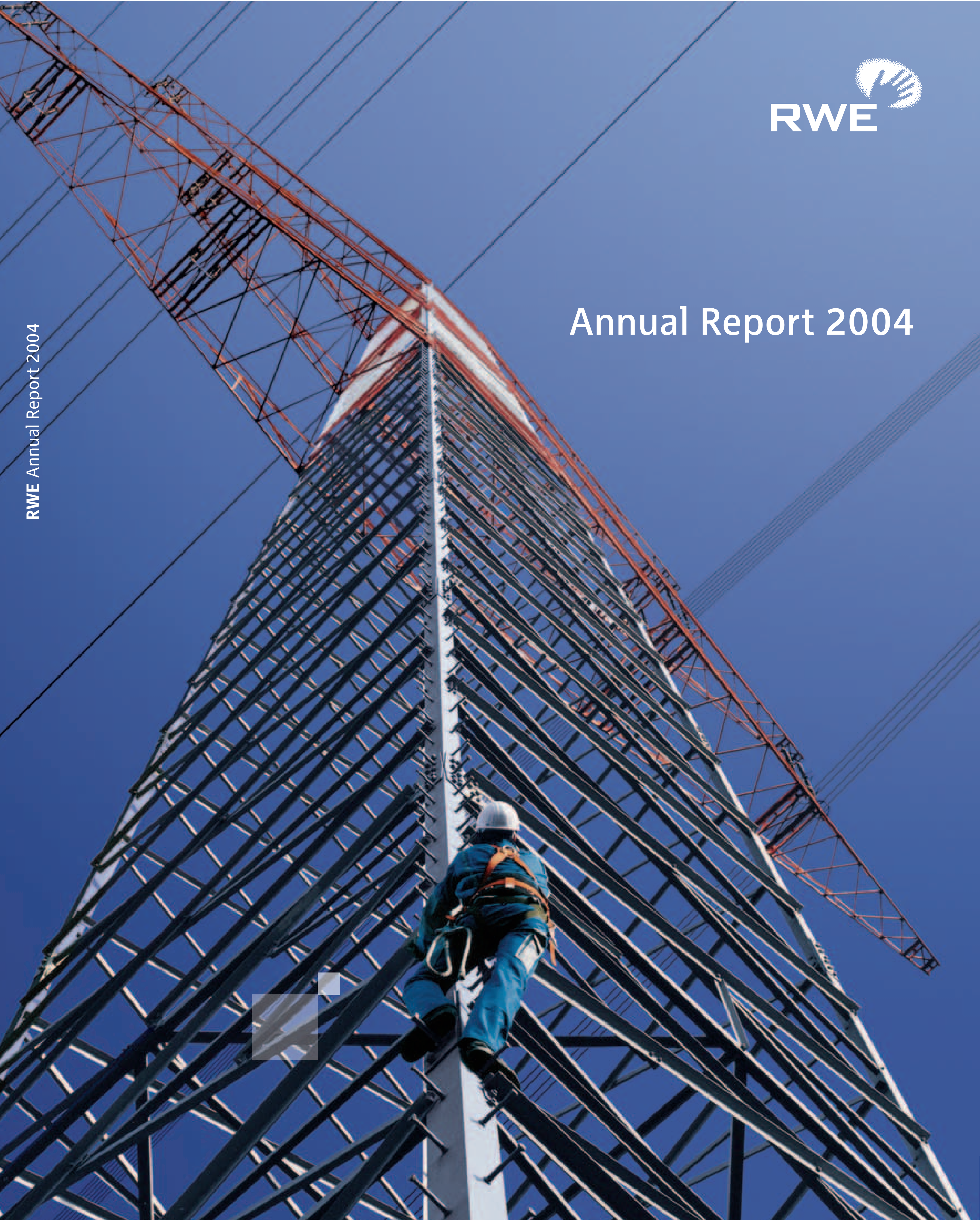
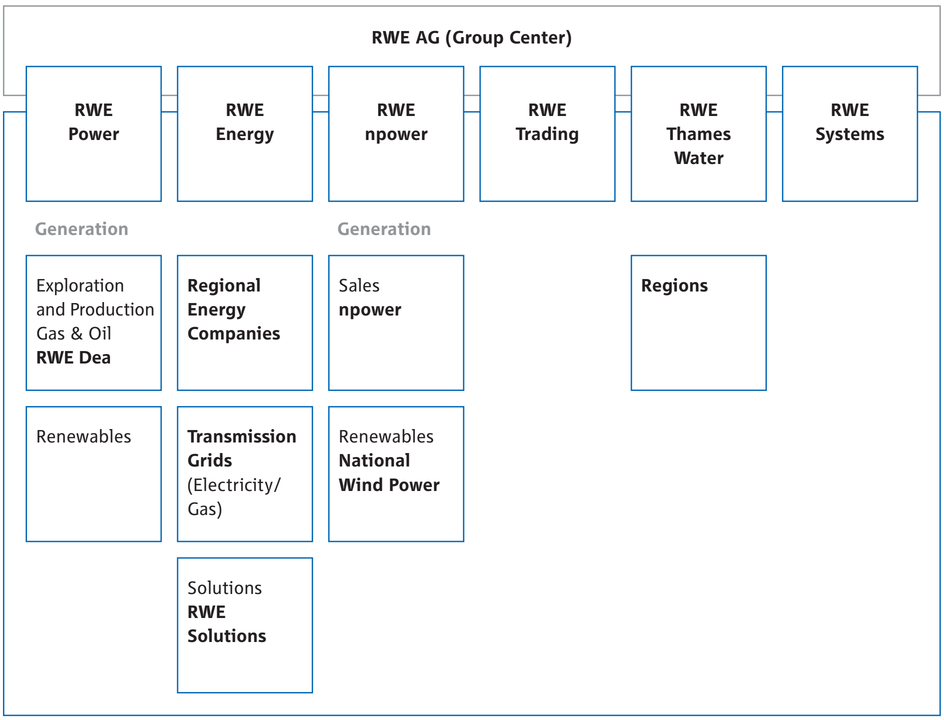
Annual Report 2004



RWE Annual Report 2004

The RWE Group – A brief portrait

In fiscal 2004, energy and water, our core businesses, generated almost €40 billion in revenue. This again ranks us among Europe's leading utilities in our 107th year of existence. Our strategic goal is to retain a top spot among European utility companies in terms of earning power and stability combined. To achieve this, we want to improve our financial result continually. More than 87,000 employees serve our customers with electricity, gas and water as well as services related to these fields. We are regarded as a reliable partner in our core markets, i.e., Germany, the UK, Central Eastern Europe and North America. Millions of households and companies rely on our products. All in all, we supply 21 million customers with electricity and 10 million with gas. RWE's drinking water and wastewater services are part of the everyday lives of 70 million people.



Key Events

02/2004 – Majority stake in HOCHTIEF sold
On February 25 we place 32.6 million HOCHTIEF shares on the capital market. This reduces our interest in the German construction group from 56 % to 9.6 %, on which we issue a three-year exchangeable bond.

05/2004 – Sale of shares in Heidelberger Druckmaschinen largely completed
Another milestone en route to locking our focus on energy and water. As with HOCHTIEF, we launch a combined offer: we divest a large portion of our 50 % stake in Heidelberg directly on the stock exchange. The remaining 15 % are reserved to redeem an exchangeable bond that we issue concurrently.

07/2004 – Bond conversion and buyback to optimize financial structure
In July we buy back and convert a total of € 1.9 billion in bonds. The transaction reduces our gross debt and long-term interest cost. In addition, it evens out our bond maturity profile.

09/2004 – Sale of RWE Umwelt initiated
The last major step towards becoming a focused energy and water company: in September we initiate the divestment of our environmental services business. Our competitor, the Rethmann Group, will purchase some 70 % of these activities.

10/2004 – Acquisition of outstanding RWE Dea and Harpen shares
In October we increase our stake in RWE Dea from 99.46 % to 100 % following a squeeze-out. Our acquisition of nearly 5 % in outstanding shares in Harpen is initiated through the approval of the squeeze-out by an extraordinary AGM.

12/2004 – RWE Supervisory Board elects new chairman
On December 8 the Supervisory Board elects Dr. Thomas R. Fischer, Chairman of the Managing Board of WestLB, its new chairman. Dr. Fischer succeeds Dr. Friedel Neuber, who passed away on October 23, 2004.

2004 Key figures at a glance

- Group operating result up 8 % and up 10 % net of one-off effects
- Net income 10 % higher year-on-year (excluding goodwill amortization)
- ROCE target for 2005 (11 %) already exceeded
- Net financial debt reduced to € 12.4 billion
- Dividend proposal envisions 20 % increase in dividend

RWE Group		**2004**	**2003**	**+/– in %**
External revenue	€ million	42,137	43,875	–4.0
EBITDA	€ million	8,400	8,476	–0.9
Operating result	€ million	5,976	5,551	7.7
Income before tax[1]	€ million	3,935	2,123	85.4
Income after tax[1]	€ million	2,414	936	157.9
Net income[1]	€ million	2,137	953	124.2
Previous year excluding goodwill amortization	€ million	2,137	1,938	10.3
Return on capital employed (ROCE)[2]	%	12.8	10.4	–
Capital costs (WACC) before tax	%	9.0	9.0	–
Value added[2]	€ million	1,778	781	127.7
Capital employed[2]	€ million	46,919	53,961	–13.1
Cash flows from operating activities	€ million	4,928	5,289	–6.8
Capital expenditure	€ million	3,737	9,762	–61.7
Property, plant and equipment	€ million	3,429	4,362	–21.4
Financial assets	€ million	308	5,400	–94.3
Free cash flow[3]	€ million	1,499	927	61.7
Earnings per share[1]	€	3.80	1.69	124.9
Previous year excluding goodwill amortization	€	3.80	3.45	10.1
Cash flows from operating activities per share	€	8.76	9.41	–6.9
Dividend per share	€	1.50[4]	1.25	20.0
		12/31/04	**12/31/03**	
Net financial debt	€ million	12,385	17,838	–30.6
Workforce	FTE[5]	97,777	127,028	–23.0

1 The 2004 figure does not include goodwill amortization due to the change in International Financial Reporting Standards (IFRS).

2 Calculated using the old method. By applying the new method introduced in 2004 (cf. details on p. 187), capital employed totaled € 44,480 million. This results in ROCE of 13.5 % and € 1,998 million in value added.

3 Cash flows from operating activities minus capital expenditure on property, plant and equipment.

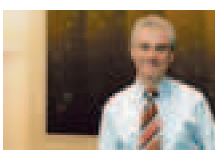
4 Dividend proposal for RWE AG's 2004 financial year, subject to approval by the April 14, 2005 Annual General Meeting.

5 Full time equivalent, according to the percentage of full-time employment.

Many approaches, one goal: Improve constantly.

There's no doubt about it: providing millions of customers with a reliable supply of electricity, gas and water is an ambitious task. To achieve this, we use modern technology. But more importantly, it is our employees who rise to this ever-changing challenge. Year after year, they draw on their creativity and competence to do their best for our customers: 24 hours a day, 7 days a week, 365 days a year.

These people are RWE. It is their personal commitment that makes the security of supply a matter of course. We are proud to have such **employees,** some of whom will be presented to you in this annual report. With their interesting work and projects, these staff members are a representative sample of our entire workforce.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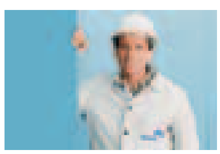
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Letter to Investors

Executive Board Report

Divisions

Consolidated Financial Statements

Icon legend

* 89 Cross reference

* 05 Internet link

☐ Negligible amount

Internet links

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»Our stable earnings growth provides the basis for continued dividend growth.«

Harry Roels
Born in 1948, obtained a degree in physical chemistry in 1971 from Leiden University. Worked for the Royal Dutch/Shell Group for 30 years. In July 1999 appointed Managing Director of Royal Dutch Petroleum Company and Group Managing Director of the Royal Dutch/Shell Group of companies. Since February 1, 2003 Chief Executive Officer of RWE AG. Responsible for: Group Strategy, Corporate Communications, Group Auditing, Group Executive Resources Development, Group Mergers & Acquisitions, Energy Policy, Group IT Strategy.

Dear Investors and Friends of the Company,
It is a pleasure for me to inform you of yet another successful year at RWE. Key data for 2004 are good, and we passed major milestones in the implementation of our strategy. This benefits you as well. RWE's common share price rose by some 30 % in 2004, ranking it among the top performers in the DAX and Euro STOXX indices. In addition, we will propose to the Annual General Meeting that the dividend for the fiscal year 2004 be increased by 20 %.

The progress we have made is illustrated by the three following points.

1. Performance: We exceeded the financial targets we presented to you last year. The Group operating result increased by 8 %. Net of consolidation and currency effects, it rose 10 %. We thus surpassed our goal of generating at least 5 % organic growth. This was made possible above all by the positive development of our Continental European energy business. We have already exceeded our 2005 value management goal of achieving a return on capital employed (ROCE) of 11 %.

2. Focus: We are pursuing two objectives. One aim is to focus on energy and water, our core businesses. Another goal is to limit our presence to our core markets in Germany, the UK, Central Eastern Europe and the North American water sector. We have achieved the first goal: in just three months, we sold our majority stakes in our non-core businesses HOCHTIEF and Heidelberger Druckmaschinen. Subsequently, we initiated our exit from the environmental services sector, another non-core business. In our core businesses, we sold peripheral activities in Portugal, Switzerland, Italy and Turkey. This took us a major step closer to achieving the second aim of our focus. In sum, we have sold nearly €5 billion in enterprise value since 2003.

3. Financial discipline: Since the end of 2003, we have reduced net debt by €5.4 billion to €12.4 billion. With respect to our target for debt (excluding one-off effects stemming from the sale of non-core businesses) of €17 billion by the end of 2005, we already attained €15.2 billion as of the end of 2004. Furthermore,

Dr. Klaus Sturany
Born in 1946 in Wehrda (Hesse), studied mathematics. From 1997 to 1999 Spokesman of the Board of Management of GEA AG. Since December 1999 Executive Vice-President of RWE AG. Responsible for: Finance, Controlling, Investor Relations, Accounting, Tax, Risk Management, Insurance.

Jan Zilius
Born in 1946 in Marburg, studied law. Joined the RWE Group in 1990. Since April 1998 Executive Vice-President and Labor Director of RWE AG. Since February 2005 also CEO of RWE Power AG. Responsible for: Group Human Resources Management, Law/Board Matters.

Dr. Gert Maichel
Born in 1949 in Timmendorfer Strand, studied agricultural economics and law. President and Chief Executive Officer of VEW AG until November 2000. From November 2000 to February 2005 Executive Vice-President of RWE AG. From April 2004 to February 2005 CEO of RWE Power AG. Responsible for: Energy and Environmental Policy, Research and Development.

Berthold A. Bonekamp
Born in 1950 in Billerbeck, studied mechanical engineering and business management. Since 1998 Executive Vice-President of RWE Rheinbraun AG. Since 2000 Executive Vice-President of RWE Power AG. Until March 2004 CEO of RWE Power AG. Since April 2004 CEO of RWE Energy AG and Executive Vice-President of RWE AG.

we optimized our financing structure through a bond buyback and conversion of bonds with a combined value of €1.9 billion. By the end of the year, we had also fully achieved the approximately €2.6 billion in savings targeted by the cost-cutting program initiated in 2000.

That rounds up our accomplishments in the past financial year. What follows is what we have planned for 2005.

Stable earnings growth: You know about our goal to improve our operating result by an average of at least 5 % every year through organic growth. Our aim to achieve a ROCE of 14 % in 2006 is yet another ambitious earnings target. To achieve this objective, we have already initiated additional measures across all our divisions. Higher electricity wholesale prices and more flexible marketing of our short-term electricity position will be driving forces. At the same time, we intend to scale back annual costs by some €700 million by the end of 2006. We expect our water operations to make a stable contribution to growth by making efficient investments in water infrastructure. Sustained growth stimuli are also expected from our Central Eastern European markets. We will examine opportunities to supplement our existing energy activities through small and medium-sized acquisitions. In doing so, we will always meet two strict conditions: fulfill the Group's return criteria and maintain our A+ and A1 credit ratings.

Investing to secure our future: By stepping up capital expenditure in our power plant and grid business, we will secure future cash flows as well as making an important contribution to security of supply. These investment programs are long-term in nature.

Forward-looking management of regulation: Supply security does not come for free. I have repeated this time and again in talks with policymakers and public authorities. Therefore, it is paramount that the electricity and gas grid regulation frameworks create long-term incentives for investment. In the years ahead, we anticipate increasing regulatory headwind in this business. We are responding to this by taking measures to improve efficiencies. The recently introduced European emissions trading system poses another regulatory challenge. We are meeting this challenge through flexible power plant deployment and optimized electricity and fuel purchasing.

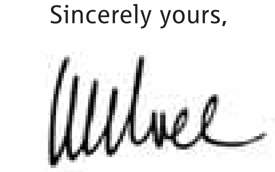
Refining our performance-oriented corporate culture: None of this will be possible without the utmost in efficiency and commitment of all our employees, to whom I would like to express my sincere gratitude for their outstanding work.

Essen headquarters

I am spending a significant amount of my time to foster an RWE culture conducive to continue making such accomplishments. After all, besides being goal-oriented, performance must also pay off—and be enjoyable.

You should also enjoy your investment. From a present point of view, the prospects are in our favor. We are confident that we will be able to continue improving our key figures in 2005 without depending on any macro-economic stimulus. Our well-balanced business model is a solid basis for stable and successful development both over the medium term and beyond. Our plan to increase the dividend payout ratio to 50 % by 2006 underscores this ambition. I would like to thank you for placing your trust in RWE's prospects. We are doing all we can to ensure that your trust remains justified in the future.

Sincerely yours,



H. J. M. Roels
CEO of RWE AG

Essen, February 15, 2005

Supervisory Board Report

Dr. Thomas R. Fischer
Chairman of the Supervisory Board
of RWE AG

Dear Shareholders,
In fiscal 2004 the Supervisory Board performed the duties mandated by German law and the company's articles of association. Moreover, it monitored the Executive Board's management of the company while functioning as management advisor. Written and oral reports submitted by the Executive Board regularly and thoroughly informed the Supervisory Board on a timely basis of material business trends, material business transactions, the company's earning situation and the risk controlled by the risk-management system.

The Supervisory Board convened four meetings. All of the Supervisory Board members attended at least half of the meetings. The average participation rate per session exceeded 95 %. When in session, the Supervisory Board passed all required resolutions on the basis of detailed information. Between meetings, the Supervisory Board was informed of projects and transactions that were especially important or urgent to the company and was asked for approval by circular where necessary. The Chairman of the Supervisory Board was constantly in touch with the members of the Executive Board in order to comprehensively discuss events of material importance to the company.

Focus on core business: energy and water
One of the main topics of the Supervisory Board's consultations was our focus on our core businesses. In the first half of 2004 the Supervisory Board addressed the divestment of our stakes in HOCHTIEF AG and Heidelberger Druckmaschinen AG. Furthermore, in the September 24, 2004 session, the sale of major parts of RWE Umwelt AG's business to the Rethmann Group was the subject of discussion and decision-making. The Supervisory Board was informed of the status of the transaction at its meeting on December 8, 2004. To streamline the portfolio of its core businesses, the Group shed the minority interests it held in peripheral markets. These principally comprised energy operations in Portugal, Turkey, Italy and Switzerland. Moreover, real estate not required for operating purposes was sold. The Supervisory Board passed the resolutions needed to implement all the aforementioned transactions.

Special focus on strategic issues
In fiscal 2004, the Executive Board informed the Supervisory Board on numerous occasions of the impact of the Group reorganization initiated in October 2003. It delivered a positive assessment on the status. In addition, a select number of aspects of RWE's strategy were dealt with in depth. Among the topics addressed in these special consultation sessions was the company's future power generation strategy in Germany and the UK. A considerable amount of time was spent dis-

cussing budgets earmarked for potential investments into power plants. The Water Division's future strategic orientation was also debated extensively—not least due to the fact that the next five-year regulatory period in the UK water industry will commence in April 2005.

Other main topics of deliberation

Regular reports were received on the revenue and result trends in the Group and our divisions as well as on measures to reduce costs. In addition, the Executive Board commented on the development of energy prices. The Supervisory Board constantly discussed the Group's financial situation and the status of the program designed to reduce the Group's net debt which was launched in January 2003. The target set for the program by the end of 2005 was achieved ahead of schedule at the end of the third quarter of 2004. In its December 8, 2004 session, the Supervisory Board dealt in detail with the corporate budget submitted by the Executive Board for fiscal 2005 as well as with the outlook for 2006 and 2007. The Executive Board explained deviations from previous budgets and goals in detail.

On several occasions, the plenum dealt with the impending change in regulatory conditions in the German and UK energy markets. The main issues discussed in this context were the intended amendment to the German Energy Act and the related establishment of a German regulator for the country's electricity and gas grids as well as the introduction of emissions trading in CO_2 certificates in the European Union as of January 1, 2005. The Supervisory Board extensively discussed the potential impact of these changes on our company's business.

Committees

The Supervisory Board formed four committees. Their members are listed in the chapter on "Boards and Committees"*. Committee chairmen delivered in-depth reports on the committees' work during the Supervisory Board meetings.

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The **Executive Committee** convened once in the 2004 financial year. Its activity primarily consisted of preparatory work for the Supervisory Board debates. Issues addressed were the corporate budget for fiscal 2005, the planned amendment to the German Energy Act and a status report on the implementation of the reorganization of the Group's structure.

The **Audit Committee** convened four times in the same period. It discussed the interim reports and financial statements of the parent company (RWE AG) and the Group at great length with the independent auditor present at some of the meetings. Debates also centered on the impact of major divestments on the company's balance sheet and tax position as well as on risk management, impairment test methods, the treatment of nuclear and mining provisions and internal audits.

The **Human Resources Committee** held four sessions in the period under review. Debates primarily addressed the compensation system for members of the Executive Board and the Long Term Incentive Plan* (LTIP). Furthermore, it passed necessary resolutions regarding the employment contracts of Executive Board members.

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Once again, there was no reason to convene the **Mediation Committee**, which complies with Sec. 27, Para. 3 of the German Co-Determination Act.

Financial statements for fiscal 2004

The financial statements of the parent company, which were prepared by the Executive Board in compliance with the German Commercial Code; the financial statements of the Group, which were prepared in compliance with International Financial Reporting Standards (IFRS); the combined review of operations for RWE Aktiengesellschaft and the Group; and the accounts were scrutinized by PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft and were issued an unqualified auditor's opinion.The auditors were elected by the AGM on April 15, 2004, and commissioned by the Supervisory Board to audit the financial statements of RWE AG and the Group. Documents supporting the annual financial statements, the annual report and the auditor's audit report were submitted to all the members of the Supervisory Board in good time. The Executive Board also commented orally on the documents in the Supervisory Board's balance sheet meeting of February 22, 2005. The auditors, who signed the audit report, attended the meeting, presented the material results of their audit, and were available to answer questions. The Supervisory Board has reviewed the financial statements of RWE AG and the Group, the combined review of operations for RWE Aktiengesellschaft and the Group, and the proposed appropriation of distributable profit. No objections were raised as a result of this review. As recommended by the Audit Committee in its February 21, 2005 session, the Supervisory Board approved the auditor's results of the audit of both financial statements as well as the financial statements of RWE Aktiengesellschaft and the Group for the period ended December 31, 2004. The annual financial statements are thus adopted. Furthermore, the Supervisory Board concurs with the appropriation of profits proposed by the Executive Board, which envisions a dividend payment of €1.50 for each share that carries dividend entitlements.

Changes in personnel

Dr. Friedel Neuber chaired the Supervisory Board last year until he passed away unexpectedly on October 23, 2004. Dr. Neuber joined the Supervisory Board in 1992 and was appointed chairman in 1997. Drawing on his outstanding expertise and extensive experience, Dr. Neuber played a major role in the strategic decisions made by our company in recent years. He thus proactively spurred RWE's evolution into one of Europe's leading utility companies, helping shape the organization in the process. We thank him for his outstanding accomplishments for the benefit of our company and will always keep him in honorable memory.

At its December 8, 2004 meeting, the Supervisory Board elected Dr. Thomas R. Fischer Chairman of the Supervisory Board. He had already been appointed to the Supervisory Board per a court resolution passed on November 9, 2004.

In addition, the Supervisory and Executive Boards changed their composition as follows. Mr. Josef Pitz retired from the Supervisory Board effective May 11, 2004. Pursuant to a resolution adopted by the Essen District Court on August 16, 2004, Mr. Wilfried Donisch was appointed to succeed him as member of the Supervisory Board. Mr. Burkhard Drescher vacated his seat on the Supervisory Board as of the end of the day on December 31, 2004. Ms. Dagmar Mühlenfeld was appointed his successor by a resolution handed down by the Essen District Court on January 4, 2005. The Supervisory Board extends its appreciation to Messrs. Pitz and Drescher for their commitment and successful performance for the benefit of the company. Mr. Berthold A. Bonekamp was appointed to the Executive Board of RWE Aktiengesellschaft as of April 1, 2004. In addition, he is the Chairman of the Executive Board of RWE Energy AG. Dr. Gert Maichel will retire from the Executive Board of RWE Aktiengesellschaft at the end of the day on February 22, 2005. The Supervisory Board thanks Dr. Maichel for the successful work he has done for the benefit of the company.

The Supervisory Board thanks the RWE Group's entire staff and the members of the Executive Board for their successful work.

Essen, February 22, 2005

The Supervisory Board

Dr. Thomas R. Fischer
– Chairman –

Corporate Governance

We attach high importance to effective and transparent corporate governance. This is why we act in line with the generally accepted principles of corporate governance. In addition, we implement all the recommendations of the German Corporate Governance Code. Nevertheless, we will continue to refine our standards in 2005.

Continued disclosure of board member compensation by individual
No changes were made to the German Corporate Governance Code in 2004. Despite this fact, the Code's July 2003 recommendation to provide a breakdown of Executive and Supervisory Board compensation by member was discussed frequently. We were one of the first DAX companies to comply with the recommendation early on in 2004. This report again discloses board member compensation by individual in the notes.

Events of relevance to the Code in the year under review
Information on RWE AG Executive and Supervisory Board activity and cooperation between these two boards, on the RWE Annual General Meeting and on the Group Business Committee (GBC) which was established at the end of 2003 can be found on the RWE website* as well as in recent annual reports. The following is a list of developments relevant to the Code in the year being reviewed.

* 01

- In 2004 the Supervisory Board of RWE AG debated the structure of the Executive Board compensation system in accordance with Item 4.2.2 of the Code.
- The reporting year marks the first time that a tranche of RWE's executive stock option plan initiated in 2000 and a tranche of the Long Term Incentive Plan introduced in 2002 to replace the previous scheme had a positive intrinsic value, becoming exercisable. Securities dealings reportable under Sec. 15a of the German Securities Trading Act were reported in an orderly fashion and published on RWE's website*. None of the board members held securities with a combined value high enough to fall under mandatory disclosure pursuant to Item 6.6 of the Code as of the balance sheet date. Due to an amendment to the German Securities Trading Act, the allowance for exemption from obligatory reporting was reduced from €25,000 over a 30-day period to €5,000 per year. The bylaws of the Supervisory Board of RWE AG have been adapted accordingly.
- In the period under review, no material transactions were concluded between RWE AG or a Group company and an Executive Board member or related party. Furthermore, no contracts were concluded between the company and members of the Supervisory Board. Executive Board and Supervisory Board members had no conflicts of interest.

* 02

- All listed companies affiliated with the Group which are obliged to issue a statement of compliance fulfilled this obligation in 2004. Details of the companies' affiliation with the Group and company size were taken into account.
- We again complied with the suggestions for voluntary action of the Code with one exception. The Code suggests that Supervisory Board members be elected and re-elected at different dates and for varying periods of tenure. In practice, the procedures we use for appointing shareholder representatives to the Supervisory Board comply with the spirit of the suggestion.

Corporate governance as a continuous process

The German Investor's Protection Improvement Act entered into force on October 30, 2004. It envisions changes in insider dealing legislation and an expansion of ad-hoc publicity. We made organizational arrangements early on in order to meet the stricter statutory requirements. In line with the Act, we maintain a directory of all individuals with access to insider information.

In addition, we have observed that ethical and sustainability issues are gaining importance within the realm of corporate governance. Therefore, the Executive Board entrusted a commission with the development of a groupwide code of conduct. Furthermore, RWE joined the UN Global Compact* Initiative. By doing so, we clearly underscored our commitment to making global improvements in environmental protection, labor conditions and safeguarding human rights.

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Statement of compliance in accordance with Sec. 161 of the German Stock Corporation Act

Following an orderly audit, the Executive and Supervisory Boards of RWE AG issued the following declaration of compliance:

"RWE Aktiengesellschaft complies with all of the recommendations of the German Government Corporate Governance Code Commission issued in the July 4, 2003 version of the Code and has complied with them since the issuance of the last declaration of compliance on February 24, 2004."

Essen, February 22, 2005

RWE Aktiengesellschaft

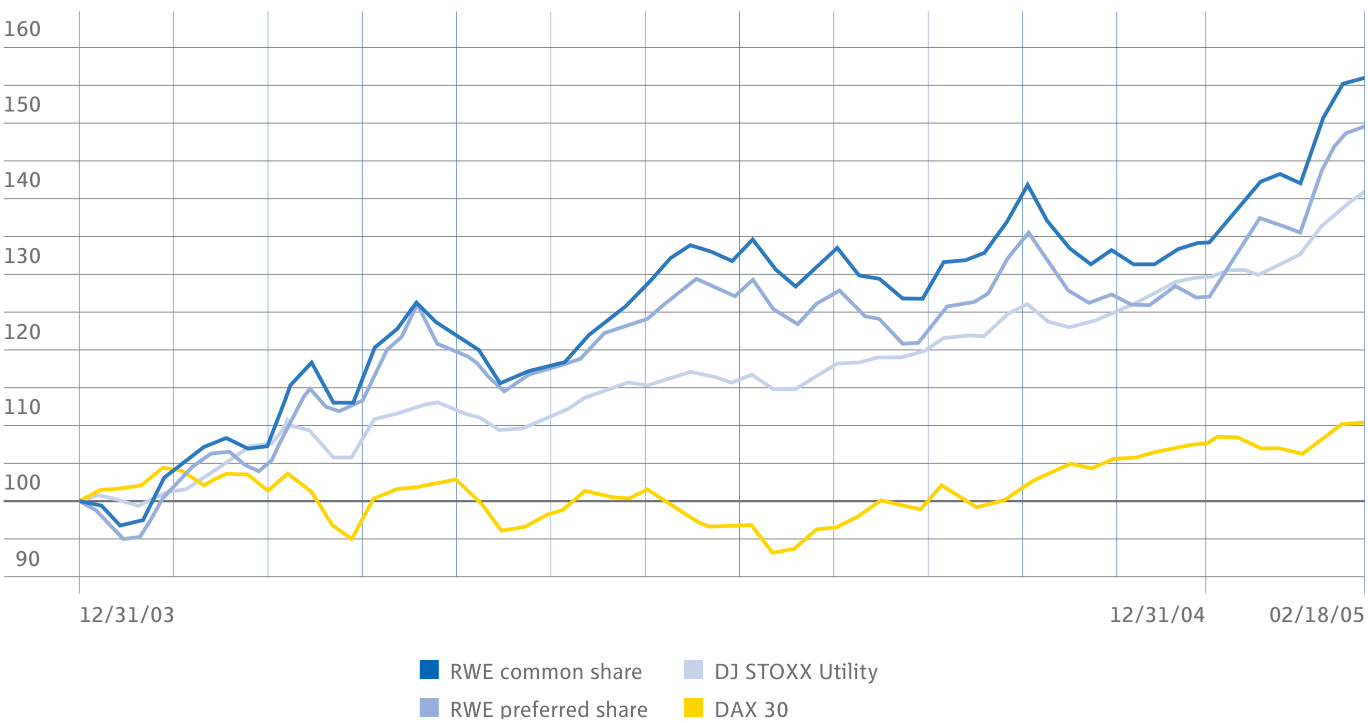
On behalf of the Supervisory Board — On behalf of the Executive Board

Dr. Thomas R. Fischer — Harry Roels — Jan Zilius

Shares and bonds put in another exceptional showing

Our shares and bonds displayed positive performance again in 2004. RWE's common shares delivered a return of 34 %. Our preferred shares posted a gain of 27 %. By contrast, the DAX was up a mere 7 %. RWE bonds also benefited from the favorable market environment, with bond spreads decreasing further.

Performance of RWE shares compared with the DAX 30 and the DJ STOXX Utility Index
in %



The DAX recorded a mediocre year when compared on an international basis.

DAX rises 7 %

Following substantial gains in 2003 and despite the continued revitalization of the world economy, Germany's stock market lost steam. This was largely due to weak economic data from Germany, the strong euro and booming oil prices. Only towards the end of the fourth quarter did the German Stock Index (DAX) benefit from a slightly improved environment. It closed 2004 at 4,256 points, recording a performance* of +7 % for the year. Compared to international indices, however, the DAX put in a mediocre showing.

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RWE common shares deliver 34 % return

RWE's common shares significantly outperformed the market. By the end of the year, their price had risen 30 % to € 40.70. Including the dividend, this corresponds to a return of 34 %. They thus outperformed the Dow Jones STOXX Utility Index, which advanced 29 %. Preferred shares jumped 22 % to € 34.21, recording a return of 27 %. This was primarily due to the positive earnings outlook for the German electricity generation business. Our declared goal to increase the dividend by an average of 15 % per year from 2004 to 2006 strengthened confidence in the company's earning power. However, the increasingly heated debate surrounding the future regulatory framework of the German energy market caused some uncertainty. The stock market's upward trend initially decelerated somewhat at the beginning of 2005. In mid-February the DAX was close to the 4,400 point mark. By contrast, RWE shares gained momentum. RWE common shares reached the € 47.71 mark on February 15, their highest level in more than three years.

RWE common and preferred shares outperformed the DAX, gaining 34 % and 27 %, respectively.

Long-term return of RWE shares posts substantial growth

Long-term investors who invested € 10,000 in RWE ten years ago and reinvested the dividends saw their investment grow to € 20,461 (common shares) or € 23,021 (preferred shares) by December 31, 2004. This corresponds to an annual average return of 7.4 % and 8.7 %, respectively. The DAX advanced 7.3 % over the same period of time.

Comparative performance of RWE shares and important indices up to the end of 2004 in % p. a.	**1 year**	**5 years**	**10 years**
RWE common share	33.9	1.9	7.4
RWE preferred share	26.8	2.8	8.7
DAX 30	7.3	–9.4	7.3
CDAX Utilities	34.0	8.3	11.3
Dow Jones EURO STOXX 50	9.4	–8.0	10.7
Dow Jones EUROPE STOXX 50	7.1	–8.3	10.4
Dow Jones STOXX	12.2	–6.0	9.8
Dow Jones STOXX Utility	29.4	2.4	11.4
REXP*	6.7	6.4	7.1

* Index for the performance of government securities on the German bond market with a remaining term of 0.5 to 10.5 years, with due regard to price changes and interest income.

