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Risk review

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QUICK OVERVIEW

Hydro faces many risks and uncertainties within the global marketplace. Changes in the competitive environment and market conditions affect margin, price and volume developments. Following a period of financial turmoil and unprecedented market decline, Hydro has faced an oversupplied aluminium market and low aluminium prices which has had a negative impact on Hydro's cash flow.

Our primary smelting operations are highly dependent on securing substantial amounts of energy at competitive prices. We are exposed to increasingly onerous legislation on CO₂ emissions that impact Hydro directly, relating to aluminium production, and indirectly, through higher power prices. Repositioning and restructuring activities are important in determining the viability of our future aluminium operations.

Risk management in Hydro is based on the principle that risk evaluation is an integral part of all business activities. Hydro's main strategy for mitigating risk related to volatility in cash flow is to maintain a solid financial position and strong credit worthiness. Hydro is also taking proactive measures to reduce credit risk, improve its financial position and further adjust the cost of its smelter operations.



Indicative price and currency sensitivities 2010 ¹⁾

NOK million	Income before tax	Net income	Change
Aluminium price per ton	640	502	100 USD
USD before financial items	2,370	1,660	1 NOK
USD financial items	50	30	1 NOK
USD with financial items	2,420	1,690	1 NOK

¹⁾ Assumptions:
 Production volume for 2010 based on already priced Q1 production
 LME = 2 000 and USD/NOK = 6
 Financial items as per end 2009"

Risk factors

Below is a description of certain risks that may affect our business, financial condition and the results of operations from time to time and, hence, our share price. All of the information in this report should be carefully considered, in particular, the risks described below.

Hydro is facing challenging economic and market conditions which continue to have an adverse effect on our operating results and liquidity

Our financial condition and results of operations depend heavily on developments in market demand and global economic conditions. Market balance, among other factors, has a significant impact on aluminium prices. Market demand and prices declined dramatically in the final quarter of 2008. At the end of December 2008, prices reached a level that was lower than the cash costs of a substantial portion of global smelter production. Prices declined further in the first part of 2009 and remained weak for much of the year. Global consumption, excluding China, dropped by about 18 percent compared with 2008. Hydro's volumes declined by an equivalent percentage from 2008. These developments led to considerable losses within Hydro's upstream operations and substantially lower earnings for the company as a whole. Despite significant curtailments, the global production of primary metal, excluding China, continues to exceed market demand while new, greenfield capacity is expected to come on stream in 2010 and beyond. Although prices strengthened in the second half of 2009, there continues to be significant uncertainty regarding the timing, magnitude and quality of the recovery in market demand and the economic conditions within various countries and geographic regions in which we operate.

Hydro may not succeed in reducing the operating cost of its smelter portfolio sufficiently to compensate for an extended period of weak aluminium markets

Hydro acted quickly to reduce costs and production capacity following the severe market decline but we have been unable to adjust the costs of our primary smelters sufficiently and our primary metal business incurred substantial underlying operating losses during the year. A substantial part of our smelter portfolio is located in Norway and a significant part of our operating costs are incurred in Norwegian kroner. The effect of the market decline has been exacerbated by the weakening US dollar, which has had a negative impact on our competitive position. We have implemented new cost-cutting measures designed to reduce the conversion costs of our smelters substantially by the end of 2011. We may not succeed in making the reductions necessary to return our smelters to profitable operations.

Hydro faces a continued higher risk of counterparty default

A significant downturn in the business or financial condition of a key customer or group of customers exposes us to the risk of default on contractual agreements and trade receivables, which would have a negative impact on our operational results. Weak and deteriorating economic conditions on a global, regional or industry sector level, combined with challenging financial markets, increase the risk of defaulting counterparties.

Hydro enters into fixed-price contracts for the majority of its primary production. In addition, Hydro engages in significant trading in physical markets in order to optimize its total portfolio position and in derivative markets for hedging purposes. All of Hydro's alumina operations and significant portions of its primary metal operations are owned and operated through joint ventures with other major players in the aluminium industry. Hydro also has several long-term commercial agreements for substantial volumes of raw materials to be used in its production processes and for metal products for re-marketing to its customers. These business activities expose Hydro to the risk that one or more counterparties will default on their obligations, resulting in direct financial loss, an unexpected increase in market exposure or higher operating costs.

