

Energy

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NOK million	2007	2006	% change prior year
Operating revenues	6,468	7,309	(12)%
Earnings before financial items and tax (EBIT)	1,303	1,457	(11)%
Items excluded from underlying EBIT	(119)	7	>(100)%
Energy underlying EBIT	1,184	1,464	(19)%
RoaCE	18.0%	23.0%	na
Number of employees	212	201	na

Operating and financial statistics

	2007	2006	% change prior year
Direct production cost, incl. transmission (NOK million) ¹⁾	490	505	(3)%
Power production (GWh)	11,018	8,326	32%
External sourcing (GWh) ²⁾	8,760	11,469	(24)%
Internal contract sales (GWh) ³⁾	14,109	15,897	(11)%
External contract sales (GWh) ⁴⁾	1,042	1,204	(13)%
Net spot sales (GWh) ⁵⁾	4,629	2,698	72%

1) Including maintenance and operational costs, transmission costs, property taxes and concession fees

2) Including long-term sourcing contracts and industrial sourcing in Germany

3) Internal contract sales in Norway and Germany, including sales from own production and resale of externally sourced volumes

4) External contract sales, mainly concession power deliveries and volumes to former Hydro businesses

5) Spot sales volumes net of spot purchases.

Variance analysis Energy

NOK million	
Underlying EBIT 2007	1,184
Underlying EBIT 2006	1,464
Variance underlying EBIT	(280)
Margin	(1,195)
Volume	1,054
Equity accounted investments	(45)
Other operational costs, net	(117)
Depreciation	23
Variance Underlying EBIT	(280)

Market conditions

Market statistics

NOK per MWh	2007	2006	% change prior year
Southern-Norway spot price (NO1)	206	397	(48)%
Nordic system spot price	224	391	(43)%

The average Nordic system price in 2007 declined by 43 percent compared with the average price in 2006. In 2007, the Nordic electricity market was dominated by low prices and high production, driven by periods with extraordinary reservoir inflows and hydropower production in Norway. By contrast, 2006 was characterised by dry hydrological conditions and high spot prices. In the third quarter of 2007, record high hydropower production and capacity constraints in the transmission grid lead to a decoupling of spot prices in Southern-Norway from the other Nordic price areas, with an average price for the quarter 38 percent below the system price.

Electricity prices on the European continent were influenced by a significant drop in the price of CO₂ emission rights. In the second half of 2007, CO₂ emission rights were priced at nearly zero value as the market was in a large surplus of CO₂ quotas not transferrable to the new EU emission trading scheme implemented from 1 January 2008. In Germany, which represents a key market for imports and exports to/from the Nordic region, the spot price quoted on the EEX power exchange averaged at EUR 38.0 per MWh, a decline of 25 percent from the average price of EUR 50.8 per MWh in 2006.

Outlook

Average water reservoir levels in Norway were reported at 77 percent of full capacity at the end of the fourth quarter, which is 5 percent higher than the normal level for this time of year. Hydro's water reservoir levels were 13 percent above the normal level at the end of 2007.

Both production capacity and spot prices in the Nordic electricity market are heavily influenced by hydrological conditions. Capacity constraints in the transmission grid may also expose Hydro to regional prices that sometimes differ from the Nordic system price.

Effective from 1 January 2008, the second phase of the EU greenhouse gas emission allowance trading scheme (ETS) was implemented. The new regulations will likely increase power producers' CO₂ emission costs compared to 2007 levels, thereby contributing to higher power prices.

Partly through common pricing of CO₂ emission rights and through increased interconnector transmission capacity, Nor-

dic power prices are expected to be increasingly influenced by power prices and generation fuel costs on the European Continent. However, hydrological conditions and local supply and demand factors, such as temperature and weather conditions, will continue to have a strong influence on price formation in the Nordic region.