RWE share indicators Per share[2]		**2004**	**2003**	**2002**	**TFY[1] 2001**	**2000/ 2001**
Earnings	€	3.80[3]	1.69	1.87	1.10	2.24
Previous years excl. goodwill amortization	€	3.80	3.45	3.25	1.53	2.90
Cash flows from operating activities	€	8.76	9.41	10.55	1.82	6.76
Dividend	€	1.50[4]	1.25	1.10[5]	1.00[6]	1.00[7]
Common share prices						
End of fiscal year	€	40.70	31.37	24.70	42.20	46.98
High	€	43.50	31.97	43.80	49.95	51.70
Low	€	29.70	17.68	24.12	37.10	35.00
Preferred share prices						
End of fiscal year	€	34.21	27.95	20.75	31.25	35.30
High	€	36.94	28.20	34.49	38.50	38.10
Low	€	25.96	16.48	20.01	26.20	28.50
Dividends	€ million	844[4]	703	619	562[6]	563[7]
Number of shares at end of fiscal year	million	562.4	562.4	562.4	570.0	570.0
Common shares	million	523.4	523.4	523.4	531.0	531.0
Preferred shares	million	39.0	39.0	39.0	39.0	39.0
Weighted average number of shares outstanding	million	562.4	562.3	562.4	562.4	564.6
Market capitalization at end of fiscal year	€ billion	22.6	17.5	13.7	23.6	26.3

1 Truncated fiscal year for the Group from July to December 2001.

2 In relation to the weighted average number of shares outstanding.

3 Due to the change in IFRS, the figure for 2004 no longer includes goodwill amortization.

4 Dividend proposed for RWE AG's 2004 fiscal year, subject to the approval of the April 14, 2005 AGM.

5 Includes bonus.

6 Dividend for RWE AG's 2001 fiscal year (January to December).

7 Dividend for RWE AG's 2000 truncated fiscal year (July to December).

20% rise in dividend

We will propose a dividend of €1.50 for fiscal 2004 to the Annual General Meeting.

The Supervisory and Executive Boards will propose a dividend of €1.50 per share for fiscal 2004 to the Annual General Meeting on April 14, 2005. This represents an increase of 20% compared with the previous year. Based on the closing share prices in 2004, this corresponds to a 3.7% dividend yield on common shares and a 4.4% yield on preferred shares. RWE thus still ranks among the premiere DAX stocks.

Weighting of RWE capital market instruments in important indices
as of December 31, 2004

Share indices	Weighting
DAX	3.9 %
Dow Jones EURO STOXX 50	1.1 %
Dow Jones STOXX	0.4 %
Dow Jones STOXX Utility	6.5 %

Bond indices	Weighting
iBoxx Euro Utilities	11.7 %
Dow Jones iTraxx Energy	5.0 %
MSCI Euro Credit Corporate	1.6 %
MSCI Eurosterling Credit Corporate	3.5 %

Free float up to 89 %

In the last two years we increased the share of our capital under foreign ownership from 15 % to 24 %. Our shareholder base in North America and the UK thus rose from a combined 11 % to 17 %. The remaining 7 % are predominantly held by investors in Continental Europe. Including major German investors, 51 % of RWE's share capital is held by institutional investors, 33 % by municipalities and 16 % by private and employee shareholders. The reduction in shares held in RWE by Allianz AG and Münchener Rück AG contributed to the rise in free float. The stakes held in RWE AG by these companies have now fallen below the 5 % threshold. Allianz and Münchener Rück now hold stakes of 4.3 % and 4.9 %, respectively. This caused free float to rise from 78 % to 89 %. Consequently, RWE's weighting in the leading indices will increase.

Our shareholder base in the US and UK expanded to account for 17 % of RWE's share capital.

Issuances marked by focus on core business and optimization of financial structure

In February 2004 we placed 32.6 million shares in HOCHTIEF AG on the stock market as well as a three-year exchangeable bond on HOCHTIEF shares with a nominal volume of €200 million. This combined transaction was the largest of its kind by then for a German issue on a single day. In May 2004 we arranged a similar issuance, placing about 30 million shares in Heidelberger Druckmaschinen AG along with a three-year exchangeable bond with a volume of €460 million. The two bonds are covered by the remaining shares we own in the two companies. In addition, we made our bond investors an attractive offer for a combined buyback and conversion of two bonds in July 2004. It was intended for holders of issues maturing in 2007 and 2008 and was met with keen interest. With this transaction, our objective was to take advantage of the favorable market environment to reduce gross debt and smooth our bonds' maturity profile. Due to the strong demand, the buyback volume was increased. Furthermore, we issued a €650 million bond that matures in 2014. RWE's 2004 gross issuance volume thus totaled €1.3 billion. By the end of 2004, a total of €19.4 billion in bonds were on the market*. €1.2 billion in bonds will mature this year.

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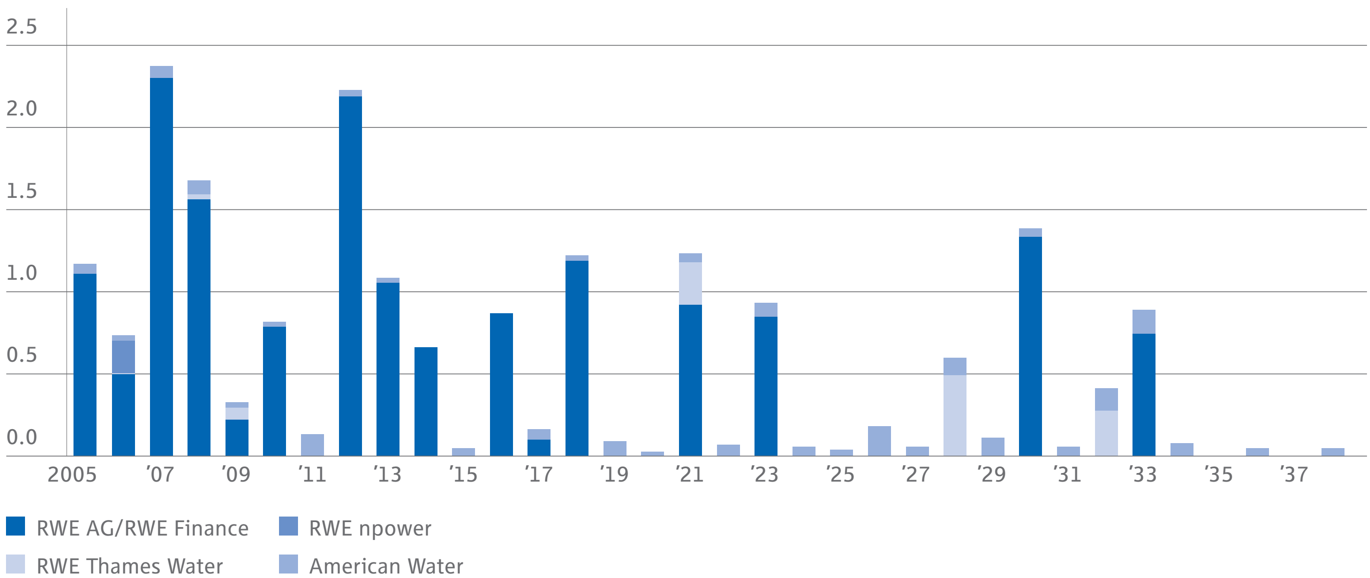
RWE Group—maturity profile of capital market debt
€ billion



Low credit default swap prices reflect RWE's high creditworthiness.

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High credit rating maintained

The leading rating agencies gave RWE a high credit rating. Standard & Poor's confirmed RWE's A+ rating in June 2004. RWE has been rated A1 by Moody's since the middle of 2002. Both ratings have a negative outlook. It was linked, among other things, to the previous level of net debt, which we have now reduced, exceeding our target. In addition, the rating agencies will monitor the development of risks from the planned introduction of a German grid regulator. Our high rating and the trust the capital market places in us are also reflected in the tight bond spreads* and low levels of credit default swaps* (CDS). Many market participants now use the credit default swaps as an indicator of a company's creditworthiness.

Development of RWE's five-year credit default swap
in basis points

RWE receives another award for high-quality investor relations work

By communicating intensively and openly, we want to enable all capital market players to evaluate RWE's business appropriately and assess our strategy. In the year under review, our communication activities centered on providing explanations and commentaries regarding the regulation of the German energy market and of the UK water market. Another focal topic was the trading of CO_2 emissions allowances which began in 2005. We assisted analysts and investors in arriving at a realistic assessment of these issues by providing them with information and establishing dialogue with RWE specialists. Another key issue was the explanation and commentary relating to our divestment strategy. We met with investors in 28 financial centers during 45 road shows, 14 conferences and numerous one-on-one discussions during which we made presentations and answered questions.

Electricity and gas market regulation and emissions trading were the main topics of our dialogue with investors and analysts.

In 2004 we received yet another award for our communications work. Besides further awards, for the third time in a row, RWE was ranked first among companies represented in the Dow Jones Euro STOXX Index by the investor relations survey conducted among investors and analysts by the German business magazine "Capital."

Group Strategy

Figuring among the four largest utility companies in Europe is not worth much alone. The yardstick we use instead of size is profitability. Our goal is to become the No. 1 player in earnings growth and stability combined. What is of essence to us is to generate continuous growth in our operating result even in periods of cyclical tension.

RWE's business model has low cyclical exposure.

RWE's business model is based on the generation and sale of energy and the sale of water. Our multi-regional portfolio is focused on Germany, the UK, Central Eastern Europe and the US water industry. We rank among the market leaders in at least one of our core businesses in these regions. Our portfolio thus has little cyclical exposure.

Balanced presence in mature and growing markets

In light of the long investment cycles in our fields of business, we are active only in markets that offer both stable earnings growth and a reliable business environment. Germany and the UK account for 55 % and 20 % of Group revenue, making them our major sales markets. Growth in demand is relatively low in these countries. However, anyone who can offer more than one product in one region has both cost and competitive advantages. In addition, Europe's single market for energy is gradually converging. As we are a multi-regional company, this offers additional potential. The markets of Central Eastern Europe are currently growing at above average rates when compared with their Western European neighbors. We positioned ourselves in Central Eastern Europe early on: 10 % of the Group's operating result already comes from this region.

Vertical integration across the value chain

Our operations are vertically integrated: we cover all of the major links in the value-added chains of each of our core business fields. For example, instead of limiting ourselves to generating electricity, we trade, operate grids for it and distribute it as well. We improve our result through the synergies we have as a vertically integrated company. This also means that we are less exposed to market changes in different parts of the value chain.

Regulated business—using stability to add value

We generate half of our operating result in regulated businesses.

The public supply of electricity, gas and water is either partially or fully subject to strict regulation. This primarily affects the grid business in the electricity and gas sectors in Germany and the UK as well as in Eastern European markets. The water industry's entire value chain is generally regulated. Companies committed to cost discipline and constant improvements in performance can generate stable growth in profits on these markets. RWE has been successfully active in regulated sectors for a long time. We achieve about half of our result in this business.

Market and cost leadership

Thanks to our leading market positions and competitive cost structure, we make a reasonable return in our markets even if the pressure on prices is high. Electricity, gas and water are commodities, so suppliers are not able to differentiate themselves from competitors through product features. Thus, cost advantages become more crucial. This is especially true given that incentive systems are increasingly used to regulate the distribution of electricity, gas and water over networks. If extremely efficient utility operations are rewarded with added earning potential, cost management is a key parameter for success.

Regionally integrated structures—value-oriented sales policy

Since our sales and grid companies have regional structures across all products and services, we can focus more sharply on the customer and promote decentralized entrepreneurship. By integrating our electricity, gas and water operations in companies which have firm local roots while being flexible, we realize synergies in terms of customers, costs and expertise. The basic premise is “margin over volume.” We focus on customer groups that have the potential to add value over the long term.

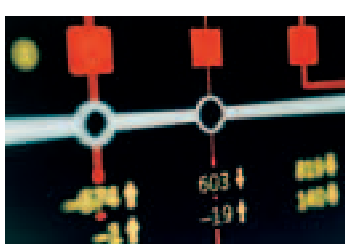
We focus on customer groups with potential to add value over the long term.

Value management, a central management and control tool

Long-term growth in value in the best interest of our investors, employees and customers is the focal point of our strategy. This is why we always measure important decisions based on the contribution they make to increasing our return on capital employed (ROCE). This and free cash flow are the yardsticks of the performance-linked compensation of our executives.

Free cash flow and ROCE are the yardsticks for determining the performance-linked compensation of executives in the RWE Group.

Review of Operations



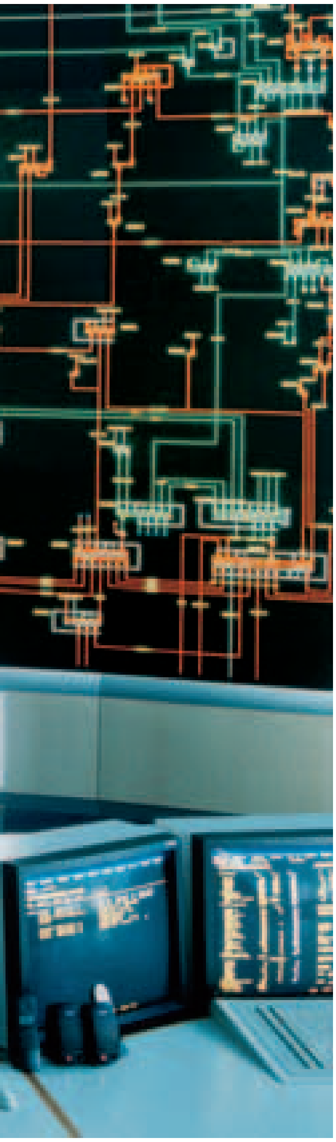
△ **Power grid control panel**

Detailed view of a station map

At work

Projection wall modules

»Demand for power fluctuates constantly. But supply security doesn't.«



"From where we sit, we can observe what people in Germany are up to. Electricity consumption curves react immediately whenever people take a shower, watch television, cook or turn off a light. And we react to these fluctuations. As fast and flexibly as possible. This is why we installed a **new main switch line.** It enables us to monitor power grid capacity even more accurately. This reduces the need for reserve and conserves resources. I think that in a nutshell: Whatever you do, we're right there with you."

Heinz Wolf, engineering MA, 1st Switch Engineer, Brauweiler Main Power Switch Line, RWE Energy

Performance improved— focus completed

In fiscal 2004, we achieved three major goals. We completed our focus on our core businesses: energy and water. We exceeded our debt-reduction target. The cost-cutting program initiated in 2000 has been fully implemented. In addition, we increased our operating result by 8 %.

Economic environment

Economic trend in RWE's key markets: Eurozone records sub-par growth

In 2004 the global economy experienced a boom. Gross domestic product (GDP) posted 5 % real growth, eclipsing the last boom of 2000. Although average GDP was high, the trend flattened out over the course of the year. The economy began to lose steam especially in the second half of the year, owing to the steep rise in oil prices and largely restrictive monetary policy.

Germany posted 1.6 % real economic growth in 2004. The UK, our second-largest core market, recorded an increase of 3.1 %.

RWE's core markets varied in momentum in 2004. Eurozone countries had relatively weak economic trends. Stimuli from the EU single market were generally moderate. Moreover, the rise of the euro against the US dollar hampered exports. Compared with the previous year, real GDP thus rose by a mere 1.6 %. Germany, RWE's largest key market, also posted 1.6 % growth in GDP. This was due to the fact that export activity was brisk despite the unfavorable currency exchange rates. However, export activity decreased in the second half of the year. Furthermore, there were about five working days more than in 2003. As high unemployment levels persisted, private consumption continued to decrease. However, the economy recovered somewhat following a brief period of stagnation in the third quarter. This was primarily driven by the service sector.

The UK economy, RWE's second largest core market, displayed far more dynamic development than the Eurozone. In the autumn, the economic climate cooled down somewhat as capital expenditure on equipment decreased. Growth in discretionary income and the stable labor market promoted consumer spending. Government spending rose as well. This enabled the UK to increase real GDP by 3.1 %, besting the Western European average.

The Central Eastern European EU accession countries continued on their road to expansion. Some of them were even able to exceed the previous year's high growth rates. Booming industry and increased export activity were the main drivers. In addition, inflationary pressure dwindled during the course of the year, strengthening consumer purchasing power. Poland had the strongest momentum among RWE's core markets, posting a gain of 5.5 %. Hungary achieved a 3.9 % rise in GDP, with the Czech Republic and Slovakia recording increases of 3.6 % and 5.2 %, respectively.

With growth of 4.4 %, the USA—alongside China—was the engine of the world's economy. The US Federal Reserve Bank employed a somewhat stricter monetary policy over the course of the year, but this hardly had an effect on private consumption since the situation on the labor market continued to improve.

Investment activity was robust as well. Furthermore, the weak dollar boosted exports.

However, the economic developments in our core markets described above had only a limited impact on our business trend. Energy consumption generally tends to react little to changes in GDP. Economic dynamics have a much stronger effect on demand among industrial enterprises. Home energy consumption largely depends on weather conditions. The water sector is even less susceptible to economic cycles. By contrast, our non-core businesses reacted much more sensitively, displaying typical behavior. However, we significantly reduced the effects of cyclical exposure on the Group's result by selling stakes in the HOCHTIEF construction group and the printing machine manufacturer Heidelberger Druckmaschinen. Once the divestment of our waste management business, which is scheduled for 2005, has been completed, the Group's cyclical exposure will be decreased even further.

Energy consumption grows less than in previous year

The favorable economic situation and adverse weather conditions characterized Germany's energy consumption.

The energy consumption trend in our core markets lost momentum compared with 2003. Whereas the favorable economic situation led to growth in demand, weather conditions largely caused demand to drop. In Germany, electricity consumption increased marginally despite the moderate growth of the economy. This was primarily due to the mild autumn and winter months as well as the relatively cool summer. As a result, less electricity was used for heating and air-conditioning. Gas consumption was marginally up year-on-year, principally owing to the rise in demand from industry.

In the UK, sustained economic growth was reflected in an increase in demand for electricity of almost 3 %. Weather-related effects had an adverse impact on consumption. Natural gas consumption rose by 2 %. Gas usage in power production rose by 9 %. Conversely, the mild winter dampened demand for heating gas.

Robust economic growth and adverse weather effects marked energy consumption in Central Eastern Europe as well. Poland recorded the steepest climb in demand for electricity (nearly 3 %) among the electricity markets on which we are active. Electricity consumption in Hungary was up 1 % while it stagnated in Slovakia. Demand for gas advanced moderately as well. In the Czech Republic, our main market in Eastern Europe, demand was virtually flat, with Hungary showing a rise of 1 %.

Electricity prices rise due to increase in fuel costs

Following the considerable increase in 2003, prices on European electricity markets stabilized at a high level. On average, they were higher than in the previous year. This was primarily a result of the steep rise in fuel prices. In Germany, this applied especially to hard coal*. The development of electricity prices also reflects the fact that power plant capacity became more scarce. This was obvious principally on the wholesale futures markets. On the German Energy Exchange (EEX*) one-year forwards cost 19 % (base load*) and 13 % (peak load*) more than in 2003. Prices in the end consumer business advanced too, primarily because power utilities passed higher electricity purchasing costs on to their customers. In Germany, prices paid by households and small commercial operations rose by an average of 3 %. Prices for industrial customers were up 5 %, with distributors recording an increase of some 8 %. Excluding taxes and levies, household customer prices in real terms were approximately 20 % below the level in 1998, the year in which the deregulation of the German energy market commenced. Average net electricity prices paid by industrial customers in 2004 were about one third lower in real terms than in 1998.

The average price of forward contracts on the German wholesale market continued to rise in 2004.

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Averaged for the year, UK electricity prices rose even more significantly. One-year forwards for base-load power jumped 47 % year-on-year. For peak-load power, they were up 33 %. Once again, the main reason was the fuel price trend. Natural gas has a very strong influence on prices. Electricity prices also rose on the UK end consumer market. They thus mirrored the price trend on the futures markets prior to 2004. In the period under review, all major utilities lifted their tariffs—some of them several times. Compared to the average price in 2003, households had to pay 6 % more for electricity. Prices for industrial customers rose even more steeply.

UK electricity prices rose considerably, mainly due to the steep increase in fuel costs.

Electricity prices also advanced on the Central Eastern European markets in which we operate. End customers in Hungary paid 9 % more than in the previous year. In Hungary, prices are determined by a governmental authority. In Poland, end consumer electricity prices were up 2 % and in Slovakia, they were up 4 %.

Marked rise in oil prices not yet reflected in gas prices

International oil markets reported a rapid increase in prices in the first three quarters, peaking at record highs above US$ 50 per barrel of Brent* crude in October. This was due to the strong rise in demand, primarily in China. At the same time, oil-producing countries had reached their capacity limits. Furthermore, the largest oil-consuming countries temporarily had very low inventories. The price of Brent slipped marginally towards the end of 2004. Averaged over the year, Brent sold for US$ 38.26 per barrel, surpassing the previous year's high level by 33 %. How-

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ever, the price hike in Eurozone countries was less pronounced owing to the euro's strength against the US dollar. Denominated in euros, Brent crude was 21 % more expensive in these countries than in 2003.

German gas imports were 3 % cheaper on average. Prices on the UK gas spot market were up 20 %.

Cross-border prices of natural gas in Central Europe advanced during the year, but were slightly below the average for 2003. Gas prices typically track the development of oil prices with an average lag of six months. As a result, they were still characterized by the temporarily moderate oil prices from the second half of 2003. The weak US dollar also had a price-dampening effect. German gas imports were 3 % cheaper on average, but they became much more expensive over the course of the year. This was reflected in end customer prices. Averaged over the year, import and end customer prices in the Czech Republic were stable. Prices on the UK gas spot market* were 20 % higher than in the previous year. This is partially due to the strong rise in demand from power producers. Gas prices charged to household customers were up 7 %.

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Regulated water market expands due to investment into infrastructure

The regulated water markets in Europe and North America, RWE's core regions, recorded stable growth.

The market for regulated water and wastewater services continued to display stable development. RWE's core regions of Europe and North America generally have low susceptibility to economic cycles. Consumption, however, sometimes fluctuates for weather-related reasons. Heavy rainfall in the summer of 2004 caused a drop in water sales in several US states. Thanks to the need for investment into the improvement of water infrastructure, which is remunerated through state-approved tariff increases, this market has potential for growth. The UK's next five-year regulatory period will commence on April 1, 2005. The privatization of state-owned water supply and wastewater management operations in most Continental European countries is still in its early stages. Private sector participation has so far largely been limited to the construction and expansion of plants and the operation and maintenance of water infrastructure.

Decreasing volume and fierce competition in the German waste-management sector

Germany's waste-management sector was unable to emerge from its crisis in 2004. Market volume and margins continued to shrink. Prices in the commercial waste segment are depressed as remaining landfill capacity is being sold at extremely low prices in the run-up to the implementation of the Technical Guideline for Residential Waste (TASi*). The guideline will be enforced nationwide starting on June 1, 2005 and will ban the dumping of waste that has not been pre-processed. As expected, business with the recycling enterprise "Duales System Deutschland" (DSD) which is the main customer, became even more competitive. The industry was forced to reduce prices considerably when DSD contracts were re-issued.

Germany's waste management market was characterized by shrinking volume and margins in 2004 again.

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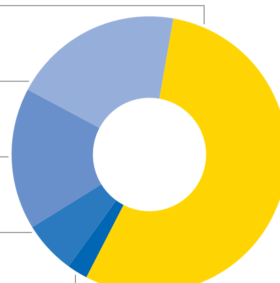
Our business performance

Revenue by region RWE Group	**2004**	**2003**
Germany	54.8 %	51.1 %
UK	20.0 %	18.6 %
Rest of Europe	16.6 %	16.0 %
Americas	6.2 %	10.5 %
Asia/Africa/Australia	2.4 %	3.8 %



Revenue up 6 % net of one-off effects

In 2004 the RWE Group generated € 42.1 billion in external revenue. Compared with the previous year, this represents a 4 % decline. This was principally a result of non-operating one-off effects. The following deconsolidations are noteworthy:

External revenue decreased by 4 % due to one-off effects.

Notes on reporting

Changes in Group and reporting structure

Once the Group's new organizational structure was adopted effective October 1, 2003, we implemented all structural changes starting at the beginning of the 2004 financial year. RWE Thames Water's major Continental European water activities and RWE Trading's industrial customer business were transferred to RWE Energy as of January 1, 2004. All of the operations of the former RWE Gas have been assigned to subsidiaries of RWE Energy. In addition, RWE Trading took over the trading business of our UK-based energy business RWE Innogy, which was renamed "RWE npower" effective August 2004.

At the end of February and the beginning of May, we divested substantial portions of our stake in HOCHTIEF and of our majority interest in Heidelberger Druckmaschinen. Furthermore, at the end of September, we set the course for the sale of our environmental services business. This has an impact on the reporting structure. Our investment in HOCHTIEF used to be accounted for using the equity method*. We stopped accounting for HOCHTIEF at equity in fiscal 2004. The shares we still hold in HOCHTIEF and Heidelberg are now accounted for as securities available for sale. We deconsolidated Heidelberger Druckmaschinen in May 2004. Therefore, the company's first four months are still included in the consolidated financial statements. In compliance with International Financial Reporting Standards (IFRS), we disclose this activity together with the environmental services business as discontinuing operations.

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Change in the treatment of goodwill

In March 2004, the International Accounting Standards Board (IASB) issued new accounting policies according to which goodwill is no longer amortized. Instead, it is subjected to an impairment test at least once a year. We have been applying this rule on a voluntary basis since January 1, 2004 and have thus stopped amortizing goodwill. This has led to a change in the way RWE manages value. Instead of determining goodwill in capital employed on the basis of historical cost, we determine it based on the net carrying amounts used for impairment tests. Although this change became effective in 2004, in the Review of Operations, we comment on the value added before applying this new rule. This ensures that the figures are comparable with those of the previous year. Value added based on the new method is shown in the chapter entitled "RWE´s Value Management" on pages 186 to 188.

- As of September 30, 2003, the US hard coal and gas producer CONSOL Energy was removed from our scope of consolidation. This group of companies belonged to RWE Power. CONSOL achieved €1,425 million in revenue in the first three quarters of 2003.

- Additional revenue was shed with the sale of the lion's share of our 50 % stake in Heidelberger Druckmaschinen. Until it was deconsolidated in May 2004, the printing machine manufacturer generated €1,359 million compared with external revenue of €3,658 million for fiscal 2003 as a whole.

We also classify the impact of currency exchange fluctuations as non-operating effects. However, these were virtually negligible since the currency trends of our foreign operations essentially offset each other. Sterling appreciated over the euro. In 2004 the average pound-to-euro exchange rate was £0.68/€ compared with £0.69/€ in the previous year. This impact was felt by revenue contributed by RWE Thames Water and RWE npower in the UK, which was 2 % higher in euros than in pounds. Conversely, the US dollar traded at US$ 1.25/€, losing considerably since 2003 (US$ 1.14/€). This diluted American Water's revenue by 8 %.

Net of all the non-recurrent effects of deconsolidation and currency exchange fluctuation, Group revenue improved by 6 %.

RWE Trading posted the strongest growth, benefiting from the takeover of RWE npower's trading business effective January 1, 2004, among other things. In addition, prices on the electricity and coal markets increased, as did sales of electricity produced by RWE in-house. Excluding deconsolidation effects, RWE Power also recorded a gain. This was partially due to revenue added from the provision of balancing power and price-induced growth in RWE Dea's oil operations. Net of consolidation and currency exchange effects, revenue generated by RWE Thames Water rose as well. The basis for this were tariff increases in the regulated business in the UK and USA. RWE Energy's revenue benefited from the effects of reclassification. As mentioned earlier, we transferred substantial parts of RWE Thames Water's Continental European water business to RWE Energy's regional companies as of January 1, 2004. RWE Solutions, a business unit of RWE Energy, assumed RWE Trading's key electricity accounts at the beginning of 2004. Net of these one-off effects, revenue produced by RWE Energy was 1 % up on the previous year's level. Despite the transfer of its trading business, UK-based RWE npower posted a slight gain as it lifted electricity and gas prices in the end consumer segment in order to pass on the rise in costs. RWE Umwelt shed revenue above all as a result of the sale of the remaining foreign operations as well as numerous peripheral activities. This business produced marginal organic growth in revenue.

A detailed description of the revenue trend by division is presented on pages 76 to 113.

External revenue €million	**2004**	**2003**	**+/–** in %
RWE Power	2,919	4,077	–28.4
RWE Energy	22,450	21,842	2.8
RWE npower	5,605	5,552	1.0
RWE Trading	3,822	2,444	56.4
RWE Thames Water	4,065	4,249	–4.3
Discontinuing activities[1]			
RWE Umwelt	1,830	1,944	–5.9
Heidelberger Druckmaschinen	1,359[2]	3,658	–62.8
Other/consolidation	87	109	–20.2
RWE Group	**42,137**	**43,875**	**–4.0**

1 Discontinuing operations in accordance with International Financial Reporting Standards (IFRS).

2 Only covers the period until the deconsolidation in May 2004.

Operating result and EBITDA clearly higher net of one-off effects

Net of one-off effects, EBITDA rose by 5 % and the operating result was up 10 %.

The persistent upward trend in the energy business was the main driver behind the continued improvement of our earnings situation. This organic growth was overshadowed by the counteracting effects of deconsolidations and changes in currency exchange rates.

EBITDA[1] € million	2004	2003	+/– in %
RWE Power	2,460	2,631	–6.5
RWE Energy	2,927	2,750	6.4
RWE npower	698	850	–17.9
RWE Trading	111	59	88.1
RWE Thames Water	1,979	2,018	–1.9
Discontinuing activities[2]			
RWE Umwelt	190	230	–17.4
Heidelberger Druckmaschinen	96[3]	120	–20.0
Other/consolidation	–61	–182	66.5
RWE Group	**8,400**	**8,476**	**–0.9**

1 Earnings before interest, taxes, depreciation and amortization.
2 Discontinuing operations in accordance with IFRS.
3 Only covers the period until the deconsolidation in May 2004.

At € 8,400 million, EBITDA was about the same as a year earlier. Excluding consolidation and currency effects, EBITDA increased by 5 %.

Reconciliation of EBITDA to the operating result € million	2004	2003	+/– in %
EBITDA	8,400	8,476	–0.9
– Operating depreciation and write-downs	–2,836	–3,130	9.4
EBIT	5,564	5,346	4.1
+ Operating income from investments	412	205	101.0
Operating result	**5,976**	**5,551**	**7.7**

We lifted the Group’s operating result by 8 % to € 5,976 million. It thus developed better than EBITDA. This was due to two factors. First, there was a significant decline in depreciation (–€ 294 million) because we deconsolidated CONSOL and Heidelberg, two very asset-intensive businesses. Second, income from investments improved (+€ 207 million) largely due to the discontinuation of goodwill amortization for companies accounted for using the equity method. These issues did not affect EBITDA since this figure does not include depreciation or income from investments.

Excluding consolidation and currency effects from the operating result leads to a rise of 10 %.

Operating result € million	**2004**	**2003**	**+/–** in %
RWE Power	1,742	1,682	3.6
RWE Energy	2,192	2,046	7.1
RWE npower	604	714	–15.4
RWE Trading	104	59	76.3
RWE Thames Water	1,389	1,374	1.1
Discontinuing activities[1]			
RWE Umwelt	76	76	–
Heidelberger Druckmaschinen	34[2]	–118	128.8
Other/consolidation	–165	–282[3]	41.5
RWE Group	**5,976**	**5,551**	**7.7**

1 Discontinuing operations in accordance with IFRS.

2 Only covers the period until the deconsolidation in May 2004.

3 Includes the operating result contributed by HOCHTIEF (€ 9 million).

The following is a breakdown of the operating result by division:

RWE Power

Higher wholesale electricity prices and further cost reductions were the basis for the double-digit organic growth of RWE Power’s operating result.

RWE Power improved its operating result by 4% over the previous year’s level. Organically-induced improvements in the result were somewhat counteracted by deconsolidation effects, with the sale of CONSOL the most significant factor (–€ 171 million). Moreover, we deconsolidated our Portuguese Turbogas/Portugen power plant operations as of September 30, 2004 (– € 12 million). Excluding the aforementioned divestments, the operating result would have risen by 16 %. Growth in the operating result came from the Power Generation Business Unit which posted a gain of 25 %. This was mainly due to the increase in wholesale electricity prices and the slight advance in generation output. In addition, we realized further savings through our cost-cutting program. By contrast, the operating result recorded by RWE Dea was 8 % lower than the very high level posted a year earlier. This was predominantly due to the weak US dollar. While we succeeded in partially offsetting the negative currency effect by currency gains on hedges, these gains were much lower than in 2003. Compared with the previous year, the overall effect was thus negative. Moreover, RWE Dea was unable to fully benefit from the boom on crude oil markets because it concluded oil price hedges. Harpen's operating result matched the previous year's level despite the fact that the 2003 result included exceptional income from divestments in the real-estate sector. This was due to the improved earnings situation in the energy business.

RWE Energy

Our earnings situation in the Continental European sales and grid business in the fields of electricity and gas continued to improve. The operating result posted by RWE Energy was 7 % up year-on-year. Income from investments achieved especially strong growth. This was principally due to the discontinuation of goodwill amortization for companies accounted for using the equity method. Our German regional companies improved their operating result by 4 %. We recorded organic growth above all in electricity sales to end customers. One of the contributing factors was our value-oriented sales policy. Furthermore, we implemented additional cost-cutting measures. Our Continental European sales activities outside Germany boosted their operating result by 46 %. Contributing factors here were improved margins in the Hungarian electricity business and in the Czech gas business. Our Polish subsidiary STOEN benefited from a drop in electricity procurement costs. By contrast, the operating result contributed by RWE Solutions declined by 11 %. This decrease was largely due to one-off charges from a large-scale plant construction project. The Electricity/Gas Transmission Business Unit closed fiscal 2004 with 3 % year-on-year growth in its operating result which included the result contributed by the newly established German gas transmission company for the first time.

RWE Energy grew its operating result especially outside Germany.

RWE npower

RWE npower's operating result was 15 % less than the year-earlier level. In 2003, the operating result reflected the extremely strong earnings of the trading business which was transferred to RWE Trading. Net of these activities and currency effects, the operating result was up 17 %. This was primarily due to improved margins in the sales business. In addition, RWE npower implemented further cost-cutting measures. Here the company has benefited from synergies with RWE Thames Water. Lower generation output following planned and unscheduled power plant outages led to a shortfall in earnings. There was a rise in fuel purchasing costs, and power supply agreements with very favorable conditions expired.

Net of one-off effects, RWE npower increased its operating result by 17 %.

RWE Trading

RWE Trading benefited from the assumption of the RWE npower trading activities.

RWE Trading's operating result increased by 76 %. One reason for this was the assumption of RWE npower's trading business. However, the result contributed by these activities was considerably lower than the outstanding level achieved in 2003. Margin improvements in the Continental European electricity trading business also contributed to the rise in the operating result.

RWE Thames Water

RWE Thames Water increased its operating result by 8 %, net of one-off effects.

The operating result achieved by RWE Thames Water increased by 1 %. Organic improvements enabled the division to absorb negative one-off effects. Non-recurrent effects stemmed from exchange rate fluctuations (–€ 54 million), the transfer of parts of the Continental European business to RWE Energy (–€ 27 million) and the sale of small peripheral activities. Excluding these one-off effects, RWE Thames Water grew its operating result by 8 %. Our US water utility American Water succeeded in introducing tariff increases for the regulated business and benefited from efficiency enhancements. In dollar terms, the operating result rose by 7 %. We also achieved a gain in the UK business thanks to cost reductions realized through the Group's reorganization and synergies with RWE npower. Furthermore, income from investments improved. Higher water prices in Berlin were the main driver. Businesses outside RWE's core regions closed fiscal 2004 with a lower operating result compared with 2003.

RWE Umwelt

RWE Umwelt maintained its operating result at the previous year's level, despite the sector's weakness.

