused losses. That has also meant that we have decreased our hedge ratio for our Nordic business. And this is now gradually becoming visible in our numbers, if you look at those.

And in Q4, in addition, there was very small price area differences between the different areas in Sweden, which means that the achieved price in the fourth quarter is actually EUR 55 per megawatt hour, which is much higher than it's been during the earlier quarters in the year. And then we also have a

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lower realized trading result for the full year compared to '21. So that's the combination of factors that gives these results.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Thank you. And now as we present the year-end result, we also discuss the strategic targets. And let's start with the financial metrics since we are on the topic.

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

Absolutely. And as I mentioned in the beginning, the balance sheet is strong and we have a good liquidity position. And if we look at our capital structure metric, FFO over adjusted net debt, that ends up at 55%. And then we have this impact from received margin calls, and if we exclude that, then we end up at roughly 47%. And that is actually almost on the same level as last year despite the large one-offs we had then with the divestment of Stromnetz Berlin and the compensation we got in Germany for the early closure of nuclear. And the reason why we can keep the same level is that we have a strong and good underlying EBITDA this year.

Anna Borg Vattenfall AB (publ) - CEO & President

And when it comes to our return on capital employed, if I may, that is based on the reported EBIT, which means that we have these temporary accounting effects impacting that, which is why it's 4.2%, but again if we then look at the underlying level connected to how the business is doing, the return on capital employed is 12.5%, which is higher compared to last year when the corresponding number was 11.5%. And this is also one of the main reasons why our Board of Directors have decided to propose a dividend of SEK 4 billion for the year of 2022.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Good. Let's now move over to the other strategic targets.

Anna Borg Vattenfall AB (publ) - CEO & President

Right. So if we start at the top with our customer engagement, we can see that, that is increasing. We measure that as our Net Promoter Score. And we're, of course, very happy about that because it's happening despite all the challenges in the market for our customers. We also see that we improve when it comes to CO2 emission intensity. So that is becoming lower. To some extent, there is an effect of the warm winter here, but also long term we see the same trend.

I'm especially happy that we also see an increase when it comes to engagement among our employees because that is very important for us when we are sort of now executing on all these quite large and challenging projects that we need to deliver on. And then we have improved also from a safety perspective. We measure that as lost time injury frequency. And we now see some results from the safety initiatives that we started and talked about earlier in 2022, so I'm very happy to see that, that is now bringing results, but we are not done, so we will continue to focus on this.

And then Kerstin and I already covered the financial targets, which are also strategic, of course.

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Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Yes, well, a reasonably green list there. We also published our 2-year investment plan.

Anna Borg Vattenfall AB (publ) - CEO & President

Yes, and we are increasing our investments. The net investments over the next 2 years are SEK 77 billion. SEK 50 billion out of that is growth, and it's mainly happening in fossil-free electricity production. In short term, it's the mature projects, so mainly wind. We're also expanding and maintaining our electricity grids, so in total for these 2 years, we put SEK 11 billion into our grids. And that is really needed in order to be able to meet this increase of requests to connect both from industries transforming but also from consumers who would like maybe to have their own solar panels, et cetera, but I think it's important to say that this is only a 2-year picture. Many of our investments are happening over much longer time periods than that, so this is heavily impacted by exactly what projects are sort of on the line exactly these 2 years, but we are increasing our investments also long term.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

You're mentioning that we're doing a lot of big projects. And one thing that has been high on the agenda during the last year is the inflation. How have we handled the cost inflation in all this?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

For the projects that are already decided, we have typically already sort of contracted the suppliers, so there we have actually limited impact from the inflation when we talk about the projects that are in construction now. However, for future projects, there we will see an impact on project costs if inflation remains on these levels. And there we try to have very good collaboration with our suppliers and being innovative and find new ways. And one example is that we are looking into increasing flexibility in the contract when it comes to the raw material so we don't have to lock in the commodity price at a very high level for future projects.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Good. Another topic: Last year, we talked a lot about political interventions. And I think there has been quite a lot of it, or at least discussions on it lately. What do you think are the latest development and the impact on Vattenfall?

Anna Borg Vattenfall AB (publ) - CEO & President

Well, it is challenging times in general, of course. You see that in all of Europe. And I think that extraordinary times also require extraordinary efforts. And that is the main reason why we see a lot of compensation schemes from governments throughout Europe towards the customers, but there is also the revenue caps also decided on the EU level and implemented in each of the countries. They've been implemented or are being implemented from December last year and onwards. And in Denmark and Germany and the Netherlands, they have already been implemented in December, so we have 1 year of impact in 2022. And the impact on Vattenfall was approximately SEK 150 million, so very limited. Then in Sweden and U.K., we expect this to be implemented and start this year. And if we look at the price level

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on the market right now, the impact on Vattenfall is very limited, but that can, of course, change quickly if the prices start to increase a lot again.