Key development activities

Through our investments in associated partnership companies, we are developing positions in the solar industry across different technologies and parts of the value chain. In 2007, we acquired a 23 percent interest in the US-based solar company Ascent Solar Technologies Inc., which is developing new technologies for thin film manufacturing. In the second quarter, we established the HyCore ANS partnership with Umicore SA of Belgium for the development of a new solar-grade polysilicon manufacturing process. Hydro also holds a 16 percent interest in Norsun AS, which is engaged in several solar business development initiatives, including the construction of an ingot pulling and wafering plant in Årdal, Norway.

Underlying results of operations

OPERATING REVENUES

Operating revenues for Energy declined by 12 percent to NOK 6,468 million in 2007. The decrease reflects lower realized prices on net spot volumes sold in Norway.

Operating revenues in a given year is largely a function of hydropower production volumes, Nordic electricity market prices for volumes sold in the spot market as well as volumes and prices for internal and external contract sales. In addition, revenues are influenced by unrealized gains/losses for derivative and embedded derivative contracts accounted for mark-to-market. As a result, operating revenues for Energy can vary significantly from quarter to quarter and year to year.

UNDERLYING EBIT

Underlying EBIT for our Energy business amounted to NOK 1,184 million in 2007, down from NOK 1,464 million in 2006. The decrease is caused by negative results from solar partnership companies, somewhat higher operating costs and lower prices realized on net spot sales, which more than offset the positive effects of higher hydropower production.

Hydro's power production in Norway amounted to 11.0 TWh in 2007, up 32 percent from the 8.3 TWh in 2006. Annual power production in 2007 was the second highest on record and more than 20 percent higher than normal. Net spot sales amounted to 4.6 TWh, 72 percent higher than in 2006. More than 40 percent of the net spot sales volumes were realized in the third quarter, when power production reached record high levels.

Primarily due to variations in hydrology, Hydro is managing surplus and shortages in its Norwegian power portfolio in the spot market. The balance of the power portfolio varies both within different periods of the year and from year to year, driven by hydrological conditions and industrial consumption as well as contractual commitments and market developments. In 2007, net spot sales, which represent the net of volumes sold and purchased, have been higher than normal due to record-high inflows and increased hydropower production.

Direct power production costs, which include operations and maintenance, transmission costs, property taxes and concession fees, were largely unchanged from 2006. Higher property taxes and transmission costs in 2007 were largely compensated by lower operations and maintenance costs. Other operational costs, which include non-production

transmission costs, were somewhat higher in 2007 than in 2006.

Results for our Solar business, including the share of profit/loss in equity accounted investments, amounted to a loss of NOK 82 million in 2007, reflecting that our partnership companies are in a developing and build-up phase and have not yet started production.

Corporate, other and eliminations

Corporate, other and eliminations incurred an underlying loss of NOK 648 million in 2007 and NOK 721 million in 2006. Net pension and social security costs amounted to a charge of NOK 326 million in 2007, compared with NOK 291 million in 2006.

Items excluded from underlying EBIT

To provide a better understanding of Hydro's underlying performance, the items in the table below have been excluded from EBIT (earnings before financial items and tax) and income from continuing operations.

See section "Use of non-GAAP financial measures" – "Items excluded from underlying EBIT and income from operations" later in this report for more information on these items.

Items excluded from underlying income from continuing operations

NOK million	2007	2006
Unrealized derivative effects on LME related contracts	(92)	157
Unrealized derivative effects on power contracts	928	1,605
Unrealized derivative effects on currency contracts	(137)	(76)
Metal effect, Rolled Products	235	(261)
Significant rationalization charges and closure costs	224	1,023
Impairment charges	144	728
Gains/(losses) on divestments	(641)	-
Correction of elimination of profit in inventory	291	-
Reversal insurance loss provision	-	(211)
Germany, change in tax rate	(47)	-
Items excluded from underlying EBIT	905	2,965
Net foreign exchange (gain)/loss	(2,254)	148
Calculated income tax effect	339	(767)
Germany, change in tax rate	(300)	-
Losses/(benefits) not previously recognized	-	(500)
Items excluded from underlying income from continuing operations	(1,310)	1,846