The RWE Umwelt operating result maintained the previous year's level despite the difficult market environment and the sale of several companies. This was due to progress made in the ongoing business realignment and cost-cutting program as well as improved income from investments.

Value management: 2005 ROCE target already exceeded*

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ROCE was 12.8 %, surpassing the 2005 target. Value added more than doubled.

RWE's value rose again considerably in 2004. We measure the extent of value added by the Group's return on capital employed (ROCE). In the year under review, ROCE was 12.8 %, clearly exceeding the Group's pretax cost of capital of 9.0 %. We have thus already surpassed the goal we set for 2005. In February 2004, we announced our ambition to achieve ROCE of at least 11 % by the end of 2005. Our strong organic growth in 2004 is reflected clearly by the absolute value added to the Group. This figure is obtained by multiplying the difference between ROCE and the capital cost by capital employed. The Group's capital employed totaled about € 46.9 billion. This translates into € 1,778 million in value added, more than twice as much as in 2003.

Value added by RWE Power increased substantially. It rose by 54 % to € 948 million largely due to the organic growth of our German power generation business. Value added by RWE Energy advanced by 15 % to € 925 million primarily as a result of the aforementioned improvements in the result generated in regions outside Germany. RWE Thames Water also grew value added. However, the division contributed –€ 189 million in value and was thus still in the red. This reflects the goodwill from the acquisition of Thames Water and American Water included in capital employed. RWE npower also clearly failed to earn back its capital costs, delivering negative value added of –€ 100 million. This outcome was also affected by the goodwill resulting from the acquisition by RWE. Value added worsened due to the division's weaker earnings. RWE Trading added € 46 million in value, also below the previous year's level. The reason for this was the assumption of RWE npower's trading activities including associated goodwill which increased capital employed. In 2004, RWE Umwelt was again unable to earn back its cost of capital due to the persistently difficult market environment (–€ 51 million). Value added by the Heidelberg Group rose by € 410 million to –€ 76 million. This was due to the company's deconsolidation in May 2004. In the first quarter of the calendar year, Heidelberg typically generates an above average return on capital employed.

As explained earlier in this report, in fiscal 2004, we have adapted our value-management concept to comply with International Financial Reporting Standards. However, the figures described above were calculated using the previous method. This enables a comparison with the previous year. Applying the new method results in ROCE of 13.5 % for the RWE Group. Absolute value added totals € 1,998 million. Figures are higher when the new method is used since the adjustments caused capital employed to decline. For further information, please turn to pages 187 and 188 of this annual report.

Net income improves considerably

The reconciliation of the operating result to the RWE Group's net income shows that in addition to generating organic growth in the operating result, we also improved both the non-operating and financial results.

Non-operating result € million	**2004**	**2003**	**+/–**
Capital gains	678	1,024	–346
Impairment losses/goodwill amortization	–492	–985	493
Restructuring, other	258	–589	847
Non-operating result	**444**	**–550**	**994**

Our non-operating result rose by nearly €1 billion to €444 million. The following effects had an impact:

- Capital gains declined by €346 million to €678 million. The previous year's figure was exceptionally high as a result of the sale of the first two tranches of our stake in CONSOL. In the year under review, we divested our remaining 18.5% interest in CONSOL (+€220 million). The sale of the lion's share of our 50% shareholding in Heidelberger Druckmaschinen (+€200 million) and of our stake in Swiss-based Motor-Columbus and Atel (+€136 million) were two further major transactions.

The non-operating result increased primarily due to the discontinuation of goodwill amortization.

- Goodwill amortization was cut in half to €492 million due to the change in accounting principles. We stopped amortizing goodwill in 2004. Conversely, we had impairment losses in 2004, which thus reflect a book loss of €292 million from the agreed sale of the bulk of our environmental services business to the Rethmann Group. The remaining €200 million are allocated to water activities outside RWE's core regions.

- Results disclosed under "restructuring, other" amounted to €258 million, clearly surpassing the negative figure recorded in 2003. This was mainly because the 2003 figure included particilarly high provisions, accrued to cover the expected charge associated with the restructuring of Heidelberger Druckmaschinen (€627 million) and the reorganization of the RWE Group (€250 million). Income from the change in nuclear provisions totaled €717 million and was thus markedly lower than in 2003 (€ 1,200 million). The amortization of RWE npower's customer base rose from € 147 million to € 330 million since, starting in 2004, we reduced the amortization period from 20 to 10 years.

Financial result € million	**2004**	**2003**	**+/–** in %
Interest income	1,117	1,116	0.1
Interest cost	–2,247	–2,247	–
Interest result	**–1,130**	**–1,131**	**0.1**
Interest accretion to long-term provisions	–1,327	–1,558	14.8
Other financial result	–28	–189	85.2
Financial result	**–2,485**	**–2,878**	**13.7**

The financial result improved by € 393 million or 14 % to –€ 2,485 million. This was due to the fact that long-term provisions decreased considerably, especially as a result of the deconsolidation of CONSOL. Associated interest accretion was thus lower. But the interest result was merely on a par with the previous year's level, despite the decline in debt and the improvement in earnings in our asset management activities. This reflects the replacement of short-term financing for the acquisition of American Water with higher-interest, long-term funds. In addition, there was a one-time charge from the bond buyback and conversion of bonds in July.

CONSOL's deconsolidation had a positive effect on the financial result.

Income before tax amounted to € 3,935 million. Compared with the previous year's figure excluding goodwill amortization, this represents a gain of 27 %.

Income after tax rose to € 2,414 million. Without taking the previous year's goodwill amortization into account, this results in an increase of 26 %. On this basis, the effective tax rate increased marginally to 39 %, because the figure for 2004 includes impairment losses which reduce income, but not the tax burden. Excluding impairment losses, the effective tax rate would have dropped.

The minority interest rose substantially. It caused net income to decrease by € 277 million. This reflected the substantial improvement in the operating result contributed by the Heidelberg Group. In the previous year, the minority interest was –€ 17 million and thus increased net income.

Net income improved by 10 % compared with the previous year's figure excluding goodwill amortization.

Net income generated by the RWE Group totaled € 2,137 million. We thus exceeded the previous year's corresponding figure (excluding goodwill amortization) by 10 %. Corresponding earnings per share grew from € 3.45 to € 3.80.

Commercial income statement		**2004**	**2003**	**+/– in %**
Income from operating activities	€ million	5,574	4,701	18.6
+ Income from investments	€ million	846	300	182.0
– Non-operating result	€ million	–444	550	–180.7
Operating result	€ million	**5,976**	**5,551**	**7.7**
Non-operating result	€ million	444	–550	180.7
Impairment losses, goodwill amortization	€ million	–492[1]	–985	50.1
Financial result	€ million	–2,485	–2,878	13.7
Income before tax	€ million	**3,935**	**2,123**	**85.4**
Taxes on income	€ million	–1,521	–1,187	–28.1
Income after tax	€ million	**2,414**	**936**	**157.9**
Minority interest	€ million	–277	17	–
Net income	€ million	**2,137**[2]	**953**	**124.2**
Previous year excluding goodwill amortization	€ million	2,137	1,938	10.3
Earnings per share	€	**3.80**	**1.69**	**124.9**
Previous year excluding goodwill amortization	€	3.80	3.45	10.1
Effective tax rate	%	**39**	**56**	**–30.4**
Previous year excluding goodwill amortization	%	39	38	2.6

1 Impairment losses; due to changes in IFRS, we stopped amortizing goodwill in 2004.

2 –€ 313 million of this sum are allocable to discontinuing operations in accordance with IFRS (previous year: –€ 609 million).

Operating cash flow was 7 % below the high level achieved in the previous year due to one-off effects.

Free cash flow improved by 62 %

At € 4,928 million, cash flows from operating activities were 7 % down on the high level achieved in the previous year, which contained cash flows from CONSOL's operating activities (€ 163 million). In addition, in 2004, more money was spent on restructuring. Working capital also felt an impact: we reduced trade accounts payable considerably. Furthermore, we made higher income and sales tax payments as a result of audits for assessment periods in prior years. Excluding the non-recurrent effects of tax payments and the deconsolidation of CONSOL, operating cash flow was slightly up on the previous year.

Capital expenditure* and divestments led to a net –€1,574 million in cash flows from investing activities. In 2003, this figure was –€6,816 million largely due to the acquisition of American Water. Our efforts to improve our financial structure and reduce debt even further is reflected in –€4,009 million in cash flows from financing activities. This was the sum by which redemptions and dividends paid exceeded the amount of borrowing. In the previous year, the €1,639 million of cash flows from financing activities reflected the higher financing requirement for the acquisition of American Water. Cash and cash equivalents have declined by €655 million since the beginning of 2004.

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Free cash flow is calculated by deducting capital expenditure on property, plant and equipment from cash flows from operating activities. Free cash flow amounts to €1,499 million and is thus clearly higher than the dividend distribution planned for the financial year that just ended. Compared with 2003, free cash flow was up by €572 million, or 62 %. This was a result of the decrease in capital expenditure on property, plant and equipment (–€933 million) which was partially caused by deconsolidations.

Cash flow statement* € million	**2004**	**2003**	**+/–** in %
Cash flows from operating activities	4,928	5,289	–6.8
Change in working capital	–623	–58	–974.1
Cash flows from investing activities	–1,574	–6,816	76.9
Cash flows from financing activities	–4,009	1,639	–344.6
Net change in cash and cash equivalents	–655	38	–
Cash and cash equivalents at year-end	1,526	2,181	–30.0
Cash flows from operating activities	4,928	5,289	–6.8
Minus capital expenditure on property, plant and equipment	–3,429	–4,362	21.4
Free cash flow	**1,499**	**927**	**61.7**

* The complete cash flow statement can be found on page 118 of this report.

We have already exceeded our goal of reducing net financial debt to less than €17 billion by 2005.

Debt-reduction target surpassed: net debt down to €12.4 billion

As of December 31, 2004, net financial debt amounted to €12.4 billion compared with €17.8 billion at the end of 2003. This considerable decline was due to cash flows from operating activities and—above all—to proceeds from the sale of investments. Major sales in 2004 included the divestment of shares in Heidelberger Druckmaschinen (€825 million), HOCHTIEF (€750 million), Motor-Columbus/Atel (€277 million), CONSOL (third tranche: €228 million) and Turbogas/Portugen (€207 million). Proceeds were also received from the sale of property, plant and equipment (€683 million) largely consisting of real estate. Deconsolidations, with Turbogas and Heidelberg leading the way, wiped €0.9 billion in financial debt off our balance sheet. Currency effects reduced debt by €0.2 billion. Capital expenditure on property, plant and equipment as well as financial assets totaled €3.7 billion. Dividends paid increased net financial liabilities by €0.9 billion. Net debt does not include derivative financial instruments which we use to hedge our liabilities against currency and interest-rate movements. As of December 31, 2004, financial derivatives had a fair value of €2.0 billion.

Group financing structure € million	**12/31/04**	**12/31/03**
Capital market debt	23,177	27,351
Money market debt	1,705	2,287
Other debt	2,501	2,152
Gross financial debt	**27,383**	**31,790**
Minus securities/cash and cash equivalents	–13,575	–12,346
Minus other assets	–1,423	–1,606
Net financial debt	**12,385**	**17,838**

We have thus already surpassed our medium-term, net debt-reduction goal. We had announced our intention of reducing net financial debt to less than €17 billion by the end of 2005. This target is based on the following exchange rates: US$1.20/€ and £0.70/€ and does not include the impact of the divestment of HOCHTIEF and Heidelberg and the initiated sale of RWE Umwelt. Based on these parameters, net financial debt totaled €15.2 billion at the end of 2004.

Favorable financing thanks to strong rating

Financing in the RWE Group is generally handled by the holding company. This enables all our divisions to benefit from our economies of scale. By balancing financing budgets throughout the Group, we reduce the amount of outside financing needed and optimize our cash and capital assets. We use various instruments to meet our financing requirements. Financing activities focus on raising funds on the capital market within the scope of our €20 billion debt issuance program* as well as on money market financing through our US$ 5 billion commercial paper program*. A €4 billion syndicated credit line is part of our liquidity reserve. €2 billion of the credit line have a term of 364 days. The other €2 billion have a term of five years (plus an option to extend the term by two years). To cover the local financing needs of our foreign subsidiaries and comply with regulatory restrictions, we make selective use of local credit and capital markets as well. Our financing activities benefit from the fact that the world's leading rating agencies assert RWE's strong creditworthiness as reflected in our high Single A credit rating*. The evaluation of creditworthiness is largely dependent on EBITDA and funds from operations. They must be sufficient to secure debt servicing over the long term. We made a commitment to the rating agencies to comply with clearly established minimum limits. These stipulate that our EBITDA must be at least five times as high as the net interest cost and that our funds from operations must be at least four times as high (including net interest). In the year under review, we were again clearly above these thresholds. The ratio of EBITDA to net interest cost was 8.0 (previous year: 7.5), and the ratio of funds from operations to net interest cost was 5.8 (previous year: 5.3).

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RWE maintained its strong Single A credit rating due to its strong organic performance.

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Balance sheet structure

Factors significantly affecting the Group's balance sheet were the deconsolidation of Heidelberger Druckmaschinen and the successful reduction of net financial debt. Additional effects stemmed from the US dollar's drop vis-à-vis the euro. As of December 31, 2004, the balance sheet total was €93.4 billion. Compared with the previous year, this represents a decrease of €5.8 billion, €4.8 billion of which are allocable to the deconsolidation of Heidelberger Druckmaschinen. This was principally reflected in non-current assets which declined by €3.8 billion to €58.6 billion. Besides the sale of the stake in Heidelberg as well as depreciation and write-downs, the deconsolidation of the Portuguese power plant activities (Turbogas/Portugen) also had an impact. Current assets declined by €0.9 billion to €31.5 billion. Net of deconsolidation and currency effects, they rose by €1.9 billion. Current securities and derivatives which were held to hedge price and currency risks posted a strong increase.

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On the equity and liabilities side, financial liabilities dropped by €4.4 billion to €27.4 billion. This was driven by bond buybacks* and the reduction in debt across the Group's divisions. Provisions decreased by €2.9 billion, of which –€1.8 billion reflected the deconsolidation of the Heidelberg Group. Equity increased by €2.1 billion to €11.2 billion thanks to the improvement in other comprehensive income*, buoyed by the encouraging development of capital markets. Our capital-to-assets ratio rose from 9.1 % to 12.0 %.

Balance sheet structure	12/31/04		12/31/03	
	€ million	%	€ million	%
Assets				
Non-current assets	58,630	62.8	62,406	62.9
Inventories, accounts receivable, etc.	29,971	32.1	30,230	30.5
Cash and cash equivalents	1,526	1.6	2,181	2.2
Deferred taxes	3,243	3.5	4,325	4.4
Total	**93,370**	**100.0**	**99,142**	**100.0**
Equity and liabilities				
Equity and minority interest	11,193	12.0	9,065	9.1
Long-term provisions	28,131	30.1	29,399	29.7
Other long-term funding	28,056	30.1	27,402	27.6
Short-term provisions and liabilities	21,856	23.4	28,750	29.0
Deferred taxes	4,134	4.4	4,526	4.6
Total	**93,370**	**100.0**	**99,142**	**100.0**

Workforce shrinks considerably due to the sale of companies

As of December 31, 2004, the RWE Group's personnel headcount was 97,777. The workforce had thus shrunk by 29,251 positions, or 23 %, since December 31, 2003. Divestments and acquisitions caused the labor force to decrease by a net 24,469 staff members. The main reason was the deconsolidation of the Heidelberg Group which caused the staffing level to decrease by 22,036 positions. Other personnel changes primarily relate to the cost-cutting programs initiated in prior years. They were largely implemented in a socially acceptable manner.

Operating personnel reductions were largely implemented in a socially acceptable manner.

€2.6 billion cost-cutting program successfully concluded

We successfully completed the cost-cutting program initiated in February 2000. In the year under review, we realized the remaining €250 million in savings. All in

Cost reductions € million	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Target**
Old program	2,305				250			**2,555**
Ongoing programs								
Reorganization					150	160	190	**500**
Acquisition synergies			60		30	50	40	**180**

all, we have lowered annual costs by €2,555 million since the beginning of 2000. Efforts concentrated on our German electricity generation operations which achieved savings of 60 %. Our German grid and sales business accounted for 30 %. The remaining 10 % are allocable to RWE Umwelt and RWE Systems.

By 2006, we want to realize an additional €680 million in savings with two programs which were launched in prior years:

- €500 million are allocable to measures taken to reorganize the RWE Group. Center stage is taken by improvements in material and staff costs in the German energy business, savings in IT and efficiency enhancements throughout the water business. The program was launched in October 2003 and is scheduled for completion by the end of 2006. In the year under review, we realized €150 million in savings with this program.

- We will realize another €180 million in synergies by capitalizing on the large-scale acquisitions made in the last few years. We intend to achieve €100 million of this sum by combining the back-office functions of our UK-based companies RWE npower and RWE Thames Water. We aim to realize €80 million in savings in our Czech gas companies. As of December 31, 2003, we had already achieved €60 million in synergies through this program. Another €30 million were added in the fiscal year.

Combined, the three programs enabled us to reduce costs by €430 million in 2004.

Capital expenditure: spending on financial assets markedly down on previous year

In 2004, capital expenditure amounted to €3,737 million compared with the €9,762 million spent in 2003. Capital expenditure on financial assets recorded the steepest decline. At €308 million, it was a fraction of the previous year's level which was exceptionally high due to the acquisition of the US-based water utility

Capital expenditure was reduced from €9.8 billion to €3.7 billion. The previous year's figure was affected by the acquisition of American Water.

Capital expenditure € million	**2004**	**2003**	**+/–** in %
RWE Power	677	1,115	–39.3
RWE Energy	1,024	1,652	–38.0
RWE npower	166	215	–22.8
RWE Trading	4	4	–
RWE Thames Water	1,531	6,129	–75.0
Discontinuing activities[1]			
RWE Umwelt	156	152	2.6
Heidelberger Druckmaschinen	70[2]	262	–73.3
Other/consolidation	109	233	–53.2
RWE Group	**3,737**	**9,762**	**–61.7**
Capital expenditure on property, plant and equipment	3,429	4,362	–21.4
Capital expenditure on financial assets	308	5,400	–94.3

1 Discontinuing operations in accordance with IFRS.

2 Only covers the period until the deconsolidation in May 2004.

American Water (€ 4.5 billion). In addition, we acquired a 49 % stake in the Slovak power utility VSE as well as the remaining 25 % interest in Thyssengas in 2003. In the fiscal year, we only made minor acquisitions.

We spent € 3,429 million on property, plant and equipment. This corresponds to a decrease of € 933 million or 21 % compared with 2003. Capital expenditure by RWE Power was much lower year-on-year (–€ 403 million). However, this sum included the deconsolidation of CONSOL to the tune of –€ 183 million. Capital spending on property, plant and equipment at RWE npower decreased considerably as well (–€ 65 million) and largely related to our renewables business: in 2004 we began selling completed wind power developments into a joint venture in which RWE npower only holds a minority stake (33 %). As a result, spending on these activities is no longer shown as capital expenditure. Additional funds were spent on equipping the Aberthaw power station with a flue gas desulphurization unit. RWE Energy (–€ 53 million) and RWE Thames Water (–€ 84 million) spent a little less capital than in the previous year. The significant decline in capital expenditure at Heidelberger Druckmaschinen (–€ 152 million) was predominantly due to the company's deconsolidation in May 2004.

Detailed information on the development of capital expenditure by division is presented on pages 76 to 113.

Net worth, financial position and earnings situation of RWE AG

RWE AG is the management holding company of the RWE Group. Through the Group Center, it performs general management tasks and optimizes the Group's structure. RWE AG's situation is largely determined by the Group's activities.

The financial statements of RWE AG, which have been issued an unqualified audit opinion by PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, are published in the Bundesanzeiger (Federal Gazette) and filed with the Commercial Register of the Essen District Court. They can be ordered from RWE AG and are also available on the Internet*.

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Financial statements of RWE AG

The financial statements of RWE AG are prepared in accordance with the German Commercial Code and the German Stock Corporation Act. A brief overview is provided below:

Balance sheet of RWE AG (abridged) € million	**12/31/04**	**12/31/03**
Non-current assets		
Financial assets	42,305	42,735
Current assets		
Accounts receivable from affiliates	4,230	4,013
Other accounts receivable and other assets	471	321
Marketable securities and cash and cash equivalents	2,734	2,882
Total assets	**49,740**	**49,951**
Equity	4,981	4,440
Provisions	8,348	8,783
Accounts payable to affiliates	30,110	29,823
Other liabilities	6,301	6,905
Total equity and liabilities	**49,740**	**49,951**

Income statement of RWE AG (abridged) € million	**2004**	**2003**
Income from investments	2,542	2,554
Net interest	–1,611	–1,257
Other expenses and income	522	–400
Profit from ordinary activities	**1,453**	**897**
Taxes on income	–209	–14
Net profit	**1,244**	**883**

RWE AG's net worth

The net worth of RWE AG (holding company) is determined by the management of investments and the activities it undertakes for the Group companies. The holding company holds the shares in the management companies and handles the financing of the management companies. This is reflected in corresponding accounts receivable from and payable to affiliates.

Provisions for pension obligations also include coverage for the vested benefits of subsidiaries' current and former employees. RWE AG is reimbursed for pension expenses by the companies concerned.

RWE AG's financial position

RWE AG's financial position is mainly characterized by the financing of the acquisition of Thames Water, Innogy, the Czech gas companies and American Water Works.

As an attractive bond issuer on the capital market, RWE AG initiated a €20 billion debt issuance program. It had already successfully placed €17.2 billion of the total issue volume as of December 31, 2004. We issued €1.7 billion of our US$ 5 billion commercial paper program.

Dividend payment up 20 %

RWE AG's net profit amounted to €1,244 million and was thus clearly up on the previous year. €400 million was transferred to retained earnings. Distributable profit thus totaled €844 million.

We will propose to the AGM that the dividend for fiscal 2004 be increased by 20 % compared with the previous year.

In light of the company's sustained earnings power and the strong trend in its operating result, the Supervisory Board and the Executive Board of RWE AG will propose to the April 14, 2005 Annual General Meeting that a dividend of €1.50 per share be paid for fiscal 2004. This dividend proposal would cause the dividend to rise by 20 % compared with the previous year. RWE thus continues to rank among the top DAX shares.

Major events in 2004

In 2004 we shed our major non-core businesses HOCHTIEF and Heidelberger Druckmaschinen and we initiated the sale of RWE Umwelt.

Focus on core business (energy and water) nearly completely established

Divestments were the highlights of 2004. We passed milestones with the sale of our stake in HOCHTIEF and of our majority interest in Heidelberger Druckmaschinen. Furthermore, we initiated the divestment of the environmental services operations—our last major non-core business—and shed activities outside our core regions. The most important transactions will be explained in more detail below. Proceeds from divestments in 2004 totaled €2.8 billion.

Exit from two large non-core businesses: HOCHTIEF and Heidelberg

On February 25, we launched a combined offer comprising shares in HOCHTIEF and an exchangeable bond to place all of our 39.3 million shares with institutional investors. We sold 32.6 million shares on the stock exchange as part of a direct placement. This generated €728 million in sales proceeds. RWE decreased its stake from 56.1 % to 9.6 %, or some 6.7 million shares, that have been reserved to service the exchangeable bond. The three-year exchangeable bond for shares in HOCHTIEF has a volume of €200 million.

We succeeded in shedding the lion's share of our 50 % stake in Heidelberger Druckmaschinen soon thereafter. As with HOCHTIEF, we sold our shares in Heidelberg directly and issued an exchangeable bond on the company's stock through a combined transaction on May 5 and 6. This resulted in aggregate proceeds of nearly €1.3 billion. Within the scope of the direct placement, we placed 30 million shares among institutional investors. This corresponds to 34.9 % of the subscribed capital. The three-year zero-coupon exchangeable bond* on Heidelberg shares has a volume of €460 million. The 12.9 million shares still held by RWE after the direct placement have been reserved to service the bond.

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Sale of RWE Umwelt initiated

We set the scene for the sale of our environmental services business at the end of September. The first step will entail the Rethmann Group, the No. 2 player on the German waste management market, acquiring about 70 % of RWE Umwelt's business. The purchase agreement was signed on September 28. Certain parts, which account for the remaining 30 % of sales and will remain under our ownership for the time being, are also earmarked for sale. The sale of our waste management business will be based on an enterprise value of about €0.8 billion for 100 % of RWE Umwelt. Including the foreign operations that have already been divested brings the company's total value up to €1 billion. As a result of the partial sale of the environmental services business, the RWE Group's net debt will decrease further. The deal is subject to antitrust approval which was pending when this report went to print.

Sale of the remaining stake in CONSOL

Another major share disposal was the sale of our remaining 18.5 % stake in the US-based hard coal and gas company CONSOL Energy in February. Proceeds from the private placement of our 16.6 million shares in CONSOL amounted to US$ 296 million. In sum, the divestment of the 58 million shares we held in CONSOL generated US$ 1,034 million (€ 873 million) in sales proceeds. The rationale behind this transaction was our decision to focus on our energy business in Europe.

Minority interest in Swiss energy holding company divested

Outside our core markets, we sold our investments in power companies in Switzerland, Turkey, Portugal and Italy.

By shedding our investment in Swiss-based Motor-Columbus (20 %) and Atel (1.23 %) for € 277 million, we made our exit from the Swiss energy market. Motor-Columbus is a holding company with investments in the energy sector including a 56.7 % stake in the power utility Atel (Aare-Tessin AG für Elektrizität). In our opinion, this activity did not offer enough prospects to expand our position.

Sale of power plant investments outside RWE's core markets

With the divestment of the following power station investments, we shed additional peripheral activities within our core business: 25 % of the Turkish power utility ISKEN (Iskenderun Enerji Üretim ve Ticaret A.S.), 75 % of the gas power station in Tapada do Outeiro, Portugal (Turbogas) along with all the shares in the operating company Portugen, as well as 25 % of the Italian-based power plant company Elettra GLL. Proceeds from these sales totaled about € 360 million.

Non-operating real estate: more than € 1 billion divested since 2000

In 2004, we successfully completed the real-estate divestment program initiated in February 2000. In December, we sold nearly all of RWE Systems' housing stock. We thus exceeded the program's target volume of € 1 billion. All in all, we divested buildings and homes with a combined market value of € 1.12 billion. We will continue to optimize our real-estate portfolio even after the conclusion of the divestment program.

The subsequent sections describe additional major events in fiscal 2004.

Acquisition of the outstanding shares in RWE Dea and Harpen

On April 7 the Annual General Meeting of RWE Dea AG decided to transfer the shares held by minority shareholders to RWE AG. Once the transaction was entered into the commercial register on October 19, our stake in RWE Dea rose from 99.46 % to 100 %. Minority shareholders received €296 in cash per share. We intend to increase our interest in Harpen, which currently amounts to just over 95 %, to 100 % as well. An extraordinary AGM held by Harpen AG on October 15 approved the proposed transaction. Compensation will be in cash, amounting to €19.50 per share. However, the deal is yet to be entered into the commercial register.

RAG and RWE agree to intensify cooperation

At the beginning of June, we signed a letter of intent with RAG establishing that we will grant RAG a €400 million line of credit at arm's length conditions. In addition, we want to step up the close cooperation we have with RAG. To this end, we agreed to enter into an agreement on the continuance of the companies' existing relationships in the electricity business and to establish RAG as preferred partner for newly-built or replacement hard coal power plants in the future. RWE also intends to invest in STEAG, the RAG Group's German energy pillar.

Construction of two topping gas turbines in Weisweiler begun

In June RWE Power commenced construction work on two topping gas turbines rated at 190 MW each which will be installed upstream of two existing 640 MW lignite blocks at our Weisweiler site. The project has a budget of €150 million. The topping gas turbines are scheduled to be commissioned in 2006. They will work in concert with the existing facilities and be used to generate mid and peak-load power.

Investing in the future: We started construction work on two topping gas turbines to optimize our Weisweiler power station.

Buyback and conversion of RWE bonds

In July we repurchased bonds with an aggregate value of €1.9 billion. Some €1.25 billion was exchanged for cash. We issued a new ten-year bond for the remaining €650 million. Our goal was to reduce gross debt and smooth our bond maturity profile. The combined buyback and conversion offer was tendered to holders of 2007 and 2008 bonds with a combined volume of €4.5 billion.

Dr. Thomas R. Fischer elected new Chairman of the Supervisory Board of RWE AG

At its December 8 meeting, the Supervisory Board of RWE AG elected Dr. Thomas R. Fischer, Chairman of the Managing Board of WestLB, as its new chairman. He had already been appointed as an ordinary member of the Supervisory Board by the Essen District Court on November 9. Dr. Fischer succeeds Dr. Friedel Neuber, who passed away on October 23.

Executive salaries even more closely linked to performance

At RWE, variable executive compensation will play a more important role in the future.

Linking pay to success started playing an even more substantial role in our executive compensation system in 2004. Our managers receive both fixed and variable remuneration which can account for up to 60 % of total compensation depending on the executive's role. The extent of variable pay used largely to depend on the value added by the division in which the manager worked. We introduced free cash flow as an additional performance criterion.

Procurement, research and development

Purchasing further optimized

Our groupwide procurement system enables us to constantly tap into potential for cutting costs. The new organizational structure makes it much easier to pool purchases and thus capitalize on economies of scale. With the exception of raw materials purchasing, all of our procurement processes are coordinated by RWE Systems through its international supplier management system.

In 2004 we occasionally reduced power generation due to high hard coal prices, thus using less hard coal.

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The amount of hard coal we purchased, primarily used to generate electricity, dropped from 25 million metric tons of hard coal units* (HCU) in 2003 to some 23 million metric tons in 2004. This includes coal procured for power stations which are not owned by RWE, but are under our control based on long-term power purchasing agreements. RWE Power consumed 17 million metric tons of HCU, 1 million metric ton less than in the previous year. At RWE npower, hard coal consumption also dropped by 1 million metric ton, to 6 million metric tons of HCU. We ramped down production intermittently because coal prices were high. In addition, RWE npower also experienced maintenance downtime, due to power plant inspections.

Over the course of 2004, the price of imported hard coal rose considerably. In August it recorded a new record high of about €75 per metric ton of HCU. This was predominantly due to strong demand for raw materials in China. Towards the end of the year being reviewed, a metric ton of HCU sold for €68 on the spot markets in European sea ports. Denominated in US dollars, the increase was even stronger. Prices set by the German Federal Office of Economic and Export Control (BAFA*), which play a major role as far as our long-term electricity purchasing agreements are concerned, tracked this trend. During the course of the year, they rose by more than 30 %. The preliminary BAFA price for December was €61 per metric ton of HCU. This represents an average price of €55 per metric ton—38 % more than a year earlier.

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RWE obtains lignite from its own opencast mines. In our main region, the Rhineland, we produced 100 million metric tons of lignite in 2004. Some 89 million metric tons thereof were used by our power plants to generate electricity while 11 million metric tons were marketed as processed products.

In the 2004 financial year, we built a centralized portfolio management system, laying the groundwork for optimizing gas purchases. This enabled us to consolidate our position as a negotiation partner in the field of international gas procurement. Nearly 60 % of our aggregate procurement is sourced directly from producers. In 2004 we bought about 420 billion kWh of natural gas, matching the level achieved in 2003. Prices for imported gas remained largely stable until the middle of the year, picking up considerably at yearend.

Groupwide electricity purchases (excluding trading) totaled 91.8 billion kWh, with RWE npower accounting for 27.0 billion kWh.

Research and development:
RWE at the crossroads between innovation and practice

Expenditure on research and development (R&D) in the fiscal year amounted to €114 million. 224 employees were active in the field of R&D. In 2003, we spent €390 million on R&D. The substantial decline is principally due to the deconsolidation of the Heidelberg Group. This company had accounted for the lion's share of R&D in the past. For energy and water, our commodity*-oriented core business, product innovations are of little importance. Efficient production processes and high security of supply are crucial to our competitiveness. This is the focal point of a number of R&D projects which we carry out in collaboration with outside partners in the fields of industry and research. We often act as a crossroads between innovation and its implementation. Therefore, the activities are only partially reflected in our R&D expenditure.

R&D activity centers on projects to improve the efficiency and stability of production processes.

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R&D work focused in the following activities in 2004:

- One of our points of focus in the field of **power generation** is the power plant technology we use to improve the efficiency with which our power stations utilize primary energy and to reduce greenhouse gas emissions. In the year under review, we optimized the technology we use to dry lignite to an extent which now allows us to carry out field trials. Furthermore, we are involved in the development of innovative materials and components for a new generation of coal-fired power plants using steam heated to 700°C. Today steam is usually heated to 600°C. These two R&D projects aim to improve efficiency by about 4 percentage points in newly constructed power stations.

  In addition, we stepped up our activities in the field of distributed power generation. Our plan is to team up with partnering companies to bring fuel cell plants of various sizes to market. In the middle of 2004 we intensified our collaborative venture with the US-based fuel cell manufacturer IdaTech by including German-based heater manufacturer BBT Thermotechnik in the project. In this arena, we want to develop fuel cell-based heaters with an output of 5 kW* (electric). Our task will be to integrate the fuel cell into the electricity and heating network as well as develop a management concept. The gas-powered fuel cell heater is designed to supply heat and most of the electricity needed to an apartment building or a small industrial operation. Eleven demonstration plants were commissioned in 2004. Initial field tests are scheduled for 2005. We continued our joint venture with MTU in the industrial and commercial sectors in order to bring a 250 kW electric-output fuel cell to market.

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- In the field of **power grids**, in light of the increasing technical demands placed on grid infrastructure, we are working on increasing grid performance as well as on a highly-sensitive grid management system designed to reduce the likelihood of grid failure even further. In April 2004 we commissioned a superconductive current limiter in RWE's medium-voltage grid in the vicinity of Siegen/Germany. This will allow us to manage short circuits much faster than by using conventional switchgear and fuses. The next project will involve the development of a current limiter for a higher-voltage grid.

- R&D activity in the **water sector** has its sights set mainly on providing our customers with a reliable and efficient supply of high-quality water and wastewater services through the usage of innovative technology. We are currently looking into using robots equipped with sensors to check the state of pipelines. This enables us to maintain subterranean water infrastructure more efficiently. RWE Thames Water had already developed the “acid-phase digestion” process in preceding years. This method optimizes sewage plant capacity and achieves a slight reduction in sewage sludge production. As a result, we reduced the investment cost of the sewage sludge treatment in our wastewater treatment plant commissioned in 2004 in Swindon, UK, by about 50 %.

- For years, we have been promoting young, high-growth companies with promising innovations for our core business via the **RWE Venture Capital Fund***. The fund has a budget of € 50 million. In the fiscal year, it was involved in three technology companies, two of which are working on projects in the petroleum and natural gas sectors, with the third developing energy storage facilities.

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Political environment

Basic political conditions play a key role on utility markets. In Germany and the UK—our key markets—the future of the power sector is about to be determined. As the debate on security of supply, climate protection and competition progresses, none of the market participants can be certain about the course that will be charted, because there are conflicts of interest. This gives rise to a host of risks for economies and the energy industry. Power outages in several countries in Europe and North America have proven just how urgently we need solutions that are feasible both economically and environmentally. As one of Europe’s largest power utilities, we have significant responsibility in this discourse.

The following issues were the focal points in fiscal 2004:

In October 2004 the German Federal Cabinet reached an agreement on the key points of the future regulatory framework for the German electricity and gas markets.