A deterioration of our financial position or a downgrade of our ratings by credit rating agencies could increase our borrowing cost and cost of capital and have an adverse effect on our business relationships

It is important for Hydro to maintain its investment grade credit rating for competitive access to capital and to support its business relationship with customers, suppliers and other counterparties. Our credit rating is also an important factor in making Hydro attractive as a joint venture partner for new growth initiatives. Following the severe market downturn for the aluminium industry, we were downgraded, together with other industry players, with one of our ratings reaching the lowest investment grade level. Any further deterioration of our financial position or another downgrade of our credit rating could increase our borrowing costs and have an adverse effect on our business relationships and attractiveness for major projects, contracts and other agreements.

Price volatility can impact our operating costs and can also have a substantial effect on our reported operating results

Commodity price volatility in general has increased significantly in recent years and can have significant impact on our operating results. Price volatility can impact our operating costs directly and can also have a substantial effect on our reported operating results due to realized and unrealized gains and losses on derivative instruments. Underlying results for our trading and hedging operations are subject to substantial variations in periods of significant fluctuation of spot and forward prices for aluminium.

Hydro's reported results and competitive position is exposed to changes in the value of the Norwegian krone

Hydro has a substantial portion of its primary capacity based in Norway and its accounting and reporting currency is the Norwegian krone. Primary aluminium prices and a major part of the raw materials for producing aluminium are denominated in US dollars. Much of Hydro's downstream business is based in Europe and a large portion of the production is sold in Euro. As a result, the relative value of the US dollar and Euro is of high importance to Hydro's operating results, and changes in the value of these currencies can be significant and highly volatile. See Market and commercial risk in this Risk review section for more information on Hydro's exposure and sensitivities to currency movements.

Periodic revaluation of foreign-denominated balances can have a significant impact on earnings. Revaluation upon realization of such balances can have a significant effect on both earnings and cash. The value of investments committed in foreign currencies is sensitive to currency movements.

Our downstream business is increasingly exposed to competition from China

China has in recent years imposed duties to reduce the export of aluminium metal, but has encouraged production of more labor intensive semi-fabricated and finished aluminium products. This development has increased the exposure of our downstream business to lower-priced exports from China.

Failure or delays in the execution of major projects could have a negative impact on our competitive position

The execution of major investment projects is subject to the risk of delays, cost increases, availability of adequate funding and other complications. Failure or delays in the execution of major projects could result in additional costs and lost operating revenues in addition to weakening our competitive position, which will in turn have a negative impact on our future operating results.

Emerging or transitioning markets present a competitive threat to our business

Emerging or transitioning markets in countries with abundant natural resources, low-cost labor and energy, and lower environmental and other standards, have posed and will continue to pose a competitive threat to our business. In 2007, the European Union (EU) reduced its duty on unalloyed aluminium. Any further reductions or cancellation of these duties could result in increased imports of primary aluminium to the EU market from sources such as Russia and the Middle East.

Hydro is exposed to increasingly onerous legislation on reducing CO₂ emissions

Hydro's smelter operations are to a large degree located in Europe. Legislation on CO₂ emissions has resulted in higher power prices for our European operations but to a lesser extent for our Norwegian smelters in the short to medium term, since most of the electricity consumption in Norway is covered by our own equity production or through long-term supply contracts. The EU has enacted new emissions regulations which would apply directly to CO₂ emissions from our smelter operations in Norway and in the EU from 2013 onward. Although it is anticipated that there will be some compensation available to aluminium producers, these regulations are more onerous than those being contemplated in other regions of the world and could negatively impact our competitive position. See also the section in this report on Regulation and taxation for more information pertaining to climate gases.

Our aluminium operations, and in particular our smelters, are dependent upon large volumes of energy

Our position could be materially affected by the inability to replace on competitive terms our long-term energy supply contracts when they expire, or our own equity production to the extent that concessions revert to the Norwegian state. See also the section in this report on Regulation and taxation for more information pertaining to the Norwegian regulatory system for hydroelectric production.