But I think it's important to say that the root cause of the high prices is not the market mechanism. It's the gap between supply and demand of fossil-free electricity in Europe and the high gas prices. So the revenue caps, the market interventions, et cetera, they create uncertainty in terms of how this market will work. And there is a very large risk that, that will sort of halt investments because investors see this uncertainty. And the only way out of this situation is actually to get rid of the dependence of gas so you're not impacted by the gas price and then invest into fossil-free generation and grids in Europe, and that's the only way out.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Very clear that that's the only way out. And that actually concludes this part of the session, and soon we'll be back with the question-and-answer session. Thank you.

QUESTIONS AND ANSWERS

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

So time for questions. And I have from Andrew Moulder.

Andrew Moulder - CreditSights

When do you expect to take the final decision on the Berlin heat business? Is there a time line for firm offers from the bidders?

Anna Borg Vattenfall AB (publ) - CEO & President

We are working on that process. It's progressing very well, and we expect to make a decision during 2023.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

From Matas Kadusauskas, Covalis Capital.

Matas Kadusauskas - Covalis Capital

Your retail recorded another very strong quarter. I would assume it includes positive results from managing the hedge book, sell-backs. Can you confirm this? Can you as well explain how you adjusted your book given structural decline in demand?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

Yes. I mean we can confirm that. Parts of the results in business area Customers & Solutions is because of the sourcing activities and our hedging activities there. And we were also able to sell back some volumes that our customers did not need, but we will not go into details exactly how we are managing our sourcing books given the changes that we have seen in the market.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Thank you. Then from Samu Wilhelmsson:

Samu Wilhelmsson - Nordea

In Q4, we saw higher transmission capacity between price areas SE2 and SE3 resulting in a dramatic narrowing of price area differences in Sweden. Throughout the year, you have stated adjusting your hedging strategy due to large price area differences, resulting in lower hedging ratios. Are you now adjusting your strategy back to hedge more now when the price area differences have narrowed? At least your change in hedge ratio for 2024 would indicate so.

Anna Borg Vattenfall AB (publ) - CEO & President

No, we have not made any additional changes in the hedge strategy. It is, of course, good that the price area differences are smaller in the last quarter, but the sort of fundamentals in the market haven't changed, so we still look at the risks the same way.

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

No, I think that's exactly -- that was very clear and good answer.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Yes. And then from Maz Plechinger, EnergyWatch.

Maz Plechinger - EnergyWatch

With inflation and increasing interest rates, investment costs are higher across the board, be it electricity grids, charging infrastructure or production plants. At the same time, you are poised to increase investments in nuclear in the coming year. How will all of these affect your ability or indeed willingness to keep up the investments in offshore wind? What difference would it make if more governments implemented upfront cost -- what difference would it make if more governments implement upfront costs, be it lease or concession payments?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

Well, I think it's a good observation, of course, that the return requirements are going up because of increasing interest rates. And that goes for the investors we work with. And that goes also for us in Vattenfall when we look at projects, but we have a sort of an increasing investment plan, anyhow, and where we are looking at different types of investments, where we are investing heavily in wind, but also we have started the feasibility study for nuclear. But here we need to time investments, of course, over time. And all investments will not come at the same time, but this is part of our strategic portfolio discussions that we have these days.

Anna Borg Vattenfall AB (publ) - CEO & President

And maybe just to add to that. We are constantly making prioritizations when it comes to investments. And as I indicated earlier, these uncertainties around the market setup and possible price caps, et cetera,

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of course, increases the uncertainty, also in some of the projects that we have planned for earlier, so we will have to evaluate that as we go.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Thank you. From Anton Tigerstedt, Montel news.

Anton Tigerstedt - Montel news

Are Vattenfall mulling to book LNG import capacities at one of Germany's new terminals which are due to come online later this year? FSRUs Wilhelmshaven (inaudible). If so, how much volumes are you aiming at?

Anna Borg Vattenfall AB (publ) - CEO & President

No. We are not aiming at booking capacity there. We are sourcing on the market hubs in Europe when we need gas.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Thank you. Andrew Moulder is back.

Andrew Moulder - CreditSights

When I look at your cash flow development, there is a change in working capital and the change in short-term investment, with both of these movements mostly due to margin calls. Why are these not both featured in working capital? Are these actual cash flows, or are they non-cash adjustments to EBITDA?

Kerstin Ahlfont Vattenfall AB (publ) - Senior VP & CFO

So we have changes in working capital, of course, and due to the margin calls, where there has, sort of comparing from the start of the year to the end of the year, it has been an outflow of margin calls. So that is also visible in our working capital, but we also have other changes there. For example, we had, when we started the year, inventories in terms of EUA certificates which we also sold off in the fourth quarter, which had sort of counteracting effects on working capital.

Andreas Regnell Vattenfall AB (publ) - Senior VP & Head of Strategic Development

Yes. Okay, thank you. Any more questions? I haven't checked if there are any questions on the phone. No questions on the phone and no more questions, so thank you all for attending this year-end report webcast. And welcome back in the Q1 report. Thank you and goodbye.

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