German energy market regulation

In October 2004 the German Federal Cabinet reached an agreement on the key points of the future regulatory framework for the German electricity and gas markets as part of the legislation of the new German Energy Act (EnWG). This will expand the regulator's (REGTP) scope of action and increase the commercial risk associated with investments in networks. The government resolutions stipulate that all grid fee increases be subjected to prior approval (ex-ante regulation). Legislators also plan to introduce an incentive regulation no later than two years after the German Energy Act has come into force. Tariff increases implemented since August 2004 are to be reviewed by the regulator ex-post. The government has confirmed the regulatory current cost accounting method to determine grid fees. The real return on equity envisioned for 2005 is 6.5 %, as set forth in the Electricity Association Agreement that has been in force to date. The regulator is to determine the return on equity that suits the market from 2006 onwards. The legislative process is expected to be completed in the first half of 2005.

Increasing compensation rates for green power (EEG) will be a further burden on end consumers and power utilities.

Amendment to the German Renewable Energy Act

August 1, 2004 saw the entry into force of the amendment to the German Renewable Energy Act (EEG). The objective of the amendment is to increase the proportion of electricity produced from renewables in Germany from 8 % at present, to at least 12.5 % by 2010 and to at least 20 % by 2020. The amendment also envisions an increase in compensation for electricity fed into the grid from biomass and small-scale hydroelectric plants. Offshore wind farms will also receive higher subsidies. Compensation rates for onshore wind power facilities will be slightly reduced. In sum, this will cause annual compensation to green energy producers payable in Germany to rise from its current level of €2.5 billion to some €5 billion by 2008. This will constitute a further burden for end consumers and power utilities.

Pan-European trading in CO_2 emissions allowances

Emissions trading commenced on January 1, 2005. Most of the EU member states have laid the required foundation at a national level in 2004.

In Germany, the Greenhouse Gas Emissions Act (TEHG) and the Allocation Act (ZuG) were passed to this end. They mandate that energy sector and the industry reduce CO_2 emissions in the first trading period (2005–2007) by 2 million p.a. to 503 million metric tons compared with the reference period (2000–2002). The cap for the second trading period (2008–2012) is 495 million metric tons. Certificates in both trading periods will be allocated free of charge. Allocation criteria for each plant provide an incentive to invest in climate-friendly technologies. If old plants are replaced by more efficient ones, companies receive the same allocation as originally given for the old plant for a full four years and 100 % of the emissions allowances required for the new facility for the next 14 years. Furthermore, the Allocation Act includes numerous special conditions for investment in power stations built not to replace existing plants, as well as for companies which have unavoidable process-related emissions or have reduced emissions substantially in the past. During the allocation progress, many more facilities than expected used these special conditions as basis for application. As a result the number of certificates applied for, far outweighed the forecast emissions of CO_2. The emissions trading authority therefore reduced the allocation for existing plants that do not benefit from the special conditions more than initially planned. The average allocation gap is 7.5 percentage points with respect to the reference period. Often, fewer emissions allowances were thus allocated than applied for. This also holds true for RWE. Consequently, we followed suit with several other companies and filed an appeal against the allocation notices in January 2005. Therefore, the final allocation is yet to be decided.

CO_2 emissions trading commenced in Germany in 2005. The allocation of allowances to existing facilities was reduced more than expected.

The UK government revised its national allocation plan for the trading of CO_2 emissions allowances in the fall of 2004, making the framework conditions for industry and the energy sector a little more favorable. The original draft, which had been submitted to the EU Commission at the end of April and had already received EU approval, put power producers at an extreme disadvantage. According to the new plan, which is pending approval from the EU Commission, the free allocation to industrial and energy-sector operations has increased from 736.3 to 756.1 million metric tons of CO_2 throughout the first trading period from 2005 to 2007. However, industrial plants would benefit more than the energy sector. The plant-specific allocation of emissions allowances was updated in mid-February. At 15.8 million metric tons per year, RWE npower’s allocation slightly exceeds the 14.9 million metric tons originally envisioned. Nevertheless, the number of emissions allowances falls clearly below the emissions produced by RWE npower in recent years.

Emissions allowances allocated to RWE npower in the UK are clearly below actual emissions in recent years.

Risk management

Proven systems for identifying and monitoring opportunities and risks
Continuous early detection and standardized recording, evaluation, control and monitoring of risks are handled by the RWE Group using a groupwide risk-management system. We strive to obtain information on risks and their financial impact as early as possible as well as to detect and seize existing opportunities along with their earning potential through our budgeting and controlling process.

The principles of RWE's risk-management system are systematically integrated into the divisions' decision-making processes.

To strike a proper balance between profit opportunities and potential losses in the long term, risks must be systematically included in the decision-making process in accordance with uniform Group standards. To that end, we have introduced a comprehensive, centrally controlled risk management system. The operating units identify and report risks in line with their accountability to the RWE Group's risk management officers who examine the risk profile on the basis of the Group's guidelines. This method fulfills the Executive Board's reporting duties pursuant to the German Controlling and Transparency in the Corporate Sector Act (KonTraG). Beyond complying with statutory requirements, thanks to its holistic approach, it also promotes the continued development of a value-based risk culture within the RWE Group.

Risks are evaluated according to their damage potential and probability of occurrence and aggregated at the divisional, business unit and Group levels. Here, a risk's damage potential is defined against reference variables, i.e. the operating result and equity of the business unit concerned or the Group as a whole. We can thus ensure a systematic and uniform analysis of our current risk situation throughout the Group, on the basis of which specific risk-control initiatives can be developed for the business units concerned. Our risk reporting scheme is fully integrated in our standardized budgeting and controlling process. The RWE Group's management and supervisory bodies are regularly informed of the current risk situation. The efficiency and efficacy of our risk management system is monitored by an internal controlling system and auditing teams and verified by the external auditor.

The following is an overview of major risks and opportunities:

- **Business risk:** At present, there are no identifiable risks that could jeopardize the continued operation of RWE AG or the RWE Group.

- **Changes in the general economic climate:** Economic trends in our core markets can affect business by changing the degree of capacity utilization, having either a positive or a negative impact on revenue and results.

- **Changes in the price of commodities:** Results achieved by our electricity business are significantly influenced by the development of market prices of electricity and fossil fuels, i.e. hard coal and gas. This can result in earnings risks and profit opportunities for the companies of the RWE Group. A risk arises, e.g., if increasing commodity prices cannot be passed on by increasing electricity prices. Opportunities stem from the widening of the spread between electricity and fossil fuels. We determine ensuing price risks on purchasing and sales markets using special evaluation models, while taking current forward prices and expected price volatility into account. We also use financial derivatives to mitigate risks associated with procurement and sales. Additional risks and opportunities arise from our oil and gas production operations. Unexpected disadvantageous changes in price are minimized through the strategic use of derivative hedges as well as the steady reduction of production and development costs.

  Our electricity and gas businesses face the price and sales risks as well as marketing opportunities resulting from the deregulation of Europe's electricity and gas markets. We address these risks with differentiated pricing strategies and appropriate marketing policies as well as with effective measures to cut costs.

  Our trading activities are principally designed to mitigate earnings risks stemming from price fluctuations on energy markets. In this context, our trading division functions as a central platform for hedging commodity price risks throughout the RWE Group. This enables us to create a stable basis of planning for our companies. In addition, we conclude trades in order to take strategic advantage of price changes to a limited extent. This leads to risks from unexpected price fluctuations as well as credit risks in the event that trading partners fail to fulfill their contractual obligations. The RWE Group's integrated trading and risk management system is firmly aligned with best practice as applied to the trading business. Specific risk benchmarks for market and credit risks are established on a daily basis. The RWE AG Risk Committee* then sets limits that are continuously monitored. Among other things, we use the value-at-risk method* to quantify price risks associated with energy trading.

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- **Operating risks:** We operate technologically complex and interconnected production plants all along our value chain. Earnings risks can arise from uninsured damage to our lignite mining equipment, production plants, or power plant components. Risks associated with possible downtimes caused by the aging of components in our power stations are addressed through high safety standards as well as audit, maintenance and servicing work carried out by qualified personnel. As appropriate, insurance policies can also limit possible effects of damage.

- **Changes in prices in the finance sector:** Within the scope of our operations, we are also exposed to interest-rate, currency, credit, and share-price fluctuation risks. Due to the Group's international presence, currency risk management is important. The British pound and the US dollar are our major foreign currencies, because RWE conducts sizeable operations in these economic regions and fuel prices are quoted in these currencies. Group companies in foreign currency zones are generally obliged to hedge all local currency risks via the Group's holding company, RWE AG. The parent company determines the net financial position for each currency and hedges it with external market partners if necessary. Interest rate management is also ascribed significant importance. We limit interest rate fluctuations from the Group's accounts receivable and payable. Negative changes in value caused by unexpected interest-rate movements are hedged with non-derivative and derivative financial transactions.

  We mitigate credit risks by performing transactions within set limits only with banks and business partners of good credit standing and through appropriate cash collateral. In addition, credit insurance policies and bank guarantees are concluded to further limit credit risk. A more detailed description of the tools used to hedge financial risks* can be found in the notes to the consolidated financial statements. Range of action, responsibilities and controls are set forth in internal guidelines to which our Group companies are obliged to adhere.

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Opportunities and risks also arise from changes in the value of current securities. Our professional fund management activities control these risks.

The Group's financial transactions are generally recorded using centralized risk-management software and monitored by the holding company. This enables the balancing of risk across individual companies.

- **Liquidity risk:** RWE AG usually handles the refinancing of the liabilities of its fully consolidated subsidiaries that mature. Liquidity risks arise if liquidity reserves are no longer sufficient for the Group to meet its financial obligations in a timely manner. Liquid assets and marketable securities worth a combined €12.5 billion are available to cover our capital requirement. In addition, we have a fully commited syndicated credit line of €4.0 billion that was renegotiated in 2004, as well as a considerable amount of unused funds from a US$ 5.0 billion global commercial paper program and a €20.0 billion debt issuance program. This makes the liquidity risk very low.

- **Regulatory risks*:** The RWE Group's exposure to the constant change in the political, legal and social environment in which it does business can be expected to have an impact on earnings. Lignite and hard coal power plants account for a significant portion of our electricity generation portfolio. This represents a considerable risk due to the introduction of the EU-wide greenhouse gas emissions trading system. Risks can arise from changes made to the allocation rules and emissions budgets for the second trading period (2008–2012) by the legislator and from unexpected increases in the price of CO_2 certificates. To counteract this, CO_2 price risk management is fully integrated in the Group's risk management system. Furthermore, we will continue to reduce specific CO_2 emissions and make our overall portfolio more flexible by investing in power plants in the future.

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  Clear earnings risks exist in the grid business as a result of the establishment of a regulator for the German electricity and gas sectors.

- **IT risks:** RWE has established a mandatory groupwide process for engineering, managing and auditing IT projects in order to manage IT risks during the development of IT solutions designed to support business processes. IT operations are handled by modern computing centers which continuously update both hardware and networks. To avoid risks, IT activities are subject to a groupwide security directive, compliance with which is regularly monitored.

- **Impact of decisions relating to capital expenditure and divestments:** Decisions approving acquisitions and capital expenditure on property, plant and equipment must take into account both the risks and oportunities associated with, tying up capital for extensive periods of time. At RWE, such decisions are prepared, implemented and subjected to follow-up checks in adherence with specific accountability rules and approval processes. The same also applies to divestments. While sales transactions enable RWE to take advantage of opportunities, they are also exposed to the danger of the negative influence of possible legal hurdles and credit risks.

- **Legal risks:** RWE Group companies are involved in litigation connected with their operations. However, RWE does not expect any major negative repercussions from this litigation on the RWE Group's economic or financial position. Additionally, companies belonging to the RWE Energy Division are directly involved in various administrative and regulatory procedures (including approval procedures) or are directly affected by the results of such procedures.

  Raw materials production and power generation activities might be curtailed by risks arising from approval processes for our opencast mines and nuclear power plants. We prepare our applications for approval with great care and ensure that the approval processes are handled competently in order to minimize such risks.

  Minority shareholders of Harpen and RWE Dea initiated several legal proceedings to examine the appropriateness of the conversion ratios and the amount of cash paid in compensation in connection with company restructurings pursuant to German company law. We are convinced that the conversion ratios and cash compensation calculated on the basis of expert opinions and by independent auditing firms are adequate and will stand up to scruting in court.

Event after the close of the fiscal year

RWE Thames Water does not challenge regulator on framework conditions for the next UK regulatory period

The next five-year regulatory period in the UK water business will start on April 1, 2005. In December the Office of Water Services (OFWAT) submitted its final determination of prices and investment required. The key element in the new framework conditions is the increased investment of £3.1 billion (€4.4 billion) into the improvement of quality, security and environmental friendliness of water supply in Greater London. Modernizing and expanding the water mains has top priority. At the same time, efficiency criteria for investment and operating costs were tightened. In exchange, the regulator will allow RWE Thames Water to increase prices by a total of 22 % (real) in the next five years. The average real return on the regulated asset base was increased to 5.1 % after tax, compared to 4.75 % in the 5 year period which ends in April 2005.

Outlook for 2005

Slight decrease in economic momentum

In 2005 the world economy will grow at a reduced pace. Major stimuli will continue to come from economies outside the Eurozone. German investment and private consumption are expected to pick up somewhat. But exports are forecast to expand less than in 2004 due to global economic unrest. According to the predictions of leading economic research institutions, real gross domestic product will increase by a little more than 1 %. Tighter monetary policy in the UK, our second major market, is anticipated to have a dampening impact. However, the expected 2 to 3 % in growth will probably paint a bright overall picture. This also applies to the EU’s Central Eastern European member states. In these countries, the robust industrial trend will probably cause real GDP to grow by more than 4 %. The upward trend in the US may lose steam due to the slackening of fiscal stimuli. However, robust private consumption will buoy the economy. At an estimated 3%, real growth will probably be marginally down on 2004.

The general outlook for our core markets remains positive.

The slight slowdown of Europe's economy is likely to curtail growth in energy consumption. Weather-related effects will also play a role. In sum, we expect energy consumption in Germany and the UK to show a marginal increase. Growth in Central Eastern Europe is likely to be stronger, driven by robust business activity in the industry.

Fuel costs are expected to remain high in 2005.

Forecasts have prices on the world's energy markets maintaining their high level in 2005. Oil prices are affected by basic geopolitical conditions more than any other fuel. At present, there is no sustained improvement in sight for the Middle East. Furthermore, we do not believe that demand for primary energy sources in countries such as China and India will tail off suddenly. As a result, we don't expect fuel costs for power generation to fall significantly in the near future. For this reason, and due to the tightening supply and demand balance, we do not expect a significant change in the German or UK electricity wholesale sector. However, uncertainty surrounding the development of the price of CO_2 certificates and weather effects on supply and demand make it difficult to issue an accurate forecast.

Good prospects for adding more value

We will continue to focus on improving operating performance in the new financial year. All our activities will center on achieving high value added with our existing market positions. The conditions are favorable: we have concluded the integration of our large-scale acquisitions. Major divestments have either been completed or are about to be finalized. The Group's reorganization, implemented in October 2003, has proven itself in daily operations although further progress must be made in integrating processes at the interfaces between electricity, gas and water. This will allow us to concentrate entirely on the real value drivers of our business. To this end, we will focus on the following points and objectives:

We want to increase our operating result organically by an average of at least 5 % every year.

- **Organic earnings growth:** We intend to increase our operating result by an average of at least 5 % per year through organic improvements. Our ROCE target for 2006 is 14 %, representing another ambitious earnings goal. This key performance indicator defines the ratio of earnings to the development of capital used. It is thus the best yardstick for measuring the success of our performance-improvement strategy. In terms of earnings, we have positioned ourselves to achieve further growth above all thanks to our highly competitive power generation business. With a 32 % share of the market, RWE is Germany's largest power producer and thus substantially affected by changes in wholesale prices. In addition, our diverse range of regulated activities in our key European markets makes stable contributions to the bottom line. To improve our use of capital, we are focusing on reducing the amount of working capital. Furthermore, we want to cut annual costs via ongoing programs aiming to realize €680 million in savings by 2006. By the end of 2004, €240 million of this target had already been achieved. Despite the risks imposed by grid regulation and volatile prices on global fuel markets, we expect to post another improvement in both our operating result and ROCE.

- **Capital expenditure on property, plant and equipment consolidates our leading market share:** Both the German and UK electricity generation sectors are at the beginning of a long-term investment cycle. We began early on to plan the replacement of old power stations with efficient and environmentally friendly power plants. Given appropriate framework conditions, we will commission the construction of a large lignite-fired power station in Germany before the end of this year. We have already begun investing on a smaller scale to improve the efficiency and lifetimes of existing facilities. We are also about to undertake significant investment in our water infrastructure, especially once the fourth UK regulatory period begins in April this year. It calls for far-reaching capital expenditure, remunerated by tariff increases which include a double-digit increase in April 2005. German electricity and gas grids also require comprehensive modernization. However, we will not be able to implement expansive measures until the legal setting conducive to such activities exists and our profitability criteria have been fulfilled. All in all, our capital spending will be of a manageable order of magnitude. We expect capital expenditure on property, plant and equipment to total about €4 billion per year, give or take 10 %. This provides a good basis for further improvement in the Group's average free cash flow over the coming years.

Given appropriate framework conditions, we will commission the construction of a state-of-the-art lignite power plant in 2005.

We expect German grid regulation to have a negative impact on our result.

- **Regulation management:** We have repeatedly emphasized that our business is exposed to political risks in this and previous reports. Our German electricity and gas operations will be faced with state grid regulation for the first time this year. While the basic shape of the future framework is slowly becoming visible in the context of the political debate, it has not yet been established definitively by legislation. We expect that this will have a negative impact on the earnings generated by our grid business in the next few years. Depending on the legislative process, we anticipate a decrease in 2005. We will offset this above all by implementing efficiency-enhancing measures. Pan-European emissions trading, which has just begun, poses yet another regulatory challenge. But we anticipate risks to be limited in the first trading period (2005–2007). We will respond to them with flexible power plant deployment and optimized electricity and fuel purchasing.

Our net debt cap is €17 billion. We intend to maintain our strong rating.

- **Financial stability:** While we have achieved our net debt reduction goal earlier than expected, we continue to be committed to our solid financial policy. Our cap for 2005 will remain at €17 billion. By staying clearly within this limit, we confirm that we intend to continue living up to our current A1 and A+ credit ratings. Thanks to the positive reputation we have as a bond issuer, we have access to short and long-term financing at all times. In 2005 €1.2 billion in bonds come due.

External revenue in 2005 is expected to be slightly lower than in 2004.

Slight decline in Group revenue

Revenue is expected to fall marginally below the previous year's level of €42.1 billion. This forecast is based on the following exchange rates: €1 = US$1.30 and €1 = £0.70. The decline will be primarily caused by the deconsolidation of RWE Umwelt, Heidelberger Druckmaschinen and Turbogas, the Portuguese power plant. This sheds about €3.6 billion in revenue. Excluding consolidation and currency effects, we expect to achieve a single-digit growth rate. We anticipate that all divisions will increase revenue. At RWE Power, however, due to high internal sales, the rise will be reflected in total revenue instead of external revenue.

Continued improvement in the operating result and net income expected

In our opinion, we have a chance to improve the Group's operating result further: Without consolidation and currency effects, we anticipate achieving a single-digit growth rate. Higher hard coal costs and the onset of regulation in the German market are likely to burden earnings. However, higher energy and water prices will be the primary contributors to an increase in income. Moreover, we plan to reduce costs by approximately €200 million in 2005. Net of consolidation and currency effects, EBITDA in 2005 is expected to match last year's level. It will develop differently than the operating result because we expect depreciation to decrease. In addition, EBITDA does not include income from investments which will probably improve further in 2005.

We expect a single digit growth rate for our operating result and net income.

We expect net income to post a single-digit growth rate. While the non-operating result will decrease owing to substantially lower proceeds from disposals, we anticipate a slight improvement in our financial result.

Medium-term targets of the RWE Group

Dividend	Operating result	ROCE	Cost cutting + Synergies
Annual increase > 15 % 2004 – 2006 **Payout ratio of 50 %** as of 2006	**At least 5 % CAGR from organic growth**	**14 %** in 2006	**Approx. € 700 m** by yearend 2006

Earnings trend by division:

We expect **RWE Power** to close 2005 with yet another improvement in its operating result. We will change our reporting structure as of January 1, 2005. In the future, RWE Trading's result will no longer be reported separately in our financial statements. This is because, as an integral component of the energy value chain, RWE Trading's primary role is to help ensure that the value of our power plants' output is safeguarded. We will therefore include RWE Trading's figures with RWE Power in the future. Without taking this change into account, we expect RWE Power to post a single-digit growth rate. An increase in the operating result generated by our Power Generation Business Unit is anticipated. Here, we expect a rise of 10 to 15 % mainly driven by wholesale price increases. We have already sold forward most of the electricity we expect to generate in 2005. Increased hard coal prices will contribute €100 – 150 million of extra costs. Due to higher coal prices and the risks arising from emissions trading in 2005, we may reduce the utilization of our hard coal power plants. Further additional costs will stem from a comprehensive maintenance program that we intend to implement at our power plants in the current fiscal year. We anticipate that RWE Dea will see a slight decline in its operating result. This forecast is based on the assumption that oil production will be lower year-on-year. Moreover, crude oil prices are likely to remain below the extremely high level recorded in 2004. Operating results generated by Harpen appear to be improving, principally driven by renewables-based electricity generation.

Based on our forecasts, **RWE Energy** will achieve an operating result that matches the 2004 level. Savings and synergies realized within the scope of the Group's reorganization will have a positive impact on the operating result, but may be offset by burdens from the regulation of Germany's electricity and gas markets. These are anticipated to be moderate in 2005 since the new German Energy Act (EnWG) will enter into force later in the year. The amendment to the German Renewable Energy Act (EEG) will also have a negative effect. It will cause RWE to incur higher expenses for supplying electricity at short notice to compensate for fluctuations in power fed into the grid by wind farms. We expect earnings at our foreign regional companies to be stable overall.

We expect the operating result recorded by **RWE npower** to be up to 20 % down on 2004. This is because the generation business will face a steep increase in costs owing to the rise in fuel prices and the need to purchase additional emission certificates. We are confident of being able to further improve earnings in the sales business. However, this will not be sufficient to offset the shortfall in the generation business. We expect the synergy project with RWE Thames Water to deliver further savings. Further development of renewables-based power generation will also have a positive impact. We anticipate that RWE npower's results will recover again in 2006.

The operating result achieved by **RWE Thames Water** is expected to post a single-digit growth rate. Tariff increases in the UK allowed for the new five-year regulatory period starting on April 1, 2005 will be the key factor. Furthermore, we will benefit from cost reductions. American Water will grow its operating result thanks to tariff increases and efficiency enhancements.

RWE Umwelt is for sale and now disclosed under "discontinuing operations" in accordance with IFRS. Since January 1, 2005, this division has been included only in net income.

Value management: another increase in ROCE expected

We expect ROCE to follow our earnings trend, posting another improvement. Most of the value added is likely to come from the German energy business. RWE npower will earn back its cost of capital in 2007 instead of in 2005 as originally planned. This is due to the transfer of the trading business as well as the considerable rise in costs relating to fuel and UK emissions trading. RWE Thames Water will meet its capital costs in 2005. This is due to the change in the value management method. If it was not for the change, we would probably reach our ROCE target in 2008. The major reason for not achieving our target is our change in strategy. We will gradually dispose of those water activities outside RWE's four core regions. In so doing, we will give precedence to stability over growth. The delay can in part also be ascribed to American Water. Lower interest rates and higher pressure to perform from regulators have led to a marginal decrease in returns from the US water business. Nevertheless, they are satisfactory when compared on an international level.

We expect ROCE to improve again in 2005.

In the future, we want to link our dividend to a payout ratio of 50 %.

Further dividend increases: payout ratio of 50 % targeted

In light of our robust earnings outlook, we are confident that the dividend will also fare well. We intend to increase the dividend for fiscal 2005 and 2006 by at least 15 % in each year. In the future, we will link our dividends to a payout ratio. In so doing, we want to show our shareholders that a specific percentage of earnings will be earmarked for the dividend every year. We are striving for a payout ratio of 50 % and intend to achieve this with the dividend for the 2006 financial year. By comparison, the dividend for fiscal 2004 has a payout ratio of 47 %. The basis for the calculation will be recurrent net income, i.e. net income excluding the non-operating result which is characterized by one-off effects. This is how we want to link the dividend directly to the development of our operating activities.

Capital expenditure on property, plant and equipment up year-on-year

We will step up capital expenditure on property, plant and equipment this year in order to carry out the aforementioned measures to modernize our power stations and networks in Germany as well as in the UK water business. Capital spending is forecast to total some €4 billion. No large-scale acquisitions are currently planned. This does not rule out the possibility of rounding off our existing competitive positions with small acquisitions.

Procurement: higher price of imported hard coal represents a further burden
According to our forecasts, prices paid for imported hard coal will remain high. Prices set by the German Federal Office of Economic and Export Control (BAFA) for German coal rose in 2004. We expect this to result in an additional burden in 2005. We anticipate that RWE npower will also experience a rise in the cost of hard coal. We have covered about 90 % of our hard coal consumption forecast for 2005 and limited price risks with physical and derivative hedges. Due to the steep climb in oil prices through October 2004, we anticipate an initial increase in the price of gas purchases. In light of the easing of the situation on oil markets at yearend, gas prices are likely to decline somewhat over the course of the year. We have identified additional potential to realize savings in the procurement of materials and services. We will step up pool purchasing even further in order to achieve price advantages.

Employee headcount
In fiscal 2005 our workforce will continue to shrink principally due to the deconsolidation of RWE Umwelt. This will cause our employee headcount to decrease by some 10,000.

Forward-looking statements
This annual report contains forward-looking statements regarding the future development of the RWE Group and its companies as well as economic and political developments. These statements are assessments that we have made based on information available to us at the time this document was prepared. In the event that the underlying assumptions do not materialize or additional risks arise, actual performance can deviate from the performance expected at present. Therefore, we cannot assume responsibility for the accuracy of these statements.

We offer prospects

As one of Europe's largest utilities, we are faced with new challenges every day. While this causes the demands placed on our employees to rise, it also gives them a chance to further their development. Therefore, we are much sought after by school and university graduates as well as by highly qualified specialists. To ensure that this does not change, we undertake systematic personnel and executive development work.

Our "I Can Do This!" initiative prepares 100 young people for training every year.

Training programs again exceed Group demand

For us at RWE, training is two-fold. We want to cover our need for young qualified staff on the one hand, while we believe it is part of our social responsibility to offer as many young people as possible both professional and personal prospects on the other. This is why in 2004, we again trained more skilled workers than the Group needs. A total of 3,644 people, 3,411 of which live in Germany, obtained the skills for one of over 50 training occupations offered in the RWE Group. Furthermore, the "I Can Do This!" initiative enables up to 100 young people to attend hands-on training preparation courses. This is our contribution to opening the window of opportunity to the job market for young unemployed people.

We offer innovative vocational training and personal advancement programs across hierarchical levels.

From grid technician training to timely succession planning

Highly qualified and motivated employees across hierarchical levels are our most important asset. Vocational training and personal advancement are the keys to securing it. This is where our executives assume special responsibility as part of the RWE Management Dialogue, a series of regular one-on-one employee reviews during which development prospects and qualification needs are established. This is what RWE's personnel development work addresses, offering proven tools such as seminars and training programs as well as innovative concepts. An example of such an approach in the commercial sector is the supplementary training program for electricity, gas and water network technicians, also referred to as multi-skilled service technicians*.

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Having considerably expanded the range of executive resource development measures in previous years, in the year under review, personnel activities concentrated on developing a groupwide integrated succession management system. This includes the potential assessments that were introduced throughout the Group in 2004 and are conducted before every succession conference. In addition, all of our personnel and executive resource development tools are based on the RWE Model of Competence which describes the demands placed on non-executive staff and managers. The consistent use of innovative personnel tools and uniform assessment standards are the keys to successful HR work. This is how we ensure that every vacant management position is promptly staffed by the most suitable employee.

Workforce FTE[1]	**12/31/04**	**12/31/03**	**+/– in %**
RWE Power	18,149	19,280	–5.9
RWE Energy	39,861	42,655	–6.6
RWE npower	9,555	9,357	2.1
RWE Trading	643	397	62.0
RWE Thames Water	16,051	17,521	–8.4
Discontinuing activities[2]			
RWE Umwelt	10,408	12,578	–17.3
Heidelberger Druckmaschinen	–[3]	22,036	–
Other[4]	3,110	3,204	–2.9
RWE Group	**97,777**	**127,028**	**–23.0**
Germany	55,407	72,191	–23.2
Outside Germany	42,370	54,837	–22.7

1 Converted to full time equivalent.
2 Discontinuing operations in accordance with IFRS.
3 Deconsolidated as of May 2004.
4 Including RWE Systems.

With the help of customized development programs, which take most candidates through various Group divisions, we prepare candidates for promotion. In so doing, we foster greater groupwide mobility among executives and young employees while affording them the opportunity to build and enlarge personal networks. Studies have shown that targeted succession planning is more efficient and helps reduce the cost of external recruitment.

Target-oriented succession planning reduces undesired fluctuation and recruitment costs.

New company pension supplement

Are legal pensions sufficient for people to maintain their standard of living when they retire? This question is also pondered by many RWE employees. We thus supplemented our company pension plan with a new option in September 2004. Our staff members can now pay part of their compensation into an additional deferred compensation company pension scheme. Added benefit: this pension component is funded by untaxed income.

Workforce decreased considerably due to divestments

The RWE Group employed 97,777 people as of December 31, 2004. This represents a decline of 29,251 positions, or 23 %, year-on-year. Company acquisitions and divestments led to a net loss of 24,949 employees. Operating personnel changes primarily relate to the cost-cutting programs initiated in prior years. RWE generally implements socially acceptable redundancy schemes, which have the approval of the company’s employee representatives.

Spotlight on climate protection

Sustainability automatically brings environmental protection, nature conservation and resource economization to mind. This is why, since our core competence lies in the energy and water business, we have chosen to focus our activities on these issues. Charitable and social commitment are two further elements of our comprehensive strategy for sustainability that rank highly as well.

State-of-the-art power plant engineering enables us to maximize environmental friendliness and supply security at an affordable cost.

Climate conservation continues to feature high on our list of priorities

To ensure that we continue to make a contribution to protecting our climate, we will reduce resource consumption and greenhouse gas emissions even further. In doing so, we intend to maximize environmental protection at a feasible cost, while offering our customers the highest possible level of supply security. Modern power plant technology plays a central role. In 2004 we applied for a permit for a second optimized lignite-fired power station at our Neurath site in Germany. In common with the first power station of this kind, which was commissioned in 2002, this new power plant would achieve an efficiency of 43 % compared with the 30–35 % obtainable with conventional technology. Each 1,000 MW of new capacity will reduce CO_2 emissions by nearly 3 million metric tons a year — 30 % less than is currently emitted by our conventional power stations. At our Weisweiler* site, we are retrofitting the power station's lignite blocks with two 190 MW topping turbines. We are thus taking advantage of the ecological and economic potential from sensible lignite-gas cogeneration. The installation is far more flexible and efficient. Excluding run-of-river plants, our renewables-based power generation capacity totaled 349 MW in 2004. We want to increase this capacity considerably, especially in the UK. In 2004 we started planning a wind farm with a combined installed capacity of up to 750 MW on the windy coast of Wales. A 60 MW facility came online in this region at the end of 2003. In Germany we are primarily expanding the small, but attractive, biomass-based power generation business.

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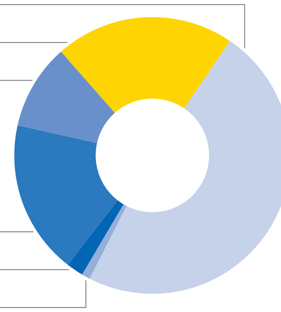
Most of our expenditure on environmental protection is earmarked for clean air and the protection of rivers and lakes.

€ 930 million spent on environmental protection

In 2004 capital expenditure on environmental measures totaled approximately € 930 million, a large portion of which was earmarked for nature conservation and landscape protection. Activities include the reclamation of the Rhenish lignite mining region, environmentally friendly engineering of power grid routes and the restoration of river courses in the Thames catchment area. As part of the Group's organizational restructuring, we continued to make the standards for recording environmental expenses more uniform — above all in the power production business. In addition, wastewater treatment costs incurred in the UK aimed specifically at controlling water pollution were included for the first time. Net of these nonrecurrent effects, which added € 514 million, expenditure on environmental protection was about 11 % up year-on-year.

RWE Group — Expenditure on environmental protection in 2004

Water protection	48 %
Air-pollution	21 %
Landscape protection	10 %
Waste disposal	18 %
Noise abatement	2 %
Restoration of contaminated sites	1 %
Total	**€ 930 million**



Showing charitable and social commitment

With a view to assuming our social responsibility, among other things, in 2004 we supported a host of projects in the fields of education, culture, charity and mass sport. Expenditure amounted to €15 million. We took great care to do justice to unique regional traits and long-established structures. In the UK social engagement among employees in their home communities is especially widespread. RWE Thames Water has years of experience with clean water projects in developing countries. In Germany programs for the promotion of young people represent an important focal point. The RWE Youth Foundation and "I Can Do It!", the project we launched to prepare people for training, are two examples. Moreover, we belong to several international committees. We have been a member of the e7, a group of leading energy utilities from the former G7 countries founded to foster sustainable action, since it was established in 1992. In 2004 we joined forces with partners from other countries to start a similar initiative for the water sector. This program is tailored to give about 700,000 people in the world's most destitute countries access to clean water by 2007. Our joining the UN Global Compact Initiative* at the end of 2003 underscores our pledge to sustainability.

In 2004 we sponsored programs in the field of education, culture, charity, and mass sports, among others.

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RWE receives international award for sustainability strategy

For the sixth time running, our far-reaching approach to responsible entrepreneurial action was rewarded with our company's inclusion in the renowned Dow Jones Sustainability Index. For the first time, in 2005, we ranked first among power utilities worldwide. One of the key components in our strategy for sustainability is a targeted, transparent information policy. Our detailed sustainability report is published once every two years and is available on RWE's website*.