Future acquisitions, mergers, or strategic alliances may adversely affect our financial condition

We may not be able to effectively integrate businesses acquired or generate the cost savings and synergies anticipated.

Business development is more likely to occur in emerging and transition markets

New primary smelter, alumina and bauxite capacity is expected to be mainly located in countries characterized by emerging and transitioning markets. Legal, fiscal and regulatory systems may be less stable and have a lower degree of transparency, making investment evaluation and any eventual implementation more difficult.

Increasing investments in jointly controlled entities reduces Hydro's ability to manage its business portfolio

Investment as a minority partner in jointly controlled entities and associates reduces Hydro's ability to manage and control this part of its portfolio. Such investments entail a risk of diverging interests between business partners, which could impede Hydro's ability to realize its objectives, repatriate funds from such entities and to achieve full compliance with its standards.

We may not succeed in developing technological solutions to support our growth strategies

Being at the forefront of technological development is important to remain competitive. Hydro is engaged in the development of new "next generation" cell and smelter technology together with key suppliers. We may fail to develop these technologies on a timely basis or they may not be commercially feasible, thereby resulting in a negative impact on our competitive position.

Major accidents could result in significant damage to Hydro's reputation

Some of our operations are located in close proximity to sizable communities. Major accidents due to human error, systems failures, extreme weather or deliberate sabotage, while considered remote, could result in loss of life or extensive damage to the environment or communities. Such events could result in major claims, fines, penalties and significant damage to Hydro's reputation.

Hydro could be negatively affected by legal proceedings or investigations

Hydro could be negatively affected by criminal or civil proceedings related to, but not limited to product liability, environment, health and safety, alleged breaches of anti-competitive, anti-corruption practices or other integrity legislation or commercial disputes. See also the section of this report on Viability for more information on issues relating to integrity and transparency, and Legal proceedings in this Risk review section for more information on these matters. Violation of applicable laws and regulations could result in substantial fines or penalties, costs of corrective works and, in rare instances, the suspension or shutdown of our operations.

Hydro may be subject to unforeseen liabilities for environmental damage

Environmental laws may impose cleanup liability on owners and occupiers of contaminated property, including past or divested properties, regardless of whether the owners and occupiers caused the contamination or whether the activity that caused the contamination was lawful at the time it was conducted. Many of our present and former operations are and were located on properties with a long history of industrial use. See also the section in this report on Regulation and taxation for more information pertaining to Environmental matters.

Hydro may be subject to liabilities transferred to successor companies

Hydro has certain joint liabilities under Norwegian statutory regulations following from demergers. Under the Norwegian public limited companies act section 14-11, Hydro and Statoil are jointly liable for liabilities accrued before the demerger date of October 1, 2007. This statutory liability is unlimited in time, but is limited in amount to the net value allocated to the non-defaulting party in the demerger. Similarly, Hydro and Yara International ASA are jointly liable for liabilities accrued before the demerger date of March 24, 2004, on the same conditions.

Rights and legal remedies may be limited for certain classes of shareholders

The exercise of shareholder rights such as voting and preferential subscription rights may not be available to beneficial shareholders whose shares are registered in a nominee account, and not in the shareholders' own names with the Norwegian Central Securities Depository, *Verdipapirsentralen* (VPS). Hydro cannot guarantee that beneficial shareholders will receive the notice for a general meeting in time to instruct their nominees to affect a re-registration of their shares. Hydro is organized under the laws of the Kingdom of Norway. It may be difficult for investors to effect service of process outside Norway upon Hydro or its directors and executive officers, or to enforce against Hydro or its directors and executive officers judgments obtained in other jurisdictions. Norwegian courts are unlikely to apply other than Norwegian law when deciding on civil liability claims under securities laws.

Market and commercial risk

Risk management in Hydro is based on the principle that risk evaluation is an integral part of all business activities. The main responsibility for risk management is therefore placed with the business areas and coordinated by staff units at corporate level. Policies and procedures have been established to manage risk.