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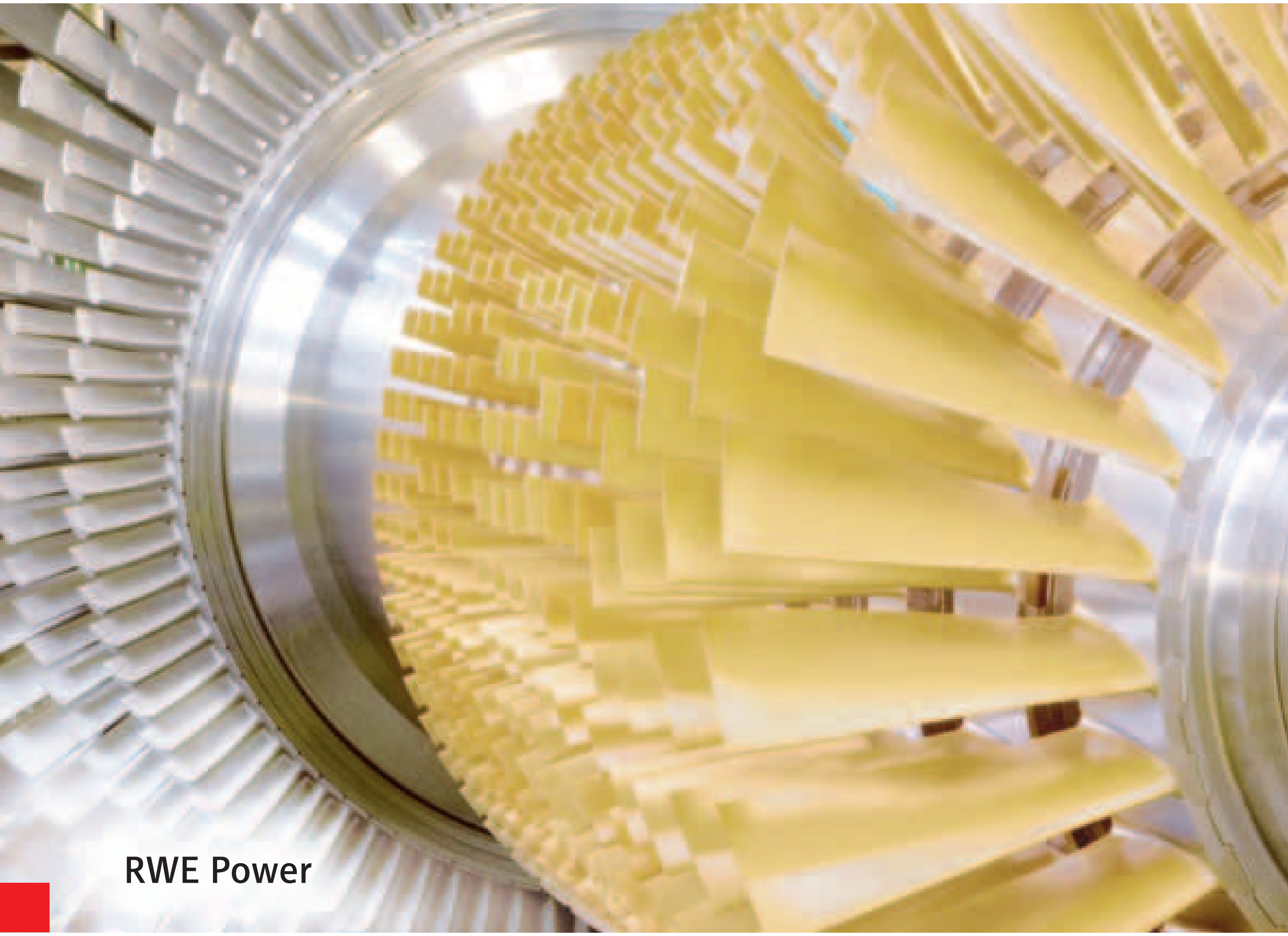


RWE Power

△ **Topping gas turbine**

Turbine hall

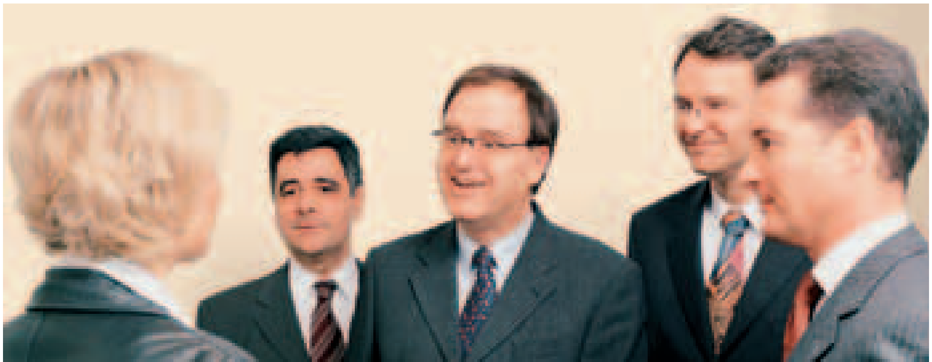
Control station

Purified gas lines leading to cooling towers

»Now our power plant will be even more powerful.«

“Putting the pedal to the metal is easy for us at RWE Power. After all, we will install **topping gas turbines.** They will boost our two lignite units, which each have an unassisted output of 640 megawatts. This means that our coal-fired power station covers basic needs. And whenever demand exceeds this level, all we have to do is turn on the turbines. They will each add up to 190 megawatts. Whenever we need them to.”

Hubert Kalz, engineering M.A., Project Manager for the topping gas turbines at the Weisweiler power plant, RWE Power



Dr. Gert Maichel (3rd from left), CEO of RWE Power and member of the Group Business Committee, with employees

Dr. Georg Schöning (RWE Dea), Member of the Group Business Committee

German power business still on course for success

Our German power plant operations continued their positive earnings trend in 2004. This was principally due to the rise in electricity wholesale prices. Consequently, we more than offset the absence of the earnings contribution from the investment in CONSOL we sold and the expected decline in earnings at RWE Dea. Net of deconsolidations, RWE Power improved its operating result by 16 %.

The rise in hard coal prices was the main factor behind the increase in electricity wholesale prices.

High electricity prices on Germany's wholesale market

German electricity wholesale prices remained high after the steep climb in the previous year. These prices were predominantly affected by the strong rise in prices paid for primary energy sources, with hard coal leading the way. Hard coal power plants are marginal sellers of medium-load electricity and thus have a significant influence on electricity prices. Furthermore, the price increase reflects the fact that power plant capacity has become more scarce as evidenced especially in forward prices. The introduction of CO_2 emissions trading on January 1, 2005 has also had an effect.

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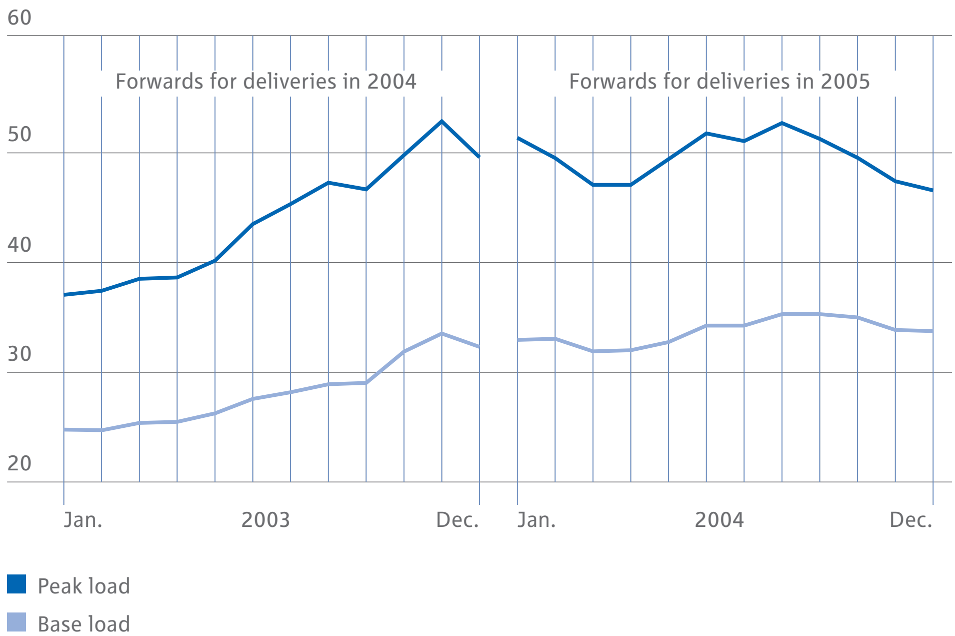
Average prices on the German Energy Exchange (EEX) for one-year forwards in 2004 were €33.48 per megawatt hour of base-load power and €49.04 per megawatt hour of peak-load power. This represents increases of 19 % and 13 % year-on-year. As shown in the diagram on page 79, forward* prices for deliveries in 2005 grew moderately in the spring and summer months of 2004. They decreased marginally towards the end of the year, partially owing to the drop in prices for hard coal forwards as well as short-term effects such as the high degree of power plant availability and mild weather.

RWE Power sells forward for one or more years nearly all of the electricity it generates via RWE Trading. Therefore, 2004 electricity revenue was primarily affected by the development of forwards in the 2002/2003 trading period. Here again, we benefited from the trend to higher prices on wholesale markets. But the clear rise in the second half of 2003 did not have a significant impact on electricity revenue since, by mid-year, we had already sold forward nearly all of the electricity we expected to generate in 2004.

Development of one year forward wholesale electricity prices in Germany
€ per MWh



Crude oil prices achieve record level, but average gas prices are slightly down
In the first three quarters, prices on world oil markets posted a rapid rise, achieving a record high of more than US$ 50 per barrel of Brent* crude in October. The strong increase was primarily driven by the steep rise in demand, especially from China. At the same time, oil-producing countries ran production at capacity, primarily for light crude. In addition, major oil-consuming countries sometimes had very low inventories. Production downtime caused by the difficult political situation in Iraq, terrorist attacks and political tension in Venezuela and Nigeria

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buoyed prices additionally. With the increased refining of heavy oils and higher inventories around the world, crude oil prices declined as the year progressed. They closed 2004 at US$ 40.

In 2004 crude oil prices were up an average of 33 % over the previous year's high level.

A barrel of Brent crude cost US$ 38.26 on average—a 33 % increase over the high level recorded in 2003 and 65 % more than the most recent 10-year average. However, due to the strength of the euro over the US dollar, prices increased less in the countries of the European Currency Union. Converted to euros, Brent prices advanced by 21 % compared with the previous year.

Gas also became more expensive in Germany over the year, but was slightly down on the previous year on average. As is customary in the utility industry, gas prices track oil prices with an average lag of six months via escalation clauses included in supply agreements. As a consequence, gas prices were still affected by the moderate price of oil in the second half of 2003. The weak US dollar also dampened the price trend.

RWE Power **Power plant capacity by primary energy source** **As of December 31, 2004** MW	**Total**	**Germany**
Lignite	10,958	10,244
Nuclear	6,308	6,308
Hard coal*	9,745	9,745
Gas	4,015	4,014
Hydro/other*	3,877	3,655
Total	**34,903**	**33,966**

* Including capacities of power stations not owned by RWE that we can deploy at our discretion on the basis of long-term agreements.

Electricity generation up 5 %

In the fiscal year RWE Power generated 205.3 billion kilowatt hours of electricity. This corresponds to a 5 % increase. In-house production grew 5 % to 202.6 billion kilowatt hours. This includes output generated with power plants which we can dispatch at our discretion, based on long-term agreements which accounted for 20 % of the total output. Following the unscheduled downtime of the Biblis A nuclear power plant in 2003, we increased the amount of electricity generated by nuclear facilities. However, we suffered production losses due to generator damage at the Gundremmingen C nuclear power station. Lignite-based electricity generation rose as well, thanks to the improved availability of the cutting-edge 1,000 MW lignite-fired block at Niederaussem. At the end of the financial year, RWE Power had an installed capacity of 34,903 MW*. Accounting for 31 %, lignite is our major energy source, followed by hard coal (28 %) and nuclear (18 %).

RWE Power benefited from its power plant portfolio's improved availability, especially as far as nuclear energy is concerned.

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RWE Power Electricity production by primary energy source Billion kWh	**2004**		**2003**	
	Total	**Germany**	**Total**	**Germany**
In-house generation	**202.6**	**192.1**	**192.5**	**181.6**
Lignite	78.0	73.0	76.5	71.5
Nuclear	48.2	48.2	36.9	36.9
Hard coal*	54.6	54.6	55.1	55.1
Gas	16.3	11.4	18.2	12.8
Hydro, other*	5.5	4.9	5.8	5.3
Electricity purchased	**2.7**	**2.7**	**3.6**	**3.6**
Total	**205.3**	**194.8**	**196.1**	**185.2**

* Including electricity purchased from power plants not owned by RWE that we can deploy at our discretion on the basis of long-term agreements. This includes 38.8 billion kWh of hard coal and 2.7 billion kWh of hydroelectric and other power in the fiscal year.

Gas and oil production down year-on-year

RWE Dea produced 2,158 million cubic meters of gas in the year under review—16 % less than in 2003. However, the previous year's level was exceptionally high. RWE Dea normally sells the gas it produces in Germany through long-term agreements in the autumn and winter. Furthermore, in 2003, we sold significant quantities on the spot market since reserves were readily available. At 5.6 million cubic meters, RWE Dea's oil production was slightly down on the previous year. New production wells in the Danish North Sea and higher production in Kazakhstan added to the amount of oil we brought to market. By contrast, there were production shortfalls due to unscheduled downtime in Norway. Moreover, production in the German Mittelplate oilfield was hampered by unfavorable weather conditions.

Revenue down due to CONSOL deconsolidation

In the period under review, RWE Power reported €2,919 million in external revenue. Compared with the previous year, this corresponds to a 28 % decline. This was caused by the fact that the year-earlier figure included revenue from CONSOL Energy, the US hard coal and gas producer which we deconsolidated as of September 30, 2003. The sale of our Turbogas/Portugen power plant activities in Portugal also contributed to the decline in revenue. It was deconsolidated effective September 30, 2004. Organically, i.e., excluding these one-off effects, RWE Power improved external revenue by 13 %. RWE Dea achieved higher prices for crude oil. The Power Generation Business Unit also lifted revenue, partially by marketing refined lignite products. Conversely, the rise in our electricity production and wholesale prices did not have a significant impact on external revenue since RWE Power sells nearly all of its output to other Group companies.

RWE Power Key figures		2004	2003	+/– in %
External revenue	€ million	2,919	4,077	–28.4
Internal revenue	€ million	5,668	5,173	9.6
Total revenue	€ million	8,587	9,250	–7.2
EBITDA	€ million	2,460	2,631	–6.5
Operating result	€ million	1,742	1,682	3.6
Return on capital employed (ROCE)	%	23.0[1]	16.5	–
WACC before taxes	%	10.5	10.5	–
Value added	€ million	948[1]	614	54.4
Capital employed	€ million	7,565[1]	10,176	–25.7
Capital expenditure	€ million	677	1,115	–39.3
Property, plant and equipment	€ million	662	1,065	–37.8
Financial assets	€ million	15	50	–70.0
		12/31/04	12/31/03	
Workforce	FTE[2]	18,149	19,280	–5.9

1 Calculated using the old method. By applying the new method for calculating capital employed introduced in 2004 (cf. details on p. 187), capital employed totaled € 7,406 million. This results in ROCE of 23.5 % and € 964 million in value added.

2 Converted to full time equivalent.

Operating result up 16 % net of one-off effects

EBITDA for RWE Power dropped 6 % to € 2,460 million. This was primarily due to the absence of the earnings contribution from CONSOL. Despite this non-recurrent effect, the operating result was up 4 % to € 1,742 million. Lower depreciation was the main reason the operating result development was better than that of EBITDA. Here, the impact of the disposal of the asset-intensive CONSOL business was felt. Net of deconsolidations, RWE Power grew its operating result by 16 %, driven by the earning power of our German electricity generation activities. Absolute value added by RWE Power amounted to € 948 million. This does not yet take into account the changes made to RWE's value-management concept. Value added by RWE Power rose by € 334 million year-on-year owing to the improvement of the operating result and the reduction in capital employed caused by deconsolidation effects.

The earning power of our German electricity generation business improved considerably. However, RWE Dea was unable to match the high level achieved in the previous year.

RWE Power Key figures by business unit € million	Total revenue		External revenue		EBITDA		Operating result	
	2004	2003	2004	2003	2004	2003	2004	2003
Power Generation	7,117	6,332	1,381	1,182	1,788	1,572	1,314	1,052
RWE Dea	1,194	1,227	1,274	1,217	558	618	357	389
Harpen	276	264	264	253	114	115	71	70
CONSOL Energy*	–	1,427	–	1,425	–	326	–	171
RWE Power	**8,587**	**9,250**	**2,919**	**4,077**	**2,460**	**2,631**	**1,742**	**1,682**

* Deconsolidated as of September 30, 2003.

The following is a breakdown of operating result trends by business unit:

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- **Power Generation:** The operating result generated by this business unit was up 25 %. Price-induced margin improvements on the back of higher generation output provided the basis for this growth. Furthermore, we realized additional savings via our cost-cutting program. The rise in fuel prices had a counteracting effect (–€ 250 million). This was primarily due to our hard coal purchases, most of which are invoiced according to prices determined by the German Federal Office of Economic and Export Control (BAFA). They track developments on the world market with a delay of several months. BAFA* prices averaged € 55 per metric ton of hard coal units (HCU*) compared with € 40 in 2003.

- **RWE Dea:** Our gas and oil activities fell 8 % short of matching the very high operating result achieved in the previous year. This was mainly due to the weak US dollar. Whereas we managed to partially offset negative currency effects by gains from foreign-currency hedges, these gains were much higher in 2003. When compared with the previous year, the impact on the result is negative. In addition, RWE Dea was unable to fully benefit from the boom on crude oil markets because it concluded oil price hedges early on.

- **Harpen:** Our subsidiary, which specializes in renewable and distributed power generation, closed fiscal 2004 with an operating result on par with the previous year although the year-earlier figure included exceptional income from divestments in the real-estate sector. This was due to the rise in earnings in the energy business.

Capital expenditure down 39 %

In the year under review, RWE Power's capital expenditure amounted to €677 million, down 39 % relative to 2003. Property, plant and equipment accounted for €662 million, with depreciation totaling €831 million. This represents a decrease of 38 %, primarily owing to the deconsolidation of CONSOL (–€183 million). Moreover, all business units spent less on property, plant and equipment, with Power Generation leading the way. In 2003, this business unit's capital expenditure included a power plant project in Duisburg-Hamborn. Opencast lignite mines were the major investment in 2004. We spent considerable sums on maintenance and land acquisitions. Furthermore, we are investing in retrofitting measures at the Biblis nuclear power plant. In addition, we are building interim storage facilities for spent fuel elements at both Biblis and Gundremmingen. RWE Dea focused on the development of oil and gas fields. RWE Power scaled back capital spending on financial assets relative to the previous year's level, which was very low. It dropped from €50 million to just €15 million.

Capital expenditure on property, plant and equipment was reduced across business units. Spending on financial assets was low.

Oil and gas reserves 12 % down on previous year

At the close of 2004, our gas reserves were 71.8 million cubic meters of oil equivalent* (OE). Oil reserves amounted to 53.3 million cubic meters of OE. These figures only include reserves whose future production can be classified as "proven" or "probable." Reserves decreased by 14 % (gas) and 10 % (oil) principally as a result of production.

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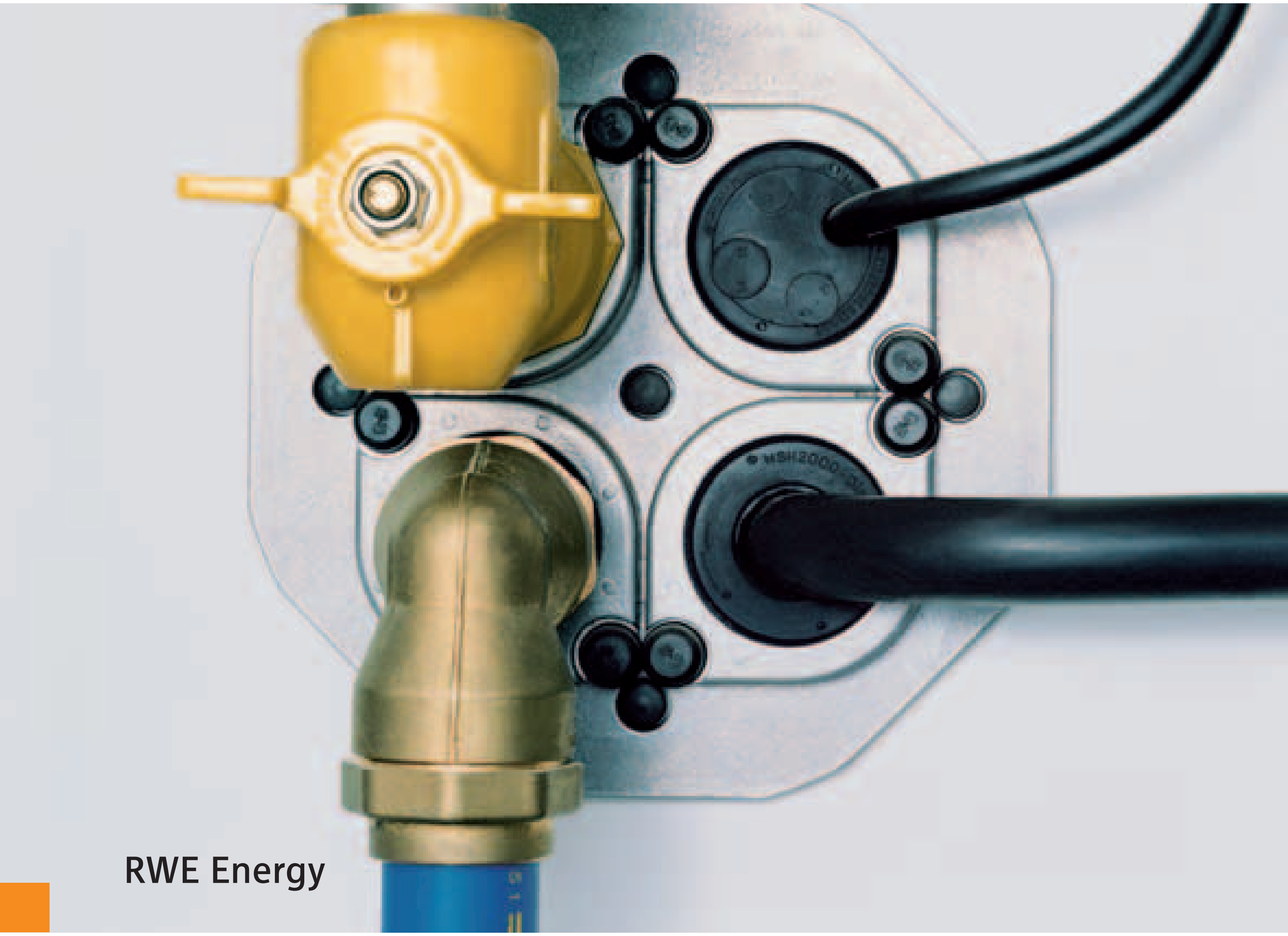
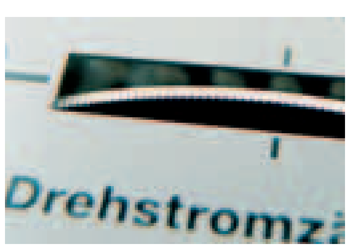
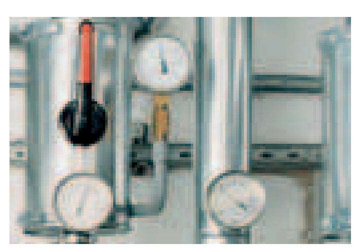
RWE Energy



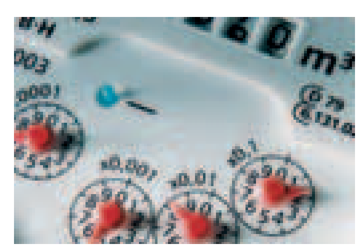
△ **Multi-purpose connection**



Power meter



Installations



Water meter

»I may turn up at the customer's site alone, but I have three experts with me.«

"A different expert for every task? That costs our customers time, stress and money. That's why I'm a **multi-skilled technician.** This means that besides being your expert for power lines, I'm your expert for gas and water connections as well. I see to it that they are all installed and serviced during a single visit. This makes life easier for our customers as it reduces the number of appointments we have to schedule and cuts costs. And it's good for me too, because it has made my job even more interesting."

Michael Schorr, Multi-Skilled Technician in St. Wendel, RWE Energy

Berthold Bonekamp (4th from left), CEO of RWE Energy and member of the Group Business Committee, with a fellow Executive Board member and employees

Dynamic earnings development outside Germany

RWE Energy improved its operating result above all in Eastern Europe. As of January 1, 2004 this division assumed RWE Thames Water's Continental European water activities as well as RWE Trading's industrial customers. RWE Energy thus now serves end customers as a grid and sales company with all three core products in Continental Europe: electricity, gas and water.

Energy consumption grew moderately despite positive economic trend. This was principally due to the mild autumn and winter.

Marginal growth in Continental European energy consumption

Electricity and gas consumption on our key European markets grew more slowly in 2004 than in 2003. Demand for electricity in Germany was only slightly higher compared with the previous year. The slight economic uptick and the calendar effect of the leap year had a slightly positive impact. In contrast, consumption of electricity for heating fell for weather-related reasons. Owing to the relatively cool summer temperatures, less electricity was used to run air conditioners. Our Central Eastern European electricity markets experienced a similar situation: the positive impact of economic growth was partially offset by weather-related effects. Driven by stronger economic momentum than in Germany, consumption in Poland increased by nearly 3 % while in Hungary, it rose by 1 %. Electricity consumption in Slovakia stagnated.

Demand for gas in Germany was marginally up year-on-year, primarily due to the cyclically-induced rise in gas used by industrial operations. Gas demand in the Czech Republic, RWE Energy's largest gas market besides Germany, stagnated despite the economy's dynamic growth. This was mainly a result of the mild weather particularly in the fourth quarter. Gas usage in Hungary declined marginally.

End customer prices reflect change in procurement costs

In Germany, electricity prices paid by households and small commercial enterprises rose by an average of 3 %. Markedly higher wholesale prices were primarily responsible for this growth. This led to a considerable increase in procurement costs for utilities. In addition, the German Renewable Energy Act resulted in a rise in grid costs. Prices paid by industrial customers were up 5 % on average, with distributors seeing an increase of 8 %. These significant growth rates are due to the fact that wholesale prices in these two segments play an even larger role in the final price. End customer prices were up in Hungary (+ 9 %), Poland (+ 2 %) and Slovakia (+ 4 %).

Cross-border gas prices in Central Europe rose over the course of the year. In euros, however, they were 3 % down on the 2003 average. As explained above, gas prices track heating oil prices with a lag of several months. As a consequence, fiscal 2004 was still marked by the moderate oil prices in the second half of 2003. The price of German gas imports was also 3 % down on the previous year. However, they increased considerably over the course of the year. Czech gas prices are determined by an independent regulator. These prices are based principally on the price of oil on world markets as well as on material currency exchange rates. End customer prices in the Czech Republic were largely stable. Conversely, prices posted a considerable rise in Hungary. The Hungarian regulator lifted tariffs by more than 30 %. Having undergone several adjustments, the prices now roughly reflect the cost of gas supply.

Electricity sales volume down 6 % on previous year

RWE Energy sold 156.4 billion kWh of electricity in the period under review, falling 6 % below the previous year's level. We will not sign new low margin contracts and adhere to our value-oriented sales policy. As a result, we lost customers primarily among distributors. This mainly affected the nothern, central and southern sales regions. Volume growth in the other German sales regions was unable to offset this. Decreases were also experienced in Hungary and Poland as these markets were deregulated.

RWE Energy shed electricity customers due to its value-oriented sales policy. We grew our customer base in the gas business above all in the Netherlands.

RWE Energy Electricity sales volume/revenue		2004		2003	
		Total	Germany	Total	Germany
Electricity sales volume	billion kWh	**156.4**	**137.7**	**167.1**	**147.5**
Private and commercial customers	billion kWh	38.9	30.6	38.6	30.2
Industrial and corporate customers[1]	billion kWh	65.4	55.3	66.3	55.9
Distributors	billion kWh	49.7	49.5	59.7	59.2
Electricity trading	billion kWh	2.4	2.3	2.5	2.2
External electricity revenue[2]	€ million	**12,975**	**11,581**	**12,243**	**10,917**

1 Includes the industrial customers transferred from RWE Trading to RWE Solutions from January 1, 2004 onwards.

2 Includes €947 million in direct electricity tax (previous year: €943 million) and grid fees.

In contrast, RWE Solutions sold more electricity although several large supply agreements expired. This was due to the transfer of industrial customers from RWE Trading.

By the end of 2004, RWE Energy and the companies in which it has shareholdings served nearly 17 million electricity customers—essentially as many as in 2003. In Germany, our main market, we have 12.2 million customers. We serve 2.1 million customers in Hungary, 0.8 million in Poland and 0.6 million in Slovakia.

RWE Energy Gas sales volume/revenue		2004		2003	
		Total	Germany	Total	Germany
Gas sales volume	billion kWh	**291.8**	**171.5**	**286.4**	**169.1**
Private and commercial customers	billion kWh	75.3	30.5	76.7	32.5
Industrial and corporate customers	billion kWh	105.5	47.0	102.0	46.5
Distributors	billion kWh	107.9	90.9	106.6	89.1
Gas trading	billion kWh	3.1	3.1	1.0	1.0
External gas revenue	€ million	**6,210**	**4,096**	**6,365**	**4,331**

Gas sales higher despite unfavorable weather

RWE Energy sold 291.8 billion kWh of natural gas, increasing its sales volume by 2%. The rise was largely due to the fact that we expanded our customer base on the deregulated Dutch market. Volume growth in the Czech Republic was marginal and principally caused by cyclical influences. Gas sales in Germany were slightly up year-on-year.

RWE Energy Key figures		**2004**	**2003**	**+/– in %**
External revenue	€ million	22,450	21,842	2.8
Internal revenue	€ million	706	555	27.2
Total revenue	€ million	23,156	22,397	3.4
EBITDA	€ million	2,927	2,750	6.4
Operating result	€ million	2,192	2,046	7.1
Return on capital employed (ROCE)	%	17.3[1]	16.5	–
WACC before tax	%	10.0	10.0	–
Value added	€ million	925[1]	805	14.9
Capital employed	€ million	12,668[1]	12,409	2.1
Capital expenditure	€ million	1,024	1,652	–38.0
Property, plant and equipment	€ million	947	1,000	–5.3
Financial assets	€ million	77	652	–88.2
		12/31/04	**12/31/03**	
Workforce	FTE[2]	39,861	42,655	–6.6

1 Calculated using the old method. By applying the new method for calculating capital employed introduced in 2004 (cf. details on p. 187), capital employed totaled €11,963 million. This results in ROCE of 18.3 % and €996 million in value added.

2 Converted to full time equivalent.

RWE Energy and the companies in which it has shareholdings currently supply just over 8 million customers with gas. Our main markets are in Germany and the Czech Republic, each accounting for almost 3 million of the total.

External revenue up 3 % due to one-off effects

In 2004 RWE Energy generated €22.5 billion in external revenue. This corresponds to a slight, 3 % rise year-on-year. The following two non-recurrent effects were the main drivers: the takeover of RWE Trading's industrial customers (+€155 million) and the integration of substantial parts of RWE Thames Water's Continental European water business (+€107 million). External revenue grew even net of these effects. German electricity sales operations improved revenue despite a decrease in sales volumes. RWE Energy passed the increased cost of purchasing wholesale electricity to corporate customers, industrial operations and power utilities. In addition, we lifted our general tariffs for private and commercial customers as of January 1, 2004. This rise also reflects the higher green levies in 2003. Furthermore, electricity prices rose in Hungary. In the gas business, we benefited from the aforementioned increase in sales recorded by our regional companies in the Netherlands and the Czech Republic. Gas revenue from the German gas business declined owing to lower prices for industrial customers and distributors.

Electricity revenue improved due to organic growth. Gas revenue experienced a price-induced decline.

Our foreign regional companies increased their operating result by 46 %, making a substantial contribution to the organic rise in earnings achieved by RWE Energy.

EBITDA and operating result post further growth

RWE Energy closed the year under review with EBITDA totaling € 2,927 million, posting 6 % growth over the previous year. The operating result was up 7 % to € 2,192 million. This was largely due to organic growth achieved by our foreign regional companies. Income from investments, which is not included in EBITDA, also posted a rise, affected by the discontinuation of goodwill amortization for companies accounted for using the equity method. RWE Energy lifted value added by € 120 million to € 925 million, buoyed by the surge in earnings. The change in RWE's value-management concept has not yet been taken into account in this figure.* RWE Energy and RWE Power are the Group's key value drivers.

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RWE Energy Key figures by business units	External revenue		EBITDA		Operating result	
€ million	2004	2003*	2004	2003*	2004	2003*
German regions	13,830	12,667	1,886	1,749	1,483	1,431
Northern	3,755	3,946	365	407	303	330
Central	4,965	3,966	633	509	527	481
Eastern	2,767	2,564	454	447	294	301
Western	371	361	58	58	64	60
Southwestern	1,272	1,158	242	210	198	158
Southern	700	672	134	118	97	101
International regions	3,371	3,216	418	337	322	221
RWE Solutions	3,102	2,825	86	122	50	56
Electricity & gas transmission	1,853	1,831	713	689	571	552
Other, consolidation	294	1,303	–176	–147	–234	–214
RWE Energy	**22,450**	**21,842**	**2,927**	**2,750**	**2,192**	**2,046**

* Figures adjusted largely due to the retroactive assignment of gas activities within the RWE Energy Division.

The following is a breakdown of operating results by business unit:

German regions: Our German regional companies closed the fiscal year 4 % up on the previous one. We generated organic growth in our electricity sales business due to our value-oriented sales policy. Furthermore, we implemented additional cost-cutting measures. The takeover of RWE Thames Water's continental water business also added to the result.

International regions: Our Continental European sales activities outside Germany increased their operating result by 46 %. This considerable rise is partially due to ongoing cost-cutting measures. In Hungary, the regulator approved price increases, enabling necessary improvements in margins. Our Polish subsidiary STOEN benefited from lower electricity procurement costs. Our Czech regional gas distributors also posted a gain on the back of improved margins in the regulated private and commercial customer business.

RWE Solutions: The operating result generated by RWE Solutions, a specialist for energy-related services, was 11 % down on the previous year. The company was faced with charges from a large-scale plant construction project. In addition, there was a rise in the cost of primary energy as well as of manufacturing material such as steel and copper, which could not be fully passed on to customers. The largest contribution to the operating result was made in the field of industrial energy supply, which benefited from exceptional income.

Electricity and gas transmission: We include all our German electricity activities associated with the ultra high-voltage grid and the gas transmission and sales business of Czech-based Transgas in this segment, to which we added the German gas transmission grid as of January 1, 2004. Therefore, the operating result was 3 % up year-on-year.

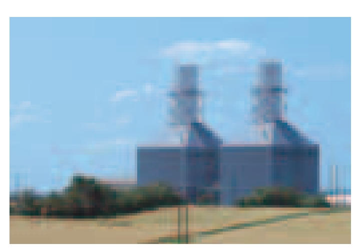
Capital expenditure: continued focus on grid modernization

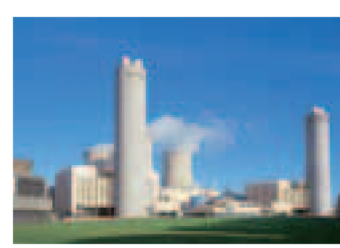
In the year under review, RWE Energy spent €1,024 million—38 %, or €628 million, less than in 2003. Capital expenditure on financial assets decreased considerably, declining by €575 million to €77 million. In 2004 the most important projects were the acquisition of the remaining stake in Dutch-based Obragas and of the investment made in a municipal utility by East German-based enviaM. RWE Energy's capital expenditure on property, plant and equipment dropped by 5 % to €947 million. Most of the funds were earmarked for the expansion and modernization of network infrastructure.

Reorganization of RWE Solutions

We initiated the reorganization of RWE Solutions at the end of 2004. Electricity and gas sales to industrial key accounts as well as the contracting activities will continue to be RWE Energy's core business. Major parts of the German and international project and service operations will be set up within a new, independent group of companies, forming the core of the "new" RWE Solutions. These activities already generate 70 to 80 % of their revenue outside the group. They are not part of our core competence. Whether RWE will keep these operations remains to be decided. RWE Solutions' remaining business is for sale. We already sold activities in 2004, i.e., the manufacture of transformers and facilities for uninterruptible power supply.

RWE npower





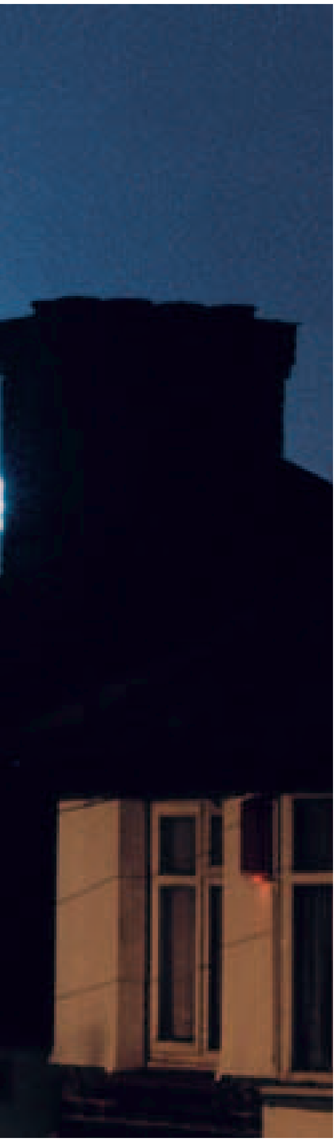
△ **Wembley National Stadium (UK)**

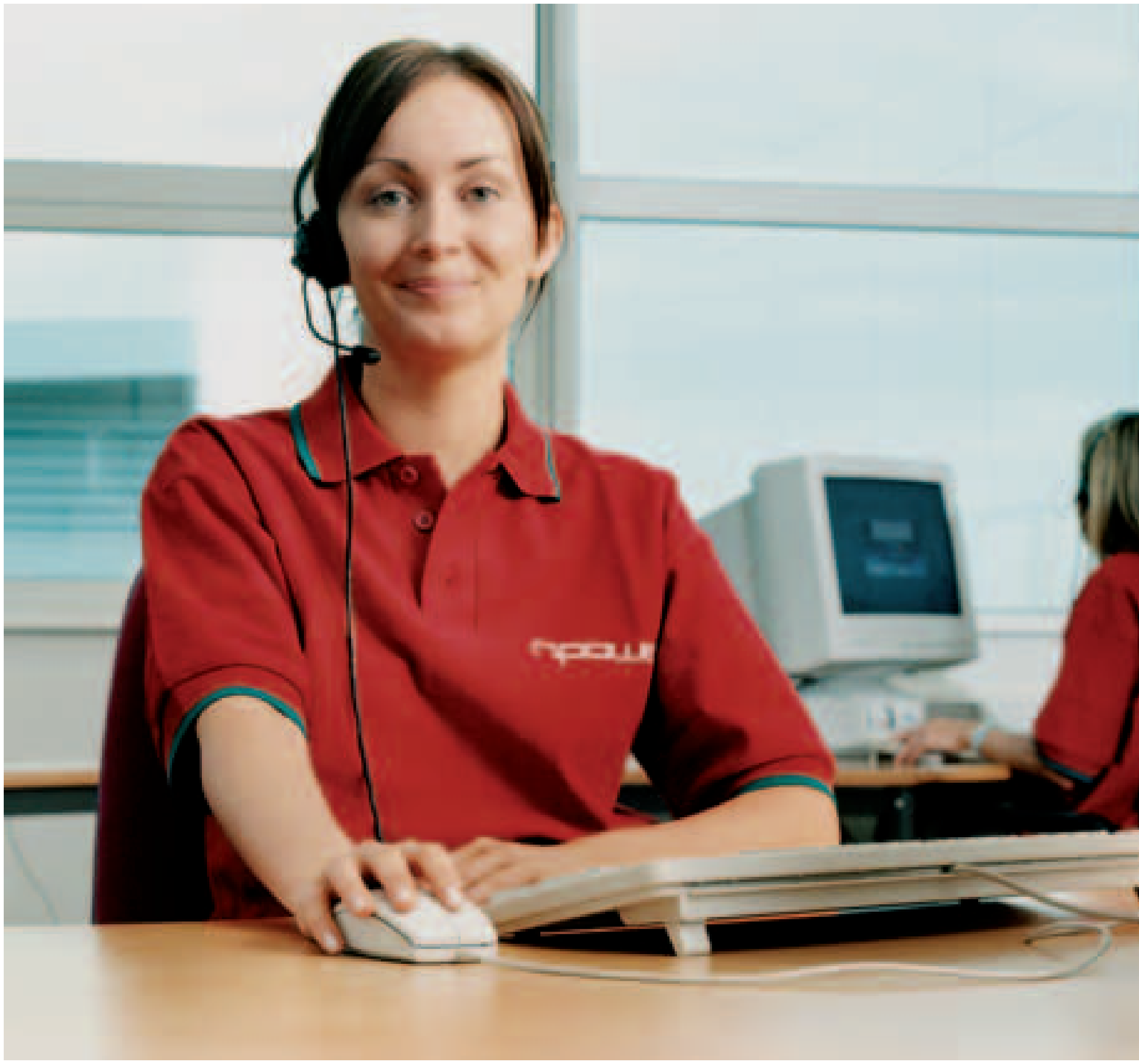
North Hoyle offshore windfarm (UK)

Little Barford gas power station (UK)

Didcot A/B coal and gas power plant (UK)

»Less time for administration. More time for our customers.«





"What do customers want? We asked this question. And we received many answers: simpler bills, less red tape, comprehensive advice. And **dual fuel.** This is why we serve our electricity and gas customers single-handedly. Not only at Wembley Stadium, but also in many households throughout the country. Because while customers may be different, their wishes aren't."

Ashliegh Foster, Customer Service Advisor, RWE npower

Andrew Duff (4th from left), CEO of RWE npower and member of the Group Business Committee, with employees

Organic growth thanks to strong sales business

RWE npower posted an organic increase in the operating result of the underlying business of 17 %, as a result of improved margins in the sales business and synergies with RWE Thames Water. However, because the UK trading operations were transferred to RWE Trading as of January 1, 2004, the operating result reported for RWE npower fell in 2004.

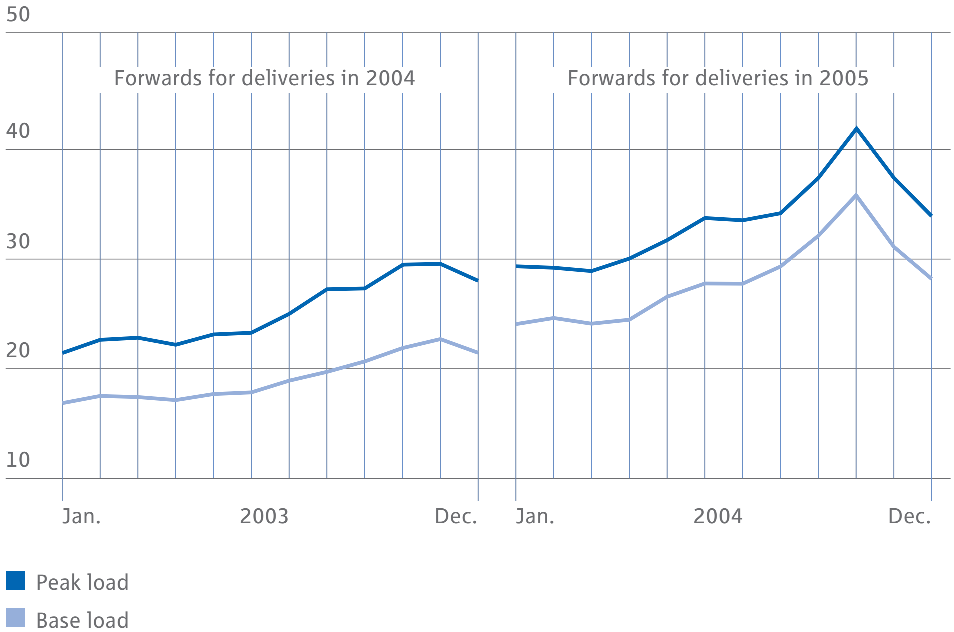
UK electricity and gas prices increase considerably

Due to sustained economic growth, electricity consumption in the UK was nearly 3 % higher than in the previous year. Demand for gas rose by more than 2 %. This was mainly because about 9 % more gas was used to produce electricity than in 2003. Demand was reduced somewhat by cool summer and mild winter temperatures, which meant that relatively little energy was used for air conditioning and heating.

Electricity forward prices were markedly up in the UK primarily due to the considerable rise in fuel costs.

Prices in the UK energy market increased substantially. Wholesale forward prices for base-load deliveries in 2005 averaged £28.22 per megawatt hour (€41.58/MWh). They thus rose by 47 % year-on-year. The price for a one-year forward for peak-load power increased by 33 % to £33.72 per megawatt hour (€49.68/MWh). The electricity market was characterized by the steep rise in the cost of fuel, particularly gas. Higher hard coal prices also had an impact. One-year forward prices for hard coal advanced by an average of 61 % over the year. Anticipated costs associated with the introduction of CO_2 emissions trading and a tighter supply and demand balance also played a role. By the end of the year, electricity forward prices had declined again, primarily due to the weather.

Development of one year forward wholesale electricity prices in England and Wales
£ per MWh



UK gas forward prices rose by an average of 40 %. This is partially due to the rise in demand from power producers. At the same time, there was a considerable drop in UK gas supply. As the UK increases imports of gas, prices are becoming more linked with oil prices.

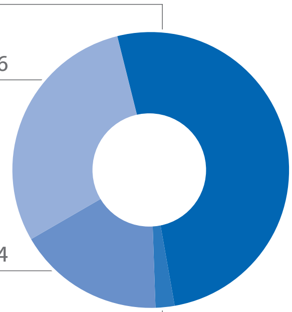
The development of UK electricity and gas wholesale prices also had an impact on energy prices in the end customer business. All major UK electricity suppliers increased tariffs in 2004—some more than once. Electricity and gas prices for household and commercial customers rose by an average of 6 % and 7 % respectively. In the industrial customer segment, prices were up even more. Nevertheless, it is unlikely that suppliers have fully passed on the increase in wholesale prices to their end customers. This is due to the fact that the UK market is fiercely competitive and has a relatively high customer churn rate.

Prices in the UK household customer segment were up an average of 6 % for electricity and 7 % for gas.

RWE npower
Power plant capacity by primary energy source

Balance at: 12/31/2004
MW

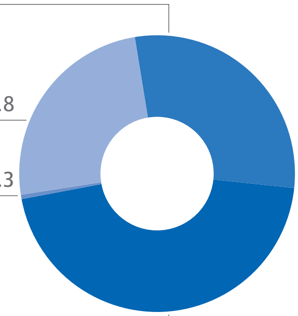
Hard coal	4,415
Gas	2,546
Oil	1,484
Other	192
Total	**8,637**



RWE npower
Electricity production by primary energy source

2004
billion kWh

In-house generation	**32.5**
Hard coal	17.4
Gas	14.8
Oil/Other	0.3
Electricity purchased*	**27.0**
Total	**59.5**



* Largely through RWE Trading.

Electricity production down on previous year due to power plant outages
In the period under review, RWE npower's in-house electricity generation amounted to 32.5 billion kWh—5.2 billion kWh less than in the previous year. This is because we had postponed power plant outages planned for 2003 until 2004, in order to take advantage of short-term market opportunities. Moreover, one of the Didcot B power station's gas units had to be shut down unexpectedly due to turbine damage. Including power purchases, RWE npower accounted for some 9 % of total UK generation. At the end of the reporting period, our power plants had a combined installed capacity of 8,637 MW. This includes electricity generated by combined heat and power facilities and from renewables. Capacity fell 25 MW compared with the end of 2003. At the beginning of 2004 we established a joint venture with two financial partners to finance wind power facilities. This joint venture, which is included in our financial statements using the equity method, purchased 128 MW in installed wind capacity from RWE npower in the year under review. Our UK business continues to operate the plant and purchases the wind energy produced by the joint venture. During 2004, RWE npower spent € 56 million on new wind power plants which will also be sold to the joint venture once construction and trial runs have been completed. The UK government has stipulated that an increasing percentage of electricity sold by UK suppliers should be produced from renewables in order to reduce CO_2 emissions.

RWE npower is expanding its wind power generation operations through a joint venture with two financing partners.

RWE npower Electricity and gas sales volume/revenue		Electricity		Gas	
		2004	2003	2004	2003
External sales volume	billion kWh	59.5	59.3	48.6	48.6
Private and commercial customers	billion kWh	22.5	24.9	38.6	39.1
Industrial and corporate customers	billion kWh	37.0	34.1	10.0	9.5
Other	billion kWh	–	0.3	–	–
External revenue	€ million	**4,154**	**4,068**	**1,096**	**1,040**

Stable energy sales despite slight decline in customers

Although customer figures declined slightly, RWE npower sold 59.5 billion kWh of electricity—nearly the same amount as in the previous year. This development is the result of RWE npower's strategy to focus on attractive customer segments. In the year being reviewed, 3.8 million household customers purchased electricity from RWE npower. This was approximately 138,000 fewer than in the previous year. Industrial, corporate and commercial customers matched the prior-year level at 373,000. At 48.6 billion kWh, gas sales were stable, as were gas customer numbers (1.9 million). About 1.4 million customers purchase both products from RWE npower, an increase of 200,000 customers during 2004.

Our focus on more attractive customer segments caused us to lose household electricity customers, but also led to the acquisition of dual-fuel customers.

Strong revenue despite transfer of trading business

RWE npower grew external revenue by 1 % to € 5,605 million. The strength of Sterling against the euro increased revenue by € 114 million. In contrast, revenue was reduced by the transfer of the UK trading operations to RWE Trading. Higher tariffs to end customers had a positive impact. In 2004 we raised average tariffs by some 7 % for electricity and by 11 % for gas. Given the significant rise in fuel costs, this increase is relatively modest, and was accompanied by a promise of a price freeze for household customers for 2005.

Organic growth in earnings thanks to strong sales business

EBITDA decreased by 18 % to € 698 million. At € 604 million, the operating result was 15 % down on the previous year, which benefited from the unusually strong result posted by the trading business that has now been transferred to RWE Trading. Net of the transfer and positive currency effects, RWE npower increased its operating result by 17 %. This was principally due to improved margins in the sales business. Synergies with RWE Thames Water also had a positive impact. Higher fuel purchase costs and lower generation output had a negative impact. Moreover, power supply agreements with very favorable conditions expired. Absolute value added* was again negative (–€ 100 million) primarily due to the goodwill from the acquisition.

Earnings were significantly affected by the transfer of the UK trading business to RWE Trading. Net of one-off effects RWE npower increased its operating result by 17 %.

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RWE npower **Key figures**		**2004**	**2003**	**+/–** **in %**
External revenue	€ million	5,605	5,552	1.0
Internal revenue	€ million	–	89	–
Total revenue	€ million	5,605	5,641	–0.6
EBITDA	€ million	698	850	–17.9
Operating result	€ million	604	714	–15.4
Return on capital employed (ROCE)	%	8.6[1]	9.4	–
WACC before tax	%	10.0	10.0	–
Value added	€ million	–100[1]	–42	–138.1
Capital employed	€ million	7,045[1]	7,559	–6.8
Capital expenditure	€ million	166	215	–22.8
Property, plant and equipment	€ million	150	215	–30.2
Financial assets	€ million	16	–	–
		12/31/04	**12/31/03**	
Workforce	FTE[2]	9,555	9,357	2.1

1 Calculated using the old method. By applying the new method for calculating capital employed introduced in 2004 (cf. details on p. 187), capital employed totaled €6,378 million. This results in ROCE of 9.5% and –€33 million in value added.

2 Converted to full time equivalent.

Capital expenditure on improved customer service

RWE npower spent a total of €166 million. Capital expenditure on property, plant and equipment amounted to €150 million, clearly falling below the previous year's level (€215 million). This was due to the fact that the prior year figure was affected by the cost of the construction of an offshore wind farm in Wales. The previously mentioned expenditure on new wind power stations in fiscal 2004 (€56 million) is no longer disclosed as capital expenditure on property, plant and equipment as the power plants are to be sold to the joint venture. Capital spending was largely devoted to environmental projects and new IT applications to further improve service for household customers. Property, plant and equipment depreciated by €93 million.

Brian Count (3rd from left), Chairman of the Board of Directors of RWE Trading and member of the Group Business Committee, with employees

Trading operations united

RWE Trading assumed RWE npower's trading business as of January 1, 2004. This caused RWE Trading's operating result to rise considerably compared with the previous year. By pooling our trading activities, we strengthened our leading position on Europe's energy trading market. At the same time, we integrated RWE Trading more deeply into the generation and sales business.

Global energy prices up on the previous year's high level

In 2004 world energy prices rose above the previous year's level*. A number of factors that had made themselves felt in 2003 also had an impact in the year under review. China's persistently strong demand for fossil fuels again played a determining role in the development of hard coal prices. Oil prices were very volatile, repeatedly reaching all-time highs over the course of the year, partially due to the situation in Iraq and reports of shrinking US inventories. Towards the end of the year, the situation on the oil market normalized somewhat. Prices on the Continental European electricity futures market stabilized at the high level achieved at the end of 2003.

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German power trading market becomes more liquid

The liquidity of the German electricity trading market improved again in 2004. In the year under review, 397 billion kWh of electricity were traded on the European Energy Exchange* (EEX) in Germany—1.5 % more than in the previous year. Over-the-counter (OTC) trading* on electronic trading platforms rose 70 % to 762 billion kWh, making a strong contribution to the market's increased liquidity.

EEX trading volume rose by 1.5 %; OTC trading on electronic trading platforms grew by 70 %.

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Non-electronic OTC trading, which is several times larger in volume than electronic off-exchange trading, also added to the total trading volume. The OTC clearing product introduced by the EEX in 2003 also developed successfully. It enables the easy settlement of OTC trades without additional credit risks. Furthermore, electricity option contracts* started trading on the EEX in November 2004. Energy exchanges in France (Powernext) and the Benelux countries (ENDEX) significantly expanded electricity trading volumes through new products. By contrast, the UK electricity trading market lost liquidity with the departure of US-based AEP, one of the most active traders. In addition, the creditworthiness of some market participants deteriorated over the year. The liquidity of the Continental European gas trading market improved further in part thanks to new entrants. A contrasting development was observed in the UK.

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Market readies itself for European emissions trading

OTC trading in European CO_2 emissions allowances continued its momentum into 2004. By the end of the year, some 40 European companies were active in pre-compliance trading. Moreover, several European exchanges started to prepare for quoted CO_2 trading. The EEX has been publishing the European Carbon Index* daily since October 2004. In so doing, the market readied itself early for the beginning of the European emissions trading system on January 1, 2005.

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External electricity sales up, trading volume expanded

RWE Trading expanded electricity trading on wholesale markets, increasing electricity sales by about 41 % year-on-year.

RWE Trading's sales to external electricity customers totaled 79.8 billion kWh. This does not include trading with purchased electricity. Sales were thus 41 % up on the previous year. Once again, RWE trading stepped up sales of electricity generated in-house on the wholesale market. Industrial customer sales operations were largely transferred to RWE Energy effective January 1, 2004, with the exception of operations in the aluminum sector. Deliveries to key accounts were markedly down to 6.7 billion kWh from 13.5 billion kWh in 2003.

By assuming RWE npower's trading activities, the division considerably expanded trading in physical products and energy derivatives. Electricity trading volumes achieved by RWE Trading totaled 1,316 billion kWh. This represents 25 % growth. Oil trading volumes rose 148 % to 1,560 million barrels*, with coal posting an increase of 110 % to 153 million metric tons*. Gas trading was the only sector to record a decrease, owing to the division's exit from the US trading market at the end of 2003. At 755 billion kWh, it was markedly down on the previous year (1,537 billion kWh).

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RWE Trading Key figures		2004	2003	+/– in %
Electricity sales volume[1]	billion kWh	79.8	56.5	41.2
External revenue	€ million	3,822	2,444	56.4
Internal revenue	€ million	5,057	3,307	52.9
Total revenue	€ million	8,879	5,751	54.4
EBITDA	€ million	111	59	88.1
Operating result	€ million	104	59	76.3
Capital expenditure	€ million	4	4	–
Property, plant and equipment	€ million	4	3	33.3
Financial assets	€ million	0	1	–
		12/31/04	12/31/03	
Workforce	FTE[2]	643	397	62.0

1 Net figures, excluding trading with electricity purchased from third parties.

2 Converted to full time equivalent.

External revenue increases by 56%

External revenue generated by the Trading Division amounted to €3,822 million and was thus 56% up on the previous year. This surge was largely caused by sales of electricity generated in-house on wholesale markets, where we posted another gain. In addition, our Dutch-based coal trading enterprise SSM Coal generated additional revenue due to higher coal prices. The inclusion of the UK energy trading activities also contributed to the jump in revenue.

Operating result grows significantly

RWE Trading lifted EBITDA by 88% to €111 million. The operating result jumped 76% to €104 million. This growth was in part driven by the integration of the UK trading activities. However, their contribution was lower than the exceptionally high result achieved in 2003. IAS applies specific accounting policies to trading operations. For example pursuant to IAS 39, trading positions on a company's books at the balance-sheet date are marked to market at fair value*. Gains on asset-based operations are recorded with an effect on income only once they are realized. This means that under certain conditions, they are recorded in subsequent accounting periods. In addition, it is important to note that, as an integral component of the energy value chain, RWE Trading primarily plays the part of asset optimizer. The division's task is to contribute to conserving the value of the entire electricity business. This means that isolated trading strategies are of secondary importance. This is why we will stop disclosing RWE Trading's key figures separately from fiscal 2005 onwards, including them in RWE Power's data instead.

The assumption of the UK trading business contributed to earnings growth. However, the operating result contributed by this business was lower than in the previous year.

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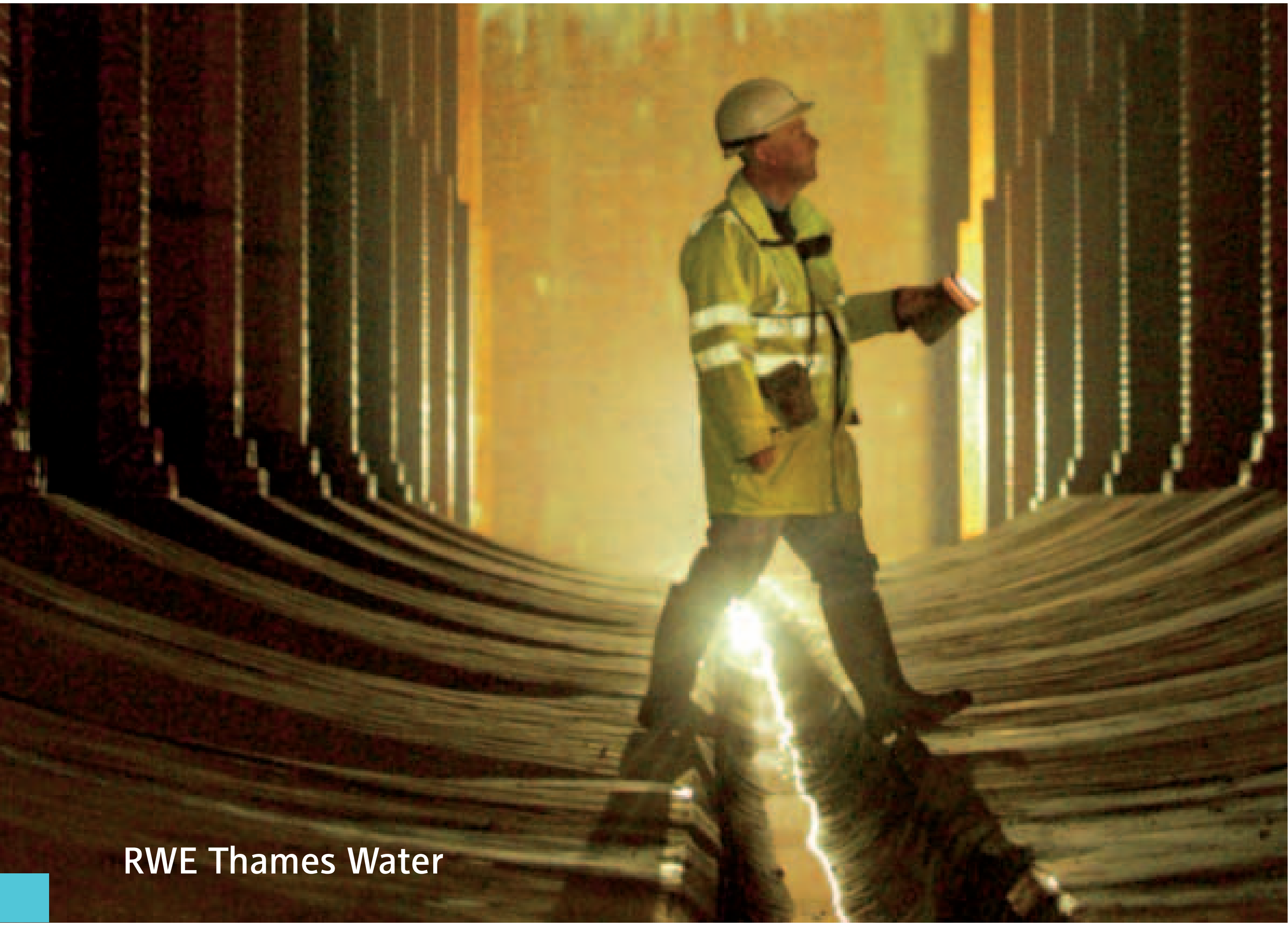
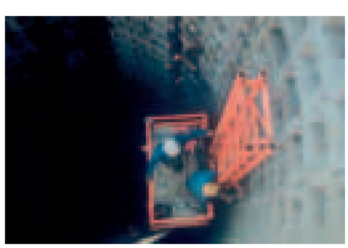




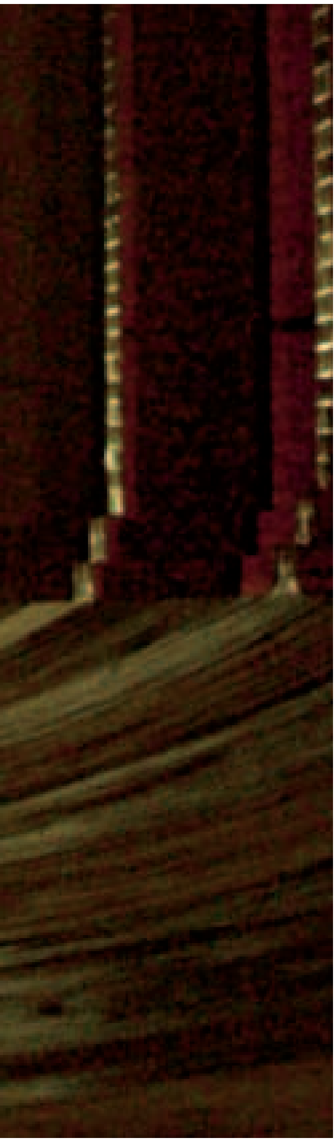
△ **London Ring Main**

Entry into the Ring Main

Crouch Hill reservoir (UK)

American Water fire hydrant

»Water for 5 million people—5 million reasons to provide the highest quality.«



"About 40 meters under London lies the Ring Main. It is **one of the world's largest water distribution systems.** An enormous reservoir that quenches an enormous thirst. London residents consume 2.7 billion liters of water every day. Drinking water in its purest form, of course. And we monitor its quality regularly. After all, the only thing that is allowed to fluctuate is the water level—not its quality."

Ken Shields, Reservoir and Pump Station Coordinator, RWE Thames Water

Bill Alexander (3rd from left), CEO of RWE Thames Water and member of the Group Business Committee, with two fellow Executive Board members and an employee

Stable organic earnings growth

Earnings at RWE Thames Water in 2004 were affected by a number of one-off items, including negative currency effects, the transfer of a substantial portion of its Continental European water business to RWE Energy and the sale of peripheral activities. Net of these effects, the operating result improved by 8 %. This was driven by tariff increases in the US and Germany as well as a continuing focus on efficiency, among other things.

Regulatory authorities reward investments into grid infrastructure by approving tariff increases, opening the door to growth in the regulated water business.

Low sensitivity to macro-economic background in the regulated water business

The regulated water and wastewater services business is relatively stable. The economic cycle has little impact on this sector especially in Europe and the USA, RWE's mature core markets. In the US earnings may be affected by weather conditions. For example, heavy rainfall in several US states led to lower than normal water consumption in the summer of 2004. Growth is provided through capital expenditure on infrastructure on which local regulators allow a return to be made through water tariffs. In the USA, state regulators approve price increases to reflect past investments. In the UK, by contrast, planned capital expenditure is subject to prior approval from the regulator. The UK's next five-year regulatory period begins on April 1, 2005. In contrast to prior periods, the regulator has allowed considerable tariffs increases for the next five years. However, these increases are linked with significant investment and improved efficiency in investments and operating costs. Private sector involvement in water and wastewater services on most Continental European water markets is still in its infancy. To date, involvement has been limited largely to the construction and expansion of plants as well as the operation and maintenance of water infrastructure. This non-regulated water business also offers stability as contracts are of long duration and are designed to provide stable returns.

RWE Thames Water Key figures		2004	2003	+/– in %
External revenue	€ million	4,065	4,249	–4.3
Internal revenue	€ million	–	–	–
Total revenue	€ million	4,065	4,249	–4.3
EBITDA	€ million	1,979	2,018	–1.9
Operating result	€ million	1,389	1,374	1.1
Return on capital employed (ROCE)	%	7.0[1]	6.5	–
WACC before tax	%	8.0	8.0	–
Value added	€ million	–189[1]	–312	39.4
Capital employed	€ million	19,723[1]	21,076	–6.4
Capital expenditure	€ million	1,531	6,129	–75.0
Property, plant and equipment	€ million	1,465	1,549	–5.4
Financial assets	€ million	66	4,580	–98.6
		12/31/04	12/31/03	
Workforce	FTE[2]	16,051	17,521	–8.4

1 Calculated using the old method. By applying the new method for calculating capital employed introduced in 2004 (cf. details on p. 187), capital employed totaled €18,971 million. This results in ROCE of 7.3 % and –€129 million in value added.

2 Converted to full time equivalent.

Revenue affected by non-recurring items

External revenue generated by RWE Thames Water was down 4 % to about €4.1 billion. This was mainly due to the following three factors:

- Currency effects of –€148 million reduced revenue. The main impact was felt from the weaker US dollar.
- In addition, we transferred some of RWE Thames Water's Continental European water activities to RWE Energy as of January 1, 2004. These operations contributed €100 million of revenue in 2003.
- By divesting peripheral activities in the UK and USA and selling operations outside our core regions, e.g. in Singapore, we shed some €72 million in revenue.

External revenue was 4 % down year-on-year. Net of one-off effects, it rose by 3 %.

Without these one-off effects, external revenue would have been roughly 3 % higher than in the previous year. This was primarily a result of tariff increases, to reflect investments already made in several US states. In dollar terms, our US water utility American Water grew revenue by 4 %. In the regulated UK business, we benefited from inflation-related tariff adjustments.

Operating result up 8 % net of one-off effects

The organic growth of the operating result was primarily driven by American Water. The entire Water Division benefited from continued cost cutting.

RWE Thames Water posted €1,979 million in EBITDA, falling just short of the previous year's figure (€2,018 million). Operating results rose by 1 % to €1,389 million. The significant rise in income from investments—in part due to the increase in water tariffs in Berlin effective January 1, 2004—were predominantly responsible for the fact that the operating result showed a better trend than EBITDA. On an organic basis, i.e., net of the aforementioned deconsolidation, reorganization and currency effects, the operating result climbed by 8 %. Our US water company posted a 7 % increase in operating results in dollar terms, primarily owing to the tariff increases mentioned earlier on.

The Water Division continued to benefit from cost-cutting. At American Water we realized savings through several measures including the use of new technology such as satellite-based metering. The regulated UK business benefited predominantly from efficiency enhancements and intensified cooperation with RWE npower. Operating results achieved by the non-regulated UK business were essentially on par with the previous year. Outside RWE's key regions, the operating result was down on 2003. Value added improved considerably, but was still negative at –€189 million due to goodwill from acquisitions.

RWE Thames Water Key figures by region € million	External revenue		EBITDA		Operating result	
	2004	2003	2004	2003	2004	2003
Europe & other markets	2,264	2,335	1,216	1,218	884	847
Regulated UK business	1,680	1,603	989	949	612	592
Americas (USA, Chile)	1,801	1,914	763	800	505	527
RWE Thames Water	**4,065**	**4,249**	**1,979**	**2,018**	**1,389**	**1,374**

Capital expenditure on financial assets clearly down on previous year
Total capital spending amounted to €1,531 million, falling far below 2004 levels. This decline was caused by the fact that capital expenditure on financial assets was only a fraction of the previous year's figure, which was almost entirely due to the acquisition of American Water (€4.5 billion). In the year under review, this was contrasted by a mere €66 million in spending on financial assets. Capital expenditure on property, plant and equipment was essentially on par with 2003 at €1,465 million. Spending focused on the improvement of water infrastructure in the UK and USA. Property, plant and equipment were depreciated by €704 million.

New contracts in the USA and UK
By winning several new contracts, we laid the foundation for future growth in the non-regulated business. American Water won the bid to remedy and operate a sea water desalination plant in Florida. In addition the company was awarded the contract to expand and operate wastewater systems in Sioux City, Iowa. In the UK, RWE Thames Water signed two contracts with the Ministry of Defence. We are building water infrastructure and providing water services for a number of military installations.

Other Activities

RWE Umwelt
In 2004, RWE Umwelt sold its remaining foreign business as well as a number of peripheral activities. The ongoing cost-cutting program was continued successfully. The company's operating result was on par with the previous year, despite the persistently difficult business environment. In September 2004, we initiated the divestment of the waste management business.

Heidelberger Druckmaschinen
We divested the lion's share of our stake in Heidelberger Druckmaschinen ahead of schedule in early May 2004. Thanks to the general improvement in the sector and leaner cost structures, the company made a positive contribution to the Group's result until it was deconsolidated. In fiscal 2003, Heidelberger recorded a loss.

Sale of waste management business initiated

Declining volume and fierce price competition

In 2004 Germany's waste management industry was again hampered by shrinking market volumes due to economic conditions. Continued crowding-out competition increased the erosion of margins. Prices in the commercial waste business were additionally depressed as remaining landfill capacity is being sold at extremely low prices in the run-up to the implementation of the Technical Guideline for Residential Waste (TASi*). The guideline will be enforced nationwide starting on June 1, 2005 and ban the dumping of waste that has not been preprocessed. Business with the recycling enterprise "Duales System Deutschland AG" (DSD) which is their main customer, became even more competitive, as expected.

Continued crowding-out competition increased the erosion of margins in the German waste management business.

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RWE Umwelt Key figures		**2004**	**2003**	**+/– in %**
External revenue	€ million	1,830	1,944	–5.9
Internal revenue	€ million	23	37	–37.8
Total revenue	€ million	1,853	1,981	–6.5
EBITDA	€ million	190	230	–17.4
Operating result	€ million	76	76	–
Capital expenditure	€ million	156	152	2.6
Property, plant and equipment	€ million	108	94	14.9
Financial assets	€ million	48	58	–17.2
		12/31/04	**12/31/03**	
Workforce	FTE*	10,408	12,578	–17.3

* Converted to full time equivalent.

Operating result on par year-on-year

External revenue generated by RWE Umwelt totaled €1,830 million, 6% down on the previous year. The decline is principally due to the divestment of peripheral activities as part of the divestment program which has been completed. Net of consolidation effects, revenue was up 1% owing to gains made in the secondary raw materials business. Conversely, the unfavorable environment in the market for municipal and commercial waste and in the DSD business had an adverse effect on revenue. EBITDA decreased by 17% to €190 million. By contrast, at €76 million, the operating result matched the year-earlier level. This is due to the significant rise in income from investments which was positively affected by the discontinuation of goodwill amortization for companies accounted for using the equity method and

Thanks to improved income from investments and continued cost-cutting, RWE Umwelt achieved an operating result matching the previous year's level.

the organic growth achieved by these companies. EBITDA does not include income from investments. RWE Umwelt's earnings were hampered by unfavorable trends. However, these were largely offset by progress made in the ongoing realignment and cost-cutting program.

Focus on replacement investments
Capital spending amounted to € 156 million, following € 152 million in the previous year. Capital expenditure on property, plant and equipment largely consisted of replacement investments and totaled € 108 million, roughly on par with the low level recorded a year earlier. It was thus clearly lower than the amount of depreciation (€ 166 million). Capital expenditure on financial assets dropped by 17 % to € 48 million.

Portfolio streamlined—costs reduced—sale initiated
In February 2004, we announced our plan to divest our waste management business over the medium term. Our prime priority, however, was to improve the earnings situation and streamline the portfolio. RWE Umwelt thus sold the remaining foreign operations in the UK, the Czech Republic and Hungary as well as non-core activities in Germany in the first half of the year. In addition, the company improved its cost structure even further. As mentioned elsewhere* in this report, we initiated the divestment of RWE Umwelt in September—earlier than planned.

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Heidelberg leaves the Group with a positive contribution to the result

Following a difficult period, the printing machine industry benefited from increased investing appetite among printing companies.

Printing industry shows slightly more willingness to invest
Spurred by the world's general economic recovery, the printing industry emerged from its cyclical trough. Buoyed by the cyclical upturn, advertising budgets grew, leading to a revitalization of investment appetite among printing companies. However, investment levels were low.

This had caused orders received by Heidelberger Druckmaschinen to record a slight increase as early as the end of 2003, following two years of extremely weak orders. This trend initially continued from January to April 2004, Heidelberg's* last four months as part of the RWE Group. As the drupa trade show which took place in May drew nearer, however, spending decreased. In sum, order intake in the first four months of 2004 amounted to € 1,276 million compared with € 3,680 million for fiscal 2003 as a whole. Orders received as of April 30, 2004 totaled € 1,086 million, 11 % down on the end of 2003.

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Heidelberger Druckmaschinen Key figures		2004[1]	2003
External revenue	€ million	1,359	3,658
Internal revenue	€ million	–	–
Total revenue	€ million	1,359	3,658
EBITDA	€ million	96	120
Operating result	€ million	34	–118
Capital expenditure	€ million	70	262
Property, plant and equipment	€ million	53	205
Financial assets	€ million	17	57
		04/30/04	12/31/03
Workforce	FTE[2]	21,307	22,036

1 Figures relate to the period ending with the deconsolidation in May 2004.

2 Converted to full time equivalent.

External revenue and operating result improved

By the time it had been deconsolidated in early May, Heidelberg had generated €1,359 million in external revenue—10% more than in the same period a year earlier. The world market leader grew revenue primarily in the sheetfed division, its largest line of business. This growth was largely achieved in Europe and the USA.

The company's earnings situation has stabilized. At €96 million, EBITDA was 4% down compared to the corresponding period in 2003. In contrast, the operating result of €34 million bested the previous year's level (€19 million) by 79%. Heidelberg had closed 2003 as a whole with a negative operating result. The improvement in the result was driven by the sheetfed and finishing divisions. Factors contributing to this showing were the cyclical uptick as well as the comprehensive cost-cutting and restructuring program which was launched by Heidelberg at the end of 2002. The program was designed to reduce annual costs by €280 million by the end of Heidelberg's 2004/05 financial year. As part of the program, Heidelberg also shed the two loss-making digital and web systems divisions.

The operating result increased by 79% driven by the sheetfed and finishing divisions.

Capital expenditure at the Heidelberg Group amounted to €70 million by the end of April. Unlike in the previous year, spending on property, plant and equipment totaled €53 million, exceeding depreciation (€39 million).

Consolidated Financial Statements

Consolidated Income Statement of the RWE Group

€ million	Note	2004	2003
Revenue	(1)	**42,137**	**43,875**
Natural gas tax/electricity tax	(2)	1,141	1,104
Revenue (without natural gas tax/electricity tax)		**40,996**	**42,771**
Changes in finished goods and work in progress		–87	–1
Other own work capitalized		321	320
Other operating income	(3)	3,260	4,380
Cost of materials	(4)	22,975	22,923
Staff costs	(5)	6,122	7,530
Depreciation, amortization, and impairment losses	(6)	3,765	4,511
Goodwill amortization and impairment losses		(492)	(985)
Other operating expenses	(7)	6,054	7,805
Income from operating activities		**5,574**	**4,701**
Income from investments*	(8)	846	300
Financial result	(9)	–2,485	–2,878
Income before tax		**3,935**	**2,123**
Gain on disposal of discontinuing operations		(200)	(–)
Taxes on income	(10)	1,521	1,187
Income after tax		2,414	936
Minority interest		277	–17
Net income		**2,137**	**953**
Basic earnings per common share and preferred share (€)	(21)	**3.80**	**1.69**
Diluted earnings per common share and preferred share (€)	(21)	3.80	1.69

* €298 million of which is income from financial assets accounted for using the equity method (previous year: €6 million).

Consolidated Balance Sheet of the RWE Group

Assets € million	Note	**12/31/04**	**12/31/03**
Non-current assets	(11)		
Intangible assets		17,718	19,418
Property, plant and equipment		35,025	36,210
Financial assets[1]		5,887	6,778
		58,630	**62,406**
Current assets			
Inventories	(12)	2,043	3,285
Accounts receivable and other assets	(13)	16,606	16,947
Marketable securities	(14)	11,013	9,615
Cash and cash equivalents	(15)	1,526	2,181
		31,188	**32,028**
Deferred taxes	(16)	**3,243**	**4,325**
Prepaid expenses		**309**	**383**
		93,370	**99,142**

Equity and Liabilities € million	Note	**12/31/04**	**12/31/03**
Equity/minority interest	(17)		
Group interest		9,656	7,013
Minority interest		1,537	2,052
		11,193	**9,065**
Provisions	(18)	**34,754**	**37,671**
Liabilities[2]	(19)	**39,119**	**44,061**
Deferred taxes	(16)	**4,134**	**4,526**
Deferred income	(20)	**4,170**	**3,819**
		93,370	**99,142**

1 Include €2,665 million in financial assets accounted for using the equity method (previous year: €3,674 million).
2 Include €20,559 million in long-term interest-bearing liabilities (previous year: €23,100 million).

Consolidated Cash Flow Statement of the RWE Group

€ million	Note (25)	2004	2003
Income after tax		**2,414**	**936**
Depreciation, amortization, impairment losses, write-backs		3,780	4,528
Changes in provisions		–307	269
Changes in deferred taxes		482	456
Income from the disposal of non-current assets and current marketable securities		–720	–1,137
Other non-cash income/expenses (mainly equity accounting method)		–90	299
Changes in working capital		–623	–58
Changes in other balance sheet items		–8	–4
Cash flows from operating activities		**4,928**	**5,289**
Intangible assets/property, plant and equipment			
Capital expenditure		–3,429	–4,362
Proceeds from sale of assets		683	506
Acquisitions and investments			
Capital expenditure		–308	–5,373
Proceeds from sale of assets/divestitures		2,637	2,995
Changes in marketable securities and cash investments		–1,157	–582
Cash flows from investing activities		**–1,574**	**–6,816**
Net change in equity incl. minority interest		–43	–
Dividends paid to RWE AG shareholders and minority interest		–939	–895
Issuance of financial debt		2,087	8,498
Repayment of financial debt		–5,114	–5,964
Cash flows from financing activities		**–4,009**	**1,639**
Net cash change in cash and cash equivalents		–655	112
Effects of changes in foreign exchange rates and other changes in value		–	–74
Net change in cash and cash equivalents		**–655**	**38**
Cash and cash equivalents at beginning of year		2,181	2,143
Cash and cash equivalents at end of year		**1,526**	**2,181**

Consolidated Statement of Changes in Equity and Minority Interest of the RWE Group

Note (17) € million	Sub-scribed capital of RWE AG	Additional paid-in capital of RWE AG	Retained earnings	Accumulated other comprehensive income: Currency trans-lation adjust-ment	Accumulated other comprehensive income: Fair value measure-ment of financial instru-ments	Distribu-table profit	Group interest	Minority interest	Total
Balance at 1/1/03	**1,440**	**1,288**	**3,848**	**–416**	**–350**	**619**	**6,429**	**2,495**	**8,924**
Dividends paid						–619	–619	–276	–895
Other comprehensive income				–340	535		195	–145	50
Income after tax			250			703	953	–17	936
Other changes			55*				55	–5	50
Balance at 12/31/03	**1,440**	**1,288**	**4,153**	**–756**	**185**	**703**	**7,013**	**2,052**	**9,065**
Repayment of equity								–43	–43
Dividends paid						–703	–703	–236	–939
Other comprehensive income				630	579		1,209	101	1,310
Income after tax			1,293			844	2,137	277	2,414
Other changes								–614	–614
Balance at 12/31/04	**1,440**	**1,288**	**5,446**	**–126**	**764**	**844**	**9,656**	**1,537**	**11,193**

* Other changes to retained earnings stem from accounting for HOCHTIEF using the equity method.

Statement by the Executive Board

The Executive Board of RWE AG is responsible for the completeness and accuracy of the consolidated financial statements and the review of operations of the group, which has been combined with the review of operations of RWE AG.

The consolidated financial statements for the period ended December 31, 2004 have been prepared in accordance with International Financial Reporting Standards (IFRS). They are in compliance with the 7th EC Directive. The previous year's figures have been calculated according to the same principles. Pursuant to Section 292a of the German Commercial Code, these IFRS-compliant consolidated financial statements have an exempting effect.

Internal control systems, the use of uniform directives throughout the group, and our programs for basic and advanced staff training ensure that the consolidated financial statements and combined review of operations are adequately prepared. Compliance with legal regulations, the internal guidelines as well as the reliability and viability of the control systems are continuously examined throughout the group.

In line with the requirements of the German Corporate Control and Transparency Act, our risk management system enables the Executive Board to identify potential risks at an early stage and initiate countermeasures, if necessary.

The consolidated financial statements, the combined review of operations and the report of independent auditors are discussed in detail by the Audit Committee and at the Supervisory Board's meeting on financial statements with the independent auditors present. The results of the Supervisory Board's examination have been included in the report of the Supervisory Board (pages 8 to 11) of this annual report.

Essen, February 15, 2005

The Executive Board

Roels Bonekamp Maichel Sturany Zilius

Basis of presentation

The consolidated financial statements have been prepared in accordance with IFRS* effective as of the balance-sheet date. Furthermore, RWE is voluntarily applying IFRS 3, "Business Combinations," IAS 36 "Impairment of Assets" (2004), IAS 38 "Intangible Assets" (2004), as well as IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities" for the first time.

Changes in equity and minority interest have been disclosed in addition to the income statement, the balance sheet and the cash flow statement. Moreover, statements made in the notes to the financial statements include segment reporting.

Several balance sheet and income statement items have been combined in order to improve clarity. These items are stated and explained separately in the notes to the financial statements. The income statement has been prepared using the nature of expense method.

The consolidated financial statements have been prepared in euros. All amounts (unless specified otherwise) are stated in millions of euros (€ million).

The consolidated financial statements presented here cover the 2004 fiscal year on the basis of the reporting period from January 1 to December 31, 2004.

* IFRS comprise the IFRS newly adopted by the International Accounting Standards Board (IASB) and the International Accounting Standards (IAS) as well as the Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and of the Standing Interpretations Committee (SIC).

Scope of consolidation

In addition to RWE AG, the consolidated financial statements contain all material German and foreign companies which RWE controls directly or indirectly. Principal associates and joint ventures are accounted for using the equity method.

If investments in subsidiaries, joint ventures or associates are of secondary importance from a group perspective, they are accounted for in compliance with IAS 39. Subsidiaries without operations and those with small business volumes are generally not consolidated. Altogether, they account for less than 1 % of consolidated revenue, income and debt. Subsidiaries with negative income or equity are generally fully consolidated.

Subsidiaries that have a different balance-sheet date prepare interim financial statements as of the group's balance-sheet date.

A collective listing of the group's investments in accordance with Sec. 313, Para. 2, Nos. 1 to 4 and Para. 3 of the German Commercial Code (HGB) has been filed in the Commercial Register of the Essen District Court. Material consolidated affiliates, entities accounted for using the equity method, and other investments are listed on pages 183 to 185 of this annual report.

Twenty-six companies domiciled in Germany and 8 domiciled abroad were consolidated for the first time in the year under review. One hundred and twenty companies, 97 of which are headquartered abroad, were excluded from the scope of consolidation. Twenty-two enterprises, 5 of which are based abroad, were merged. Twelve associates and joint ventures, including 4 abroad, were accounted for using the equity method for the first time. Twenty-eight enterprises, which had been accounted for using the equity method in the previous year, including 11 abroad, have been sold, merged, or have been fully consolidated for the first time. First-time consolidation and deconsolidation generally take place when control is transferred or relinquished.

	German 12/31/04	Foreign 12/31/04	Total 12/31/04	Total 12/31/03
Fully consolidated companies	231	358	589	697
Investments accounted for using the equity method	132	87	219	235

No major share acquisitions were made in the year under review.

Discontinuing operations

In a combined transaction on May 5 and 6, 2004, RWE directly placed 30 million shares of Heidelberg-based Heidelberger Druckmaschinen AG with institutional investors and issued an exchangeable bond for the company's shares. Proceeds from this combined transaction totaled about €1.3 billion. This caused RWE's investment in Heidelberger Druckmaschinen to drop from 50.02 % to 15.1 %. Since this investment no longer fulfils the criteria required for full consolidation, it is stated as part of "Non-current securities" as of December 31, 2004. The investment in Heidelberger Druckmaschinen, which is not part of the core business, was previously stated under "Financial investments;" it will be stated under discontinuing operations hereinafter.
The following table shows the material effects of the partial sale of the stake in Heidelberger Druckmaschinen AG on the consolidated financial statements for the period ended December 31, 2004, as well as the previous year's corresponding figures:

€ million		12/31/04	12/31/03
Assets		–	4,906
Liabilities, etc.		–	3,536

€ million		2004	2003
Revenue		1,359	3,658
Income before tax		25	–748
Taxes on income		–44	–46
Income after tax		–19	–794
Net income		–11	–417
Basic/diluted earnings per common share and preferred share	€	–0.02	–0.74
Cash flows from operating activities		313	258
Cash flows from investing activities		–163	–120
Cash flows from financing activities		–233	–130

Taking the first step to divest RWE Umwelt, RWE sold approximately 70 % of the business to its competitor Rethmann per a contract signed on September 28, 2004. The transaction is subject to approval from the German Federal Cartel Office. The remaining 30 %, which will remain under RWE ownership in the meantime, are scheduled to be sold as well. Based on the agreed selling price, an impairment loss was recognized for the carrying amount of RWE Umwelt's goodwill of €292 million. The following table shows the material impact that the Environmental Division's operations have on the consolidated financial statements for the period ended December 31, 2004 and on the previous year's period.

€ million		12/31/04	12/31/03
Assets		2,178	2,701
Liabilities, etc.		1,886	2,436
€ million		**2004**	**2003**
Revenue		1,830	1,944
Income before tax		–302	–221
Taxes on income		–1	30
Income after tax		–303	–191
Net income		–302	–192
Basic/diluted earnings per common share and preferred share	€	–0.54	–0.34
Cash flows from operating activities		83	156
Cash flows from investing activities		92	–117
Cash flows from financing activities		–240	–1

As far as subsidiaries and investments accounted for using the equity method are concerned, the following share disposals are significant:

Subsidiaries
Turbogás-Produtora Energética S.A., Portugal; sale of the 75 % stake in the 990 MW Tapada do Outeiro gas power plant as well as of all the shares in the operating company Portugen.

Starkstrom-Gerätebau GmbH; sale of the 100 % stake.

Investments accounted for using the equity method
HOCHTIEF AG, Essen; stake reduced to 9.6 %. As of December 31, 2004, this investment is measured under "Non-current marketable securities."

CONSOL Energy Inc., USA; sale of the 18.5 % stake remaining after the share divestment in 2003.

NAFTA, a.s., Slovakia; sale of the 40.13 % stake.

Motor-Columbus AG, Switzerland; sale of the 20 % interest.

Iskenderun Enerji Uretim ve Ticaret, A.S., Turkey; sale of the 25% stake.

A total of €81 million was used to acquire stakes in companies that were consolidated for the first time (previous year: €4,918 million). All in all, a net –€522 million in non-current assets (previous year: €3,808 million), –€3,481 million in current assets (including deferred taxes) (previous year: –€982 million), –€128 million in cash and cash equivalents (previous year: –€22 million) as well as –€3,924 million in liabilities and provisions (previous year: €2,032 million) were assumed or transferred as a result of the acquisition and divestment of consolidated enterprises.

Divested subsidiaries fetched a total selling price of €1,180 million, which was paid in cash or cash equivalents (previous year: €698 million).

The review of operations contains further information on major share disposals.

Effects of changes in the scope of consolidation have been stated in the notes insofar as they are of particular importance.

Consolidation principles

The financial statements of German and foreign companies included in the scope of consolidation are prepared using uniform accounting policies.

According to IFRS 3, which we have applied together with IAS 36 (2004) and IAS 38 (2004) since January 1, 2004, all business combinations must be reported according to the purchase method. Pursuant to this method, at the time of acquisition, capital consolidation takes place by offsetting the purchase price against the subsidiaries' revalued prorated net assets. The subsidiaries' identifiable assets, liabilities and contingent liabilities are measured at full fair value, regardless of the amount of the minority interest. Intangible assets shall be reported separately from goodwill if they are separable from the company or if they stem from a contractual or other right. No new restructuring provisions may be recognized within the scope of the purchase price allocation. Acquisition costs not allocated to assets, liabilities, or contingent liabilities are capitalized as goodwill. Negative goodwill from first-time consolidation is recorded as income. As of January 1, 2004, negative goodwill recognized so far was offset against retained earnings without an effect on profits.

According to IFRS 3 in combination with IAS 36 (2004), capitalized goodwill is no longer amortized as of January 1, 2004. Rather, the carrying amount of goodwill is tested for impairment once a year, or when there are indications of an impairment. If this results in the carrying amount of a cash-generating unit to which goodwill was allocated exceeding the recoverable amount, the allocated goodwill is initially written down by the difference. Impairment losses that must be recognized in addition to this are taken into account by reducing the carrying amount of the other remaining non-current assets on a prorated basis. In the deconsolidation, residual carrying amounts of capitalized goodwill are taken into account when calculating income from disposals.

Expenses and income as well as receivables and payables between consolidated companies are eliminated. Intra-group profits and losses are eliminated unless they are of minor significance.

The same consolidation principles apply to entities accounted for using the equity method, whereby recognized goodwill is reported on the balance sheet under investments. According to the new rules for accounting for business combinations, goodwill from the application of the equity method is no longer amortized either. If necessary, impairment losses on the equity value are reported under income from investments. Uniform accounting principles are also adopted for the financial statements of all material entities accounted for using the equity method.

Currency translation

Non-monetary foreign-currency transactions disclosed in companies' separate financial statements as of the balance-sheet date are valued at the exchange rate valid when they are recognized. Monetary items are converted using the exchange rate valid on the balance-sheet date. Exchange rate gains and losses from the measurement of monetary assets or monetary liabilities in foreign currency occurring up to the balance-sheet date are included in income.

Functional currency translation is applied when converting the currencies of foreign companies' financial statements. In the consolidated financial statements, the balance-sheet items of all foreign companies are translated into euros at the average exchange rate prevailing on the balance-sheet date, since principal foreign enterprises included in the consolidated financial statements conduct their business activities independently in their national currencies. When translating the adjusted equity of foreign enterprises accounted for using the equity method, the same procedure is followed. Differences to previous-year translations are netted out against other comprehensive income without an effect on the profit or loss. Goodwill is translated at yearend as an asset of the economically autonomous foreign sub-unit. Expense and income items are translated at annual average exchange rates. Annual financial statements of group companies based in a country with hyperinflation are translated according to IAS 29. No material entities were headquartered in a country with hyperinflation in the fiscal or previous year.

The following exchange rates (among others) were used as a basis for currency translation:

	Average		Yearend	
€	2004	2003	12/31/04	12/31/03
1 US dollar	0.80	0.88	0.73	0.79
1 British pound	1.47	1.44	1.42	1.42
100 Czech korunas	3.14	3.14	3.28	3.09
100 Hungarian forints	0.40	0.39	0.41	0.38
1 Polish zloty	0.22	0.23	0.24	0.21

Accounting policies

Intangible assets are accounted for at amortized cost. With the exception of goodwill, all intangible assets have finite useful lives and are thus amortized. Software for commercial and technical applications is amortized over three to five years using the straight-line method; concessions and other usage rights generally have useful lives of up to 20 years. From 2004 onwards, customer relationships are amortized on the basis of a useful life reduced from 20 to ten years.

In accordance with IFRS 3 in combination with IAS 36 (2004), which were applied for the first time in the year under review, goodwill is no longer amortized; instead, it is subjected to an impairment test once a year, or when there are indications of an impairment.

Development costs are capitalized if a newly developed product or process can be clearly defined, is technically feasible, and it is the company's intention to either use the product or process itself or market it. Furthermore, asset recognition requires that there be a sufficient level of certainty that the development costs will provide future cash inflows. Capitalized development costs are amortized over the time period during which the products are expected to be sold. Research expenses are recognized as an expense.

Property, plant and equipment is stated at depreciated cost. The borrowing cost is not capitalized as part of the cost. Exploratory drillings are disclosed according to the successful efforts method, i.e. as a rule, they are capitalized only in the event of commercial success.

As a rule, property, plant and equipment is depreciated using the straight-line method unless in exceptional cases another depreciation method is better suited to the usage pattern.

Investment property is measured at depreciated cost. The fair value of the group's investment property is stated in the notes to the financial statements. Fair values are determined using internationally accepted valuation methods such as the discounted cash flow method, or derived from current market prices of comparable real estate.

The depreciation of property, plant and equipment is calculated according to the following useful lives, which apply throughout the group:

	Years
Buildings	**12–80**
Technical plants	
Thermal power plants	15–20
Electricity grids	20–35
Water main networks	20–100
Gas and water storage facilities	20–100
Gas distribution facilities	14–20
Waste management facilities	6–15
Mining facilities	4–20, 25
Mechanical and electrical engineering facilities	4–15
Mine developments	**33–35**
Wells owned by RWE Dea	**up to 28**

Property, plant and equipment held under a finance lease is capitalized at the lower of the fair value of the leased asset and the present value of the lease payments and depreciated using the straight-line method over its expected useful life or lease term—whichever is shorter.

An impairment loss is recognized for intangible assets (including capitalized development costs and goodwill) as well as for property, plant and equipment, if the recoverable amount of an asset is less than its carrying amount. If the asset is part of a cash-generating unit, the impairment loss is calculated based on the recoverable amount of the cash-generating unit. If the reason for an impairment loss recognized in prior years has ceased to exist, a write-back is performed. Impairment losses on goodwill are not reversed.

Shares of companies accounted for using the equity method are accounted for based on their amortized acquired prorated net assets.

Shares in non-consolidated subsidiaries, in associates and joint ventures not accounted for using the equity method, in other investments as well as other non-current **financial assets**, e.g. marketable securities disclosed as financial assets, are nearly exclusively classified as “available for sale”. They are stated at fair value as long as it can be determined reliably. They are initially valued on their settlement date. Unrealized gains and losses are stated as other comprehensive income as part of equity. Gains and losses are recognized in the income statement at the time of sale. If there are substantive objective indications of a reduction in value of an asset, an impairment loss is recognized for it.

Company loans are stated at amortized cost. Loans with interest rates common in the market are shown on the balance sheet at nominal value; no or low interest-bearing loans are discounted to their present value.

Inventories are carried at cost. Production costs include full costs and are determined based on the production facilities' normal capacity. Specifically, in addition to directly allocable costs, production costs include adequate portions of required materials and production overheads, including production-related depreciation and pension benefit expenses. The borrowing cost is not capitalized as part of the cost. Assessment is generally based on average values. The usage of excavated earth for lignite mining is determined according to the FIFO method.

We disclose lower values at yearend stemming from reduced net realizable values. If the net realizable value of inventories written down in earlier periods has increased, the resulting reversal of the write-down is recognized as a reduction of the cost of materials.

Prepayments received from customers are carried as liabilities.

Nuclear fuel assemblies shown under inventories are stated at depreciated cost. Depreciation is determined by operation and capacity based on consumption and the reactor's useful life, respectively.

Customer-specific construction contracts are recognized under the percentage of completion method. The capitalizable amount is disclosed under accounts receivable. Negative balances for construction contracts are carried as accounts payable from construction contracts. The percentage of completion is determined according to the costs incurred (cost-to-cost method). Expected contract losses are covered by valuation allowances or provisions and are determined taking identifiable risks into account. Contract revenue comprises the amount of revenue agreed in the contract and is shown under revenue.

Accounts receivable and other assets, excluding derivative financial instruments, are stated at amortized cost. Necessary allowances are based on the actual default risk. Under accounts receivable for supplies and services from utilities, prepayments received are netted out against customer consumption which is yet to be metered and billed.

Current marketable securities are all classified as "available for sale" and are stated at fair value. This item is primarily composed of marketable securities held in special funds as well as fixed-interest securities with a maturity of more than three months from the date of acquisition. They are initially valued on their settlement date. Unrealized gains and losses are stated as other comprehensive income. Gains and losses are recognized in the income statement at the time of sale. If there are substantive objective indications of a reduction in value of an asset, an impairment loss is recognized for it.

Provisions for pensions and similar obligations are calculated according to the projected unit credit method. This benefit/years-of-service method not only takes into account the pension benefits and benefit entitlements known as of the balance-sheet date, but also increases in salaries and pension benefits to be expected in the future. Actuarial gains and losses exceeding 10 % of total benefit obligations and the fair value of plan assets are amortized over the employees' average remaining working lives with an effect on income. The service cost is allocated to staff costs, and the interest accretion to provisions is allocated to the financial result.

All **other provisions** (accrued liabilities) take into account all obligations identifiable as of the balance-sheet date which result from previous events whose amount or due date is not certain. Provisions are only recognized when based on legal or constructive obligations to third parties. Provisions are carried at settlement amounts and are not offset against reimbursement claims. Provisions including a large number of different items are stated at expected amounts.

All long-term provisions are recognized at the settlement amount that is discounted as of the balance-sheet date. The settlement value also includes the cost increases to be taken into account as of the balance-sheet date. Excluded from this are pension provisions for which special rules apply in accordance with IAS 19. Provisions for nuclear waste disposal and mining are now also measured in compliance with the Interpretation IFRIC 1 “Changes in Existing Decommissioning, Restoration and Similar Liabilities” passed by the IFRIC in May 2004. According to IFRIC 1, changes in the estimated timing or amount of the payments or changes in the discount rate are taken into account at the same amount in measuring the existing decommissioning, restoration and similar liability as well as the respective asset. If the decrease in the liability exceeds the carrying amount of the underlying asset, the excess is recognized immediately in the profit or loss. For reasons of materiality, when IFRIC 1 was applied for the first time, amounts stated for the previous year did not have to be adjusted.

Deferred taxes result from temporary differences in the carrying amount in the separate IFRS financial statements and the tax base and from consolidation procedures. Deferred tax assets also include tax reduction claims resulting from the expected utilization of existing loss carryforwards in subsequent years. They are capitalized when the realization of these loss carryforewards is guaranteed with sufficient certainty. Deferred taxes are assessed based on tax rates that are applicable or expected in the individual countries at the time of realization. The taxation rate used to calculate German deferred taxes is 39.28 %. The group’s average local trade tax rate has been taken into account in addition to the 25.0 % corporate income tax rate and the 5.5 % solidarity surcharge.

Otherwise, tax regulations for calculating deferred taxes valid or adopted as of the balance-sheet date apply.

Liabilities, excluding derivative financial instruments, are stated at amortized cost. Liabilities from finance lease agreements are measured at the amount of the present value of the lease payments.

Advances and contributions in aid of construction and building connection that are carried as liabilities by the utilities as **deferred income** are generally amortized with an income effect over the term of the corresponding asset. Taxable and non-taxable government grants for capital expenditure on non-current assets are disclosed as deferred income on the balance sheet and recognized as other operating income in line with the assets’ depreciation.

Derivative financial instruments are accounted for as assets or liabilities. They are measured at fair value regardless of their purpose. When stated for the first time, they are stated as of the settlement date.

Fair value hedges are used to hedge the risk of a change in the fair value of an asset or liability carried on the balance sheet. In such cases, changes in the fair value of the hedging instrument are stated in the income statement, analogously to the changes in the fair value of the respective underlying transactions. This means that the gains and losses from the fair valuation of the hedging instrument are allocated to the same line item of the income statement as those of the related hedged item.

Cash flow hedges are used to hedge the risk of a variability in cash flows related to an asset or liability carried on the balance sheet or a forecast transaction. If a cash flow hedge exists, unrealized gains and losses from the hedge are initially stated as other comprehensive income. Gains and losses are disclosed in the income statement as soon as the hedged underlying transaction has an effect on results. If the gain or loss on a hedge relates to the acquisition of an asset or a liability, the gain or loss on the hedge is taken into account when determining the acquisition costs and/or when stating the value of the liability.

Hedges of a net investment in a foreign entity are used to hedge the currency risk from investments with foreign functional currencies. Unrealized gains and losses from hedges are recognized as part of the currency translation adjustment in other comprehensive income until the net investment is sold.

The ineffective part of a hedging relationship is immediately recognized with an effect on results in the income statement.

Results of derivative energy trading activities are stated in net amounts.

Contingent liabilities are possible or present obligations that arise from past events and for which an outflow of resources is not probable. They are not recorded on the balance sheet unless they have been assumed as part of an acquisition. The amounts disclosed are the amounts that would have to be paid to settle the obligation at the balance-sheet date.

Notes to the Income Statement

(1) Revenue

Revenue is recorded once the risk has been transferred to the customer. This does not apply to contract revenue recognized under the percentage of completion method for customer-specific construction contracts. Natural gas tax/electricity tax paid by group companies directly is disclosed separately.

To improve the presentation of the business development, revenue generated by energy trading operations is stated as net figures. This means that revenue only reflects realized gross margins. By contrast, electricity, gas, coal and oil transactions that are subject to physical settlement are stated as gross figures. Energy trading revenue is generated by RWE Trading and RWE Energy. In fiscal 2004, gross revenue (including energy trading revenue) amounted to €58,060 million (previous year: €59,785 million).

The segment reporting on pages 168 and 169 contains a breakdown of revenue by division and geographical region. Of the €42,137 million in revenue (previous year: €43,875 million), €327 million (previous year: €429 million) are attributable to revenue from customer-specific construction contracts. Deconsolidations and first-time consolidations reduced revenue by a net €3,938 million.

(2) Natural gas tax/electricity tax

Natural gas tax/electricity tax are the taxes paid directly by group companies. Changes in the scope of consolidation caused expenses to increase by €6 million.

(3) Other operating income

€million	2004	2003
Release of provisions	1,508	1,546
Disposal of non-current assets excluding financial assets, including income from deconsolidation	543	1,074
Disposal and write-back of current assets excluding marketable securities	68	87
Derivative financial instruments	70	252
Currency gains	275	271
Cost allocations/refunds	59	144
Rent and lease	40	54
Compensation for damage/insurance benefits	33	27
Miscellaneous	664	925
	3,260	**4,380**

Income from the disposal of financial assets is disclosed under income from investments if it relates to investments; otherwise it is recorded as part of the financial result, as is the income from the disposal of current marketable securities.

Currency gains are contrasted against currency losses that are disclosed under other operating expenses.

The change in the scope of consolidation caused other operating income to decline by €266 million.

(4) Cost of materials

€ million	2004	2003
Cost of raw materials and of goods for resale	17,734	17,528
Costs of purchased services	5,241	5,395
	22,975	**22,923**

The cost of raw materials used also contains additions to provisions for the disposal of spent nuclear fuel assemblies as well as €119 million (previous year: €105 million) in amounts written off for nuclear fuel assemblies and €65 million (previous year: €80 million) in taxes paid for RWE Dea's foreign production companies.

A total of €15,923 million in material costs (previous year: €15,910 million) were netted out against energy trading revenue. Due to the change in the scope of consolidation, the cost of materials decreased by €1,837 million.

(5) Staff costs

€ million	2004	2003
Wages and salaries	4,886	5,963
Cost of social security, pensions and other benefits	1,236	1,567
	6,122	**7,530**

The cost of pension benefits is €305 million (previous year: €388 million); this figure consists mainly of €216 million in current service costs (previous year: €293 million) as well as adjustments for past service costs in the amount of €46 million (previous year: €30 million) and recognized actuarial losses of €0 million (previous year: €14 million).

Converted to full time equivalent, the RWE Group's average personnel headcount totaled 106,138 (previous year: 135,220). Employee equivalents include full-time staff members at 100 %, whereas part-time and fixed-term employees are included on a prorated basis in accordance with the extent of their part-time work or their duration of employment. In addition, converted to full time equivalent, the Group employed 3,554 trainees (previous year: 4,315).

Consolidation effects caused staff costs to drop by €1,286 million.

(6) Depreciation, amortization, impairment losses

Property, plant and equipment have been depreciated by €2,710 million (previous year: €3,136 million). Intangible assets have been amortized by €1,055 million (previous year: €1,375 million); €330 million of this (previous year: €147 million) is related to customer relationships capitalized in connection with acquisitions made in prior financial years.

Goodwill stopped being amortized on January 1, 2004, due to the first-time application of IFRS 3 in combination with IAS 36 (2004). €492 million in impairment losses on goodwill were recognized in the year under review. In the previous year, €985 million in goodwill from capital consolidation was amortized, €15 million of which was recognized as an impairment loss.

In the year under review, the impairment losses of property, plant and equipment amounted to €107 million (previous year: €237 million); the impairment losses of intangible assets (excluding goodwill) amounted to €41 million (previous year: €53 million).

Depreciation, amortization and impairment losses decreased by €305 million due to changes in the scope of consolidation.

(7) Other operating expenses

€million	2004	2003
Concessions, licenses and other contractual obligations	577	576
Disposal of non-current assets without financial assets, including deconsolidation expenses	223	96
Additions to provisions	482	719
Disposal of current assets and decreases in values excluding inventories and marketable securities	304	411
Derivative financial instruments	140	156
Maintenance and renewal obligations	559	650
Insurance, commissions, freight and similar distribution costs	453	568
Lease payments for plants and networks as well as rent	392	454
Advertising	169	162
Currency losses	290	197
Other taxes, primarily on property	114	189
Postage and monetary transactions	181	179
Structural and adaptation measures	347	1,104
General administration	412	605
Legal and other consulting and data processing services	453	521
Miscellaneous	958	1,218
	6,054	**7,805**

Miscellaneous other operating expenses include fees and membership dues, among other items.

Expenses declined by €1,280 million due to changes in the scope of consolidation.

(8) Income from investments

Income from investments contains profit contributions from operating investments. They represent almost all interests held in unconsolidated entities, including companies accounted for using the equity method. The business activities of these investments are closely linked to the operating activity of fully consolidated entities. Income from investments includes all income and expenses which have arisen in connection with these investments.

€ million	2004	2003
Income from profit- and loss-pooling agreements	7	20
Expenses from profit- and loss-pooling agreements	–13	–34
Income from investments		
Affiliates	11	65
Companies accounted for using the equity method	291	73
Other investments	62	37
	364	**175**
Corporate income tax imputation credit	(1)	(2)
Income from the disposal of investments	483	307
Expenses from the disposal of investments	–8	–73
Amortization and impairment losses on investments	–23	–145
Amortization and impairment of goodwill of companies accounted for using the equity method	(–)	(–125)
Impairment of shares in affiliates	(–15)	(–13)
Income from loans to investments	36	34
Expenses from loans to investments	–7	–27
Other	7	43
	846	**300**

Impairment losses on financial assets included in income from investments amounted to €24 million (previous year: €27 million); €1 million thereof is accounted for as loans to investments (previous year: €6 million).

Changes in the scope of consolidation increased income from investments by €38 million.

(9) Financial result

The financial result breaks down into net interest, the interest accretion to provisions and the other financial result.

€ million	2004	2003
Interest and similar income	1,117	1,116
Affiliates	(4)	(12)
Interest and similar expenses	–2,247	–2,247
Affiliates	(–9)	(–11)
Net interest	**–1,130**	**–1,131**
Interest accretion to provisions for pensions and similar obligations	–557	–688
Interest accretion to provisions for nuclear waste management as well as to mining provisions	–559	–585
Interest accretion to other provisions	–211	–285
Interest accretion to provisions	**–1,327**	**–1,558**
Other financial income	838	813
Other financial expenses	–866	–1,002
Other financial result	**–28**	**–189**
	–2,485	**–2,878**

Net interest includes interest income from interest-bearing marketable securities and loans, expenses and income relating to current marketable securities, and all interest expenses. Net interest also includes shares in profits and dividends from marketable securities held as non-current and current assets.

Interest accretions to provisions contain the reversal allocable to the current year of the discounting of long-term provisions due to the annual update of the present value calculation.

The other financial result contains all other financial income and financial expenses which cannot be allocated to the net interest or to the interest accretion to provisions. Among other things, financial income includes €155 million in gains realized from the disposal of marketable securities (previous year: €566 million). Other financial expenses include write-backs of marketable securities due to their increased fair values in the amount of €41 million (previous year: €85 million) and €201 million (previous year: €618 million) in losses realized from the disposal of marketable securities.

Changes in the scope of consolidation improved the financial result by €134 million.

(10) Taxes on income

€ million	2004	2003
Current taxes on income	1,039	731
Deferred taxes	482	456
	1,521	**1,187**

Current taxes on income contain €85 million in net tax expenses (previous year: €44 million) relating to prior periods.

Changes in tax rates led to a deferred tax income of €6 million (previous year: €34 million). German deferred taxes are calculated using a tax rate of 39.28 %, as in the previous year.

Due to the utilization of tax loss carryforwards unrecognized in prior years, current taxes on income were reduced by €112 million (previous year: €119 million). Deferred tax expenses decreased by €1 million (previous year: €11 million) due to previously unrecognized tax loss carryforwards that are to be reassessed.

The income tax expense is derived from the theoretical tax expense. As in the previous year, a tax rate of 39.28 % was applied to income before tax.

€ million	2004	2003
Income before tax	**3,935**	**2,123**
Theoretical tax expense	**1,546**	**834**
Differences from foreign tax rates	–78	–119
Tax effects on		
tax-free domestic dividend income	–42	–72
tax-free foreign dividend income	–35	–21
other tax-free income	–22	–19
expenses not deductible for tax purposes	102	101
amortization of goodwill from capital consolidation	193	387
accounting for associates and joint ventures using the equity method (including amortization of associates' and joint ventures' goodwill)	–10	97
unutilizable loss carryforwards and/or the utilization of unrecognized loss carryforwards	–6	73
realized and expected tax-free disposals of investments	–99	–88
other	–28	14
Effective tax expense	**1,521**	**1,187**
Effective tax rate in %	38.7	55.9

Notes to the Balance Sheet

(11) Non-current assets

An analysis and description of the movements of non-current assets summarized in the balance sheet for the period under review is provided on pages 142 and 143.

In the year under review, a total of €114 million (previous year: €390 million) was spent on research and development. This decrease is nearly entirely due to the deconsolidation of Heidelberger Druckmaschinen. Development costs of €14 million (previous year: €46 million) were capitalized.

The carrying amount of **intangible assets** in fiscal 2004 and 2003 breaks down as follows:

€ million	2004	2003
Balance as of January 1	**19,418**	**18,518**
Additions/disposals through changes in the scope of consolidation	–516	3,259
Additions	101	318
Transfers	11	2
Depreciation, amortization and impairment losses	–1,055	–1,375
Currency translation adjustments	–225	–1,270
Disposals	–16	–34
Balance as of December 31	**17,718**	**19,418**

Goodwill was allocated to cash-generating units at the segment level or at a level beneath the segment level to carry out impairment tests. The carrying amounts of **goodwill** allocated to segments breaks down as follows:

€ million	12/31/04	12/31/03
RWE Power	514	659
RWE Energy	3,675	3,475
Czech gas	(1,361)	(1,286)
RWE npower	4,215	4,635
RWE Trading	442	28
RWE Thames Water	5,514	6,089
North America	(2,613)	(2,886)
Other	19	772
	14,379	**15,658**

In line with the annual impairment test carried out on goodwill in accordance with IAS 36 (2004), RWE wrote down €292 million in goodwill remaining from RWE Umwelt in the third quarter of fiscal 2004 based on the purchase agreement concluded between RWE and Rethmann on September 28 and on the agreed selling price. Due to the adverse effect of changes in the economic environment of parts of RWE Thames Water's international water business, goodwill had to be written down by €200 million as of December 31, 2004.

The impairment test involves determining the recoverable amount of the cash-generating units, which corresponds to the fair value less costs to sell or the value in use. The fair value reflects the best estimate of the sum that an independent third party would pay to purchase the cash-generating units as of the balance-sheet date; selling costs are deducted. The fair value is determined on the basis of an enterprise valuation model from an external perspective. Fair values and the value in use are determined based on cash flow budgets, which are based on the medium-term budget for a period of five years, which has been approved by the Executive Board and which is valid when the impairment test is performed. These budgets are based on past experience as well as on future expected market trends.

The medium-term budget is based on the general economic data derived from macroeconomic and financial studies and makes assumptions primarily on the development of gross domestic product, consumer prices, interest rates and nominal wages.

Key assumptions underlying the budgets for the divisions active on Europe's electricity and gas markets—RWE Power, RWE Energy and RWE npower—are the premises relating to the development of world market prices for crude oil, natural gas and coal, wholesale and retail electricity and gas prices as well as to the development of market shares and regulatory framework conditions.

Basic conditions established by regulatory authorities constitute a further key assumption underlying the budget for RWE Thames Water and Czech Gas, both of which are predominantly active in regulated markets. These assertions determine end consumer prices, the budget of capital expenditure and the return achievable in the corresponding regulatory period.

Discount rates are determined on the basis of market data and are between 5.8 % and 7.3 % after tax and between 7.5 % and 11.0 % before tax for the cash-generating units.

RWE extrapolates expected currency devaluation going beyond the detailed budget horizon based on constant growth rates of 0.0 % to 1.0 %, which are derived from past experience for each division, and none of which exceed the average growth rates of the markets on which the companies are active. Growth rates are determined subtracting the capital expenditure required to achieve them.

RWE is of the opinion that, based on current knowledge, expected changes in the aforementioned key assumptions on which the determination of the recoverable amounts is based would not cause the carrying amounts of the cash-generating units to exceed the recoverable amounts.

Investment property is all property held to earn rental income or for long-term capital appreciation rather than for use in production or for administrative purposes. This property is measured at depreciated cost. Depreciable investment property is depreciated over 12 to 80 years using the straight-line method. Its fair value is €715 million (previous year: €760 million). Fair values are determined using internationally accepted valuation methods such as the discounted cash flow method, or derived from current market prices of comparable real estate. €111 million of the fair value (previous year: €86 million) are based on a valuation made by independent appraisers. Rental income generated in the reporting period amounted to €66 million (previous year: €67 million). Direct operating expenses totaled €27 million (previous year: €22 million).

Property, plant and equipment are subject to restrictions on disposal in the amount of €278 million (previous year: €312 million) in the form of land charges and chattel mortgages. Of the carrying amount of property, plant and equipment, €519 million (previous year: €531 million) are attributable to assets leased under finance leases. They principally comprise technical plant and equipment (€508 million; previous year €530 million). Disposals of property, plant and equipment resulted from the sale and decommissioning of plants.

Additions to **financial assets** total €308 million (previous year: €5,400 million) and reflect €108 million in acquisitions made in the period under review (previous year: €4,796 million) as well as capital contributions made to subsidiaries and joint ventures. The additions to non-current marketable securities and to loans as well as the additions from applying the equity method and measurement at fair value of other investments amount to €641 million (previous year €588 million).

Non-current **marketable securities** are predominantly fixed-interest marketable securities and shares of public companies. They are not subject to any restrictions on disposal. They generally belong to the class of marketable securities designated “available for sale” and are measured at fair value.

The loans’ remaining terms are summarized in the following table:

€ million	≤ 1 year	> 1 year
Loans to affiliates	4	14
Loans to investments accounted for using the equity method and other investments	5	957
Other loans	21	282

Roll-forward of Non-current Assets

€ million	Cost					
	Balance at 1/1/04	Additions/ disposals through changes in scope of cons.	Additions	Transfers	Currency translation adjustments	Disposals	Balance at 12/31/04
Intangible assets							
Development costs	193	–85	14		–3	2	117
Concessions, patent rights and similar rights and assets as well as licenses in such rights and assets	2,251	99	92	12	–13	483	1,958
Customer relationships and similar assets	2,905	2	□		–1		2,906
Goodwill	18,097	–858			–199	2,167	14,873
Prepayments	150	2	–5	□	–2	10	135
	23,596	**–840**	**101**	**12**	**–218**	**2,662**	**19,989**
Property, plant and equipment							
Land, land rights and buildings including buildings on third-party land	13,488	–792	426	9	–111	227	12,793
Investment property	872	1	6	39	3	37	884
Technical plant and machinery	71,482	–1,273	2,016	256	–215	840	71,426
Other equipment, factory and office equipment	4,326	–876	239	32	17	310	3,428
Prepayments to other enterprises	73	1	26	–5	1	1	95
Construction work in progress	890	–78	615	–339	–28	26	1,034
	91,131	**–3,017**	**3,328**	**–8**	**–333**	**1,441**	**89,660**
Financial assets							
Investments in affiliates	659	932	132[1]		4	1,317[1]	410
Loans to affiliates	47	–28	6	□	□	3	22
Investments							
Associates accounted for using the equity method	4,178	–368	399[2]		17	1,561[2]	2,665
Other investments	755	150	68[3]		□	264[3]	709
Loans to associates and other investments	849	28	138	□	–1	48	966
Non-current marketable securities	555	367	166[4]			51	1,037
Other loans	492	–11	40		□	213	308
	7,535	**1,070**	**949**	**4**	**20**	**3,457**	**6,117**
	122,262	**–2,787**	**4,378**		**–531**	**7,560**	**115,766**

1 €2 million of the additions and €43 million of the disposals result from the fair valuation pursuant to IAS 39.

2 €288 million of the additions and €265 million of the disposals result from applying the equity method.

Accumulated depreciation/amortization/impairment losses								Carrying amounts	
Balance at 1/1/04	Additions/ disposals through changes in scope of cons.	Deprecia- tion/amorti- zation/im- pairment losses in reporting period	Transfers	Currency trans- lation adjust- ments	Disposals	Write- backs	Balance at 12/31/04	Balance at 12/31/04	Balance at 12/31/03
68	–12	6		–1	□		61	56	125
1,441	–20	227	1	–2	480		1,167	791	810
230	1	330		–12			549	2,357	2,675
2,439	–293	492		22	2,166		494	14,379	15,658
								135	150
4,178	**–324**	**1,055**	**1**	**7**	**2,646**		**2,271**	**17,718**	**19,418**
5,158	–461	537	–23	–22	125	4	5,060	7,733	8,330
337	1	49	8	□	18		377	507	535
46,049	–661	1,819	9	–22	674	2	46,518	24,908	25,433
3,365	–732	298	6	22	291	□	2,668	760	961
								95	73
12	–6	7		–1			12	1,022	878
54,921	**–1,859**	**2,710**	**□**	**–23**	**1,108**	**6**	**54,635**	**35,025**	**36,210**
179	–3	15		1	20	1	171	239	480
16	–11			□	1		4	18	31
504	–312				192		–	2,665	3,674
41	1	8		□	4	1	45	664	714
7	□	1			4	□	4	962	842
5	–4						1	1,036	550
5	–1	1			□	□	5	303	487
757	**–330**	**25**	**□**	**1**	**221**	**2**	**230**	**5,887**	**6,778**
59,856	**–2,513**	**3,790**	**1**	**–15**	**3,975**	**8**	**57,136**	**58,630**	**62,406**

3 €1 million of the additions and €223 million of the disposals result from the fair valuation pursuant to IAS 39.

4 €129 million of the additions result from the fair valuation pursuant to IAS 39.

□ Negligible amount.

(12) Inventories

€ million	12/31/04	12/31/03
Raw materials including nuclear fuel assemblies and the earth excavated for lignite mining	1,244	1,542
Work in progress—goods	111	534
Work in progress—services	229	211
Finished goods and goods for resale	386	885
Prepayments	73	113
	2,043	**3,285**

Due to changes in the scope of consolidation, inventories decreased by € 971 million. € 324 million (previous year: € 231 million) of the total amount of inventories recognized as of December 31, 2004 are carried at their net realizable value.

Inventories are not subject to restrictions on disposal, and there are no further burdens.

(13) Accounts receivable and other assets

€ million	12/31/04	Thereof RT* > 1 y.	12/31/03	Thereof RT* > 1 y.
Trade accounts receivable	7,078	–	7,509	37
Accounts receivable from affiliates	75	–	128	5
Accounts receivable from investments accounted for using the equity method and other investments	432	48	651	20
	7,585	**48**	**8,288**	**62**
Other assets				
Derivatives	5,937		4,648	
Loans	240		265	
Tax refund claims and prepayments	311		554	
Guarantees for trading activities	471		348	
Deferred interest	184		224	
Accounts receivable from the revenue financing provided by Heidelberger Druckmaschinen	–		773	
Foreign pension plan assets	529		516	
Prepayments for items other than inventories	278		262	
Accounts receivable from investment grants and subsidies	23		42	
Miscellaneous other assets	1,048		1,027	
	9,021	**3,512**	**8,659**	**1,727**
	16,606	**3,560**	**16,947**	**1,789**

* RT = remaining term.

Due to changes in the scope of consolidation, accounts receivable and other assets decreased by €1,767 million. Accounts receivable from associates totaled €333 million. €17 million (previous year: €38 million) of accounts receivable from affiliates and €322 million (previous year: €519 million) of accounts receivable from investments accounted for using the equity method and other investments were attributable to trade transactions.

Expenses and profit contributions from customer-specific construction contracts totaling €881 million (previous year: €549 million) were capitalized. Prepayments in the amount of €813 million (previous year: €513 million) were deducted. A profit of €72 million (previous year: €24 million) was earned on construction contracts.

Except for derivative financial instruments, accounts receivable and other assets are stated at amortized cost, which essentially corresponds to their fair value. Derivative financial instruments are stated at fair value.

Loans had interest rates between 3 % and 11 % (previous year: between 3 % and 11 %).

In the previous year, other assets included €105 million in lease payments receivable from finance lease agreements of Heidelberger Druckmaschinen.

(14) Marketable securities

Current marketable securities amount to €11,013 million (previous year: €9,615 million) and include fixed-interest marketable securities with a value of €8,164 million with a term of more than three months from the date of acquisition as well as stocks and profit-participation certificates with a value of €2,849 million. Marketable securities are stated at fair value. As of December 31, 2004, the average return obtainable on the market on fixed-interest bonds directly held by the group was 3.6 % (previous year: 3.9 %).

(15) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, demand deposits, and fixed-interest marketable securities with a maturity of three months or less from the date of acquisition.

Demand deposits are only kept for short-term cash positions at banks with outstanding creditworthiness. As in fiscal 2003, interest rates are maintained at interbank levels.

Cash and cash equivalents break down as follows:

€ million	12/31/04	12/31/03
Cash	1,354	1,938
Marketable securities and other cash investments (maturity three months or less from the date of acquisition)	172	243
	1,526	**2,181**

(16) Deferred taxes

Deferred tax assets and liabilities amount to €3,243 million and €4,134 million, respectively (previous year: €4,325 million and €4,526 million, respectively) and principally relate to measurement differences to the tax bases.

The following is a breakdown of deferred tax assets and liabilities by item:

€ million	12/31/04 Deferred tax assets	12/31/04 Deferred tax liabilities	12/31/03 Deferred tax assets	12/31/03 Deferred tax liabilities
Non-current assets	769	4,257	589	4,341
Current assets and other assets	81	1,087	179	1,115
Exceptional tax items	–	514	–	556
Provisions for pensions	1,407	72	1,296	64
Other provisions	2,643	410	3,007	622
Other liabilities	504	125	1,098	59
	5,404	**6,465**	**6,169**	**6,757**
Tax loss carryforwards	170	–	387	–
Gross total	**5,574**	**6,465**	**6,556**	**6,757**
Offsetting	–2,331	–2,331	–2,231	–2,231
Net total	**3,243**	**4,134**	**4,325**	**4,526**

Deferred tax assets and deferred tax liabilities were netted out against each other for each company and/or tax group.

Total deferred tax assets include the following capitalized tax reduction claims which result from the expected utilization of previously unused tax loss carryforwards in subsequent years:

€ million	12/31/04	12/31/03
Corporate income tax (or comparable foreign income tax)	166	381
Trade tax	4	6
	170	**387**

The realization of these tax loss carryforwards is guaranteed with sufficient certainty. There are €1,527 million in corporate income tax loss carryforwards and €3,816 million in trade tax loss carryforwards for which no deferred tax claims have been recognized (previous year: €1,905 million and €4,516 million, respectively).

As of December 31, 2004, the balance of corporate income tax reductions and increases related to future disbursements amounted to €699 million (previous year: €806 million). These corporate income tax reductions and increases can occur or be utilized by 2019. According to the German Tax Benefit Reduction Act, corporate income tax credits based on profit distributions can be utilized again from January 1, 2006 onwards.

In the year under review, €33 million in deferred taxes (previous year: €183 million) arising from the translation of foreign financial statements and €78 million (previous year: €208 million) from valuations without an effect on net income were offset against equity.

(17) Equity/minority interest

A breakdown of equity and the minority interest is shown on page 119.

Subscribed capital breaks down as follows:

	12/31/04 Number of shares ʹ000	%	12/31/03 Number of shares ʹ000	%	12/31/04 € million	12/31/03 € million
Common shares	523,405	93.1	523,405	93.1	1,340	1,340
Preferred shares	39,000	6.9	39,000	6.9	100	100
	562,405	**100.0**	**562,405**	**100.0**	**1,440**	**1,440**

Subscribed capital and the additional paid-in capital relate to RWE AG. Common and preferred shares are no-par value bearer share certificates.

Stock option plans
Contingent capital in the amount of €51,200,000 (previous year: €51,200,000) is available to offer subscription rights for common shares in the name of the bearer to members of the Executive Board and to other executives of RWE AG and subordinate affiliates.

The Executive Board of RWE AG has been authorized to issue non-transferable subscription rights to a total of up to 20,000,000 common shares to the aforementioned persons up to the end of the day on March 8, 2004, within the scope of the **executive stock option plan (AOP-F)**. There is a three-year waiting period for the stock options, which have a term of five years after their respective issue.

The following stock options have been issued:

	Originally issued	Balance at 12/31/03	Exercised in 2004	Expired in 2004	Balance at 12/31/04
1999 tranche	1,935,800	1,244,100	0	–1,244,100	0
2000 tranche	4,336,500	2,740,900	–2,740,900	0	0
2001 tranche	5,222,300	4,143,000	0	–491,800	3,651,200
2001A tranche	5,262,300	4,530,900	0	–502,300	4,028,600
	16,756,900	**12,658,900**	**–2,740,900**	**–2,238,200**	**7,679,800**

The stock options can only be exercised if the quoted market price of the common share—calculated on the basis of the total return approach—has increased by at least 6% annually on average (absolute performance) before being exercised and has not trailed the Dow Jones STOXX share index by more than ten percentage points (relative performance) in the same period. The four-week exercise periods start on the 21st trading day following the publication of the revenue and earnings figures for the completed fiscal year and of the semi-annual results.

The stock options can be exercised by payment of the exercise price. The exercise price equals the quoted market price of the common share on the first trading day after expiry of the relevant exercise period, minus a markdown, which is composed of the absolute and relative performance components. The markdown is limited to 40 percentage points.

Exercise conditions stipulate that the stock options can be fulfilled by already existing common shares instead of new shares from contingent capital or that the markdown can be paid in cash instead of in common shares. If the persons holding stock options are not employed by RWE AG, the expenses associated with the exercise are borne by the respective group company.

In the 2002 fiscal year, a **long-term incentive plan (LTIP)** was introduced for Executive Board members, other executives of RWE AG, and subordinate domestic and foreign affiliates, based on stock appreciation rights (SARs), in line with a resolution passed by the Supervisory Board.

There is a two-year waiting period for the SARs, which have a term of five years after their respective issue. The following stock options have been issued so far:

	Originally issued	Balance at 12/31/03	Exercised in 2004	Expired in 2004	Balance at 12/31/04
2002 tranche	5,950,350	5,870,350	–2,628,260	–428,775	2,813,315
2003 tranche	6,677,450	6,654,450	0	–277,050	6,377,400
2004 tranche	9,192,800	0	0	–18,700	9,174,100
	21,820,600	**12,524,800**	**–2,628,260**	**–724,525**	**18,364,815**

SARs can be exercised if the common share price has risen by at least 10 % before the exercise date (absolute performance) and has outperformed the Dow Jones STOXX Utility Price Index on ten consecutive days in the same period (relative performance). The relative success hurdle does not apply if the common share price increases by at least 20 %.

SARs can be exercised daily on expiry of the waiting period and once the aforementioned performance targets have been hit, except during short blocking periods prior to the publication of corporate data. The number of exercisable SARs is determined by the extent to which the common share has risen over the exercise price established when the SARs were issued. If the common share price increases by 20 %, all SARs can be exercised; an increase of 15 % enables the exercise of 60 %, and an increase of 10 % enables the exercise of 25 % of the SARs. Whenever SARs are exercised, the issuing company pays the difference between the current share price and the exercise price. The payment is limited to 50 % of the exercise price.

The LTIP's exercise conditions stipulate that common shares may be given instead of cash to pay out gains on the exercise of SARs. If the persons holding stock options are not employed by RWE AG, the expenses associated with the exercise are borne by the respective group company.

Under the **employee stock option plan**, eligible staff members were granted up to three non-transferable stock options on each common share of RWE AG for each employee share purchased.

The following stock options with a term of three years have been issued so far:

	Originally issued	Balance at 12/31/03	Expired in 2004	Balance at 12/31/04
2001 tranche	735,274	588,623	–588,623	0
2001A tranche	533,570	432,311	–432,311	0
	1,268,844	**1,020,934**	**–1,020,934**	**0**

The stock options can be exercised if the common share's quoted market price has risen to at least 110 % of the initial price set. Employees can then either purchase existing common shares at a reduced price or be paid out the difference. The capital gain is limited to 20 % of the initial price.

Commitments arising from the stock option plans and the LTIP are accrued over their terms to maturity and generally stated at the prorated fair value as of the balance-sheet date. €97 million in provisions were recognized as of the balance-sheet date (previous year: €71 million).

RWE Thames Water Plc, RWE Npower plc and **RWE Trading GmbH** introduced an **employee stock ownership plan** that enables entitled employees to save a maximum fixed sum of £100 and £125 respectively per month over a period of three years to purchase RWE shares. RWE shares can be purchased after the end of the blocking period at a 20 % discount on the price quoted at the cut-off date at the beginning of the respective tranche. RWE Thames Water, RWE npower and RWE Trading have hedged the expected number of purchased shares through options with the same exercise price. The option price is accrued over the three-year duration of the employee stock ownership plan.

	Originally issued	Balance at 12/31/03	Expired in 2004	Balance at 12/31/04
2001 tranche	412,608	295,279	–245,510	49,769
2002 tranche	1,068,040	765,803	–88,781	677,022
2003 tranche	788,081	772,478	–72,235	700,243
2004 tranche	210,675	0	–8,843	201,832
	2,479,404	**1,833,560**	**–415,369**	**1,628,866**

Under the **long-term incentive plans (LTIPs)** of **RWE Thames Water Plc, RWE Npower plc** and **RWE Trading GmbH** entitled executives receive stock options that enable them to purchase shares in RWE AG after a blocking period. Shares expected to be required at the time of exercise are purchased on the capital market and held by an independent trust until the options on them are exercised. The sum required to purchase these shares is deferred for the duration of the program.

Accumulated other comprehensive income

Accumulated other comprehensive income reflects changes in the fair values of financial instruments available for sale and of cash flow hedges as well as currency translation adjustments from foreign financial statements.

In the year under review, €406 million in changes in fair values of cash flow hedges (previous year: €179 million) and €406 million in financial instruments available for sale (previous year: €153 million) were disclosed under accumulated other comprehensive income. In the fiscal year, €34 million in cash flow hedges were realized as income (previous year: €65 million) and €199 million in financial instruments available for sale were realized as income (previous year: expense of €268 million).

Dividend proposal

We propose to the Annual General Meeting that RWE AG's distributable profit for fiscal 2004 be appropriated as follows:

Distribution of a dividend of €1.50 per individual share certificate on the dividend-bearing capital stock of

€1,439,756,800.00:	€843,607,500.00
Profit carryforward:	€90,564.82
Distributable profit:	**€843,698,064.82**

Minority interest

The **minority interest** shows the share ownership of third parties in group entities. In the fiscal year, it decreased primarily due to the deconsolidation of Heidelberger Druckmaschinen. Above all, a minority interest is held in the Hungarian-based power utilities, enviaM, in subsidiaries of the RWE Thames Water Division, and the Czech gas companies.

(18) Provisions

€million	12/31/04	12/31/03
Provisions for pensions and similar obligations	11,853	12,303
Provisions for taxes	2,400	2,773
Provisions for nuclear waste management	9,683	10,124
less: prepayments	–671	–651
	9,012	**9,473**
Provisions for mining damage including reclamation	1,948	1,951
Other provisions		
Staff-related obligations (excluding restructuring)	1,128	1,134
Restructuring obligations	1,086	2,441
Purchase and sales obligations	3,524	3,737
Uncertain obligations in the electricity business	756	679
Environmental protection obligations	369	426
Interest payment obligations	385	402
Miscellaneous other provisions	2,293	2,352
	9,541	**11,171**
	34,754	**37,671**

Provisions for pensions and similar obligations
Provisions are made to cover obligations to pay future and ongoing post-employment benefits to entitled current and former employees and their surviving dependants. In particular, the obligations refer to retirement pensions in the form of both basic and supplementary benefits. Individual commitments are based on the differing industry and country-specific benefit arrangements. They are generally calculated according to the employees' length of service and compensation. In view of their benefit status, the obligations of US group enterprises for their employees' post-retirement medical expenses are also disclosed under pension provisions and similar obligations.

The company pension plan consists of defined contribution and defined benefit plans. In the case of defined contribution plans, the enterprise's obligation is limited to the amount it contributes to the plans. Expenses are disclosed under staff costs. In the reporting period, €53 million were paid into defined contribution plans (previous year: €51 million). In the case of defined benefit plans, the enterprise's obligation is to provide agreed benefits to current and former employees. Provisions for defined benefit plans are valued according to the projected unit credit method. The provision is reduced by the amount of the plan assets. The service cost is disclosed under staff costs, the interest cost under the financial result.

The amount of the provision was calculated using actuarial methods. The following assumptions are applied:

	2004		2003	
%	Germany	Foreign	Germany	Foreign
Discount rate	5.00	5.25–6.25	5.50	5.55–6.75
Compensation increase	2.75	3.50–4.75	2.75	3.40–4.75
Pension increase	1.50	2.50–2.90	1.75	2.40–4.75
Rise in health service cost	–	5.00–10.00	–	4.75–9.00
Expected return on plan assets	–	6.10–8.75	–	6.00–8.75

Provisions for pensions are derived as follows:

€ million	12/31/04	12/31/03
Present value of funded benefit obligations	**7,613**	**7,150**
Fair value of plan assets	6,746	6,598
Less: plan assets capitalized	–529	–516
Fair value of plan assets (excluding plan assets capitalized)	**6,217**	**6,082**
Unrecognized net actuarial gains/losses	–1,018	–678
Accrued provision for funded benefit obligations	**378**	**390**
Present value of unfunded benefit obligations	**10,946**	**11,245**
Unrecognized actuarial gains/losses on unfunded benefit obligations	529	668
Accrued provision for unfunded benefit obligations	**11,475**	**11,913**
	11,853	**12,303**

The unrecognized net actuarial losses/gains of –€489 million (previous year: –€10 million) that have not yet been recognized primarily result from losses/gains in connection with changes in the number of employees and differences in the actual market trends compared with the actuarial assumptions made. This amount is recognized as income or an expense over the employees' average remaining working lives to the extent that it exceeds 10% of the greater of the benefit obligation or of the fair value of the plan assets.

The table below shows the reconciliation of the fair value of plan assets:

€ million	2004	2003
Fair value of plan assets at start of fiscal year	6,598	6,524
Expected return on plan assets	523	557
Contributions to the funded plans	92	210
Benefits paid by the funded plans	–392	–468
Actuarial gains/losses (related to plan assets)	59	125
Other changes (mainly changes in the scope of consolidation, transfers and currency adjustments)	–134	–350
Fair value of plan assets at end of fiscal year	**6,746**	**6,598**

The actual return on plan assets is €521 million (previous year: €665 million).

Provisions for pensions in fiscal 2004 and 2003 developed as follows:

€ million	2004	2003
Beginning balance	12,303	13,376
Additions	262	337
Unused amounts reversed	–12	–7
Interest accretion/discount rate changes	557	688
Changes in the scope of consolidation, currency adjustments, transfers	–648	–1,463
Amounts used	–609	–628
Closing balance	**11,853**	**12,303**

Expenses relating to provisions for pensions break down as follows:

€ million	2004	2003
Service cost	216	293
Interest cost	1,080	1,245
Expected return on plan assets	–523	–557
Amortization of past service cost	46	30
Recognized actuarial losses/gains	–	14
	819	**1,025**

Roll-forward of provisions € million	Balance at 1/1/04	Additions	Unused amounts reversed	Interest accretion/ discount rate changes	Changes in the scope of consoli-dation, cur-rency adjust-ments, transfers	Amounts used	Balance at 12/31/04
Provisions for pensions	12,303	262	–12	557	–648	–609	11,853
Provisions for taxes	2,773	677	–42	–	–515	–493	2,400
Provisions for nuclear waste management less prepayments	9,473	105	–821	461	–	–206	9,012
Provisions for mining damage	1,951	84	–78	98	2	–109	1,948
	26,500	**1,128**	**–953**	**1,116**	**–1,161**	**–1,417**	**25,213**
Other Provisions							
Staff obligations (excluding restructuring)	1,134	667	–52	10	–179	–452	1,128
Restructuring obligations	2,441	75	–220	52	–575	–687	1,086
Purchase and sales obligations	3,737	1,399	–55	63	–291	–1,329	3,524
Uncertain obligations in the electricity business	679	136	–41	23	100	–141	756
Environmental protection obligations	426	35	–14	3	–39	–42	369
Interest payment obligations	402	63	–8	0	–15	–57	385
Miscellaneous other provisions	2,352	914	–219	60	–408	–406	2,293
	11,171	**3,289**	**–609**	**211**	**–1,407**	**–3,114**	**9,541**
	37,671	**4,417**	**–1,562**	**1,327**	**–2,568**	**–4,531**	**34,754**
Of which with a term of up to one year	(8,272)						(7,779)
Of which changes in the scope of consolidation							(–1,907)

Provisions with a term of up to one year relate to tax provisions and to other provisions.

Provisions for nuclear waste management
Waste management provisions in the nuclear energy sector are based on obligations under public law and restrictions included in operating licenses.

Provisions for the disposal of spent nuclear fuel assemblies cover expected costs, which primarily include reprocessing costs on the basis of contractual agreements, and direct final storage. The associated cost of transporting, treating and taking back waste, including the cost of final storage and associated pre-financing costs calculated based on data from the German Federal Office for Radiation Protection, are included accordingly. These provisions are used over a period of up to 80 years.

Provisions for the decommissioning of nuclear power station facilities are measured based on expected costs. The calculation of expected costs is based on outside expert opinion and assumes that the facilities concerned are dismantled completely. Costs incurred during the interim period preceding decommissioning operations are also included. Furthermore, provisions were recognized for other waste management measures (management of radioactive operational waste).

Waste management provisions in the nuclear energy sector are stated as long-term provisions, and their settlement amount is discounted to the balance-sheet date. An interest rate of 5.5 % (previous year: 5.5 %) was used as the discount rate. Volume-induced increases in the provisions are measured at their present value. In the fiscal year, they amounted to € 105 million (previous year: € 68 million). By reversing € 821 million in unused provisions (previous year: € 999 million), we accounted for the expected reduction in waste disposal costs principally caused by changes in the legal environment. Additions to provisions for nuclear waste management primarily consist of an interest accretion of € 461 million (previous year: € 485 million).

Provisions for mining damage
These provisions are formed to cover obligations to restore mining damage that has already occurred or been caused. Such risks and obligations are those that exist as of the balance-sheet date and are identifiable when the balance sheet is being prepared. They have to be recognized due to obligations under public law that are based on the German Federal Mining Act and formulated, above all, in operating schedules and water law permits. Provisions are generally recognized based on the increase in the obligation, i.e. in line with coal production. They are measured at full expected cost or according to estimated compensation payments.

Furthermore, provisions are made owing to obligations under public law to dismantle production facilities and fill wells. The amount of these provisions is based on total cost estimates derived from past experience and comparative rates determined by the German Association of the Oil and Natural Gas Production Industry and/or similar assumptions made by foreign subsidiaries.

Provisions for mining damage are long-term provisions that are recognized at the settlement amount discounted to the balance-sheet date. An interest rate of 5.5 % (previous year: 5.5 %) was used as the discount rate. In the reporting period, allocations to provisions for mining damage amounted to € 84 million (previous year: € 105 million) and stemmed from an increase in the volume of commitment. The interest accretion of the additions to provisions for mining damage is € 98 million (previous year: € 100 million). By reversing € 78 million in unused provisions (previous year: € 100 million), we accounted for the expected reduction in costs.

Provisions for restructuring
Provisions for restructuring mainly comprise socially acceptable measures for further payroll downsizing. The agreement on personnel measures reached in 2000 expired on June 30, 2004.

The restructuring of group companies in the German electricity and gas business initiated in fiscal 2003 will largely be completed in 2005.

(19) Liabilities

€ million	12/31/04	Thereof RT* ≤ 1 y.	Thereof