Financial position

Hydro's main strategy for mitigating risk related to volatility in cash flow is to maintain a solid financial position and strong credit worthiness. Hydro's target, over the business cycle, is to keep its adjusted net interest-bearing debt/equity ratio below 0.55 and to maintain a ratio of funds from operations to adjusted net interest-bearing debt above a level of 0.40. In addition, Hydro has established guidelines for liquidity reserves and for the profile of installment payments on debt in order to secure its financial position. Economic developments in 2009 resulted in low funds from operation and we were not able to meet our minimum target level for this key ratio. We have initiated actions to improve our financial position in order to maintain our investment grade credit rating.

Liquidity risk

The challenging market conditions during 2009 have led to an increased attention on cash flow and credit risk throughout our entire organization. In addition to measures aimed at securing our cash position, we have total undrawn committed credit facilities amounting to NOK 16 billion to provide back-up in the case of future cash deficits, should alternative financing sources not become available.

Hydro is taking a proactive approach toward customers to reduce credit risk. We are also monitoring the financial performance of key suppliers in order to reduce the risk of default on operations and key projects.

Prices and currency

Hydro's operating results are primarily affected by price developments of its main products, aluminium and power, in addition to fluctuations in the value of Norwegian kroner to the US dollar and the Euro, which are the most significant currencies for Hydro. Our main risk management strategy for upstream operations is to accept exposure to aluminium and energy prices movements, while at the same time focusing on reducing the average cost position of our smelter portfolio. In certain circumstances, we may also use derivatives to mitigate overall financial and commercial risk exposures.

Downstream and other margin-based operations are to a certain extent hedged to protect processing and manufacturing margins against raw material price fluctuations. This is done within the framework of an operational hedging system which has been established to protect commercial contracts from aluminium price fluctuations. In order to mitigate part of the exposure to US dollar currency fluctuations, Hydro has used forward currency contracts, mainly selling US dollars against Norwegian kroner. As of the end of 2009, no major currency contracts were outstanding, reflecting lower net exposures due to weak LME prices and an increasing amount of US dollar-denominated liabilities. Hydro may to a limited extent enter into forward contracts in other currencies to hedge certain revenue and cost positions.

An indication of the sensitivities regarding aluminium prices and foreign currency fluctuations for 2010 is provided in the table below. The table illustrates the sensitivity of earnings, before and after tax, to changes in these factors and is provided to supplement the sensitivity analysis required by IFRS, included in note 41 to the Consolidated Financial Statements.

Indicative price and currency sensitivities 2010¹⁾

NOK million	Income before tax	Net income	Change
Aluminium price per ton	640	502	100 USD
USD before financial items	2 370	1 660	1 NOK
USD financial items	50	30	1 NOK
USD with financial items	2 420	1 690	1 NOK

1) Assumptions:

- Production volume for 2010 based on already priced Q1 production
- LME = 2 000 and USD/NOK = 6
- Financial items as per end 2009

In addition to the above sensitivities, the revaluation of derivative instruments and contracts classified as derivatives may influence reported earnings. For accounting purposes, derivative financial and commodity instruments are recognized at fair value, with changes in fair value impacting earnings unless specific hedge criteria are met. This can result in volatility in earnings, since the associated gain or loss on the related physical transactions may be reported in earnings in different periods. Please see note 41 - 42 to the Consolidated Financial Statements for a detailed description of Hydro's commercial and financial risk exposures and hedging activities related to such exposures.

In accordance with IFRS requirements, Hydro has chosen to provide information about market risk and potential exposure to hypothetical loss from its use of derivative financial instruments and other financial instruments, and derivative commodity instruments through sensitivity analysis disclosures. Please see note 41 to the Consolidated Financial Statements for more information, and for additional information on these disclosures.

Legal proceedings

Hydro is involved in or threatened with various legal and tax matters that arise in the ordinary course of business. Hydro is of the opinion that resulting liabilities, if any, will not have a material adverse effect on our consolidated results of operations, liquidity or financial position.

Hydro and Statoil have, in close cooperation with Norwegian and US authorities, concluded their parallel investigations in order to clarify the facts surrounding payments in connection with Hydro's (now Statoil's) operations in Libya and consultancy agreements relating to Hydro's previous international oil and gas operations in relation to applicable anti-corruption regulations. The fact findings of the investigations were submitted and presented to the Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime (Økokrim) on October 7, 2008, and to the US authorities in November 2008. Neither of these authorities have found reason to open investigations of the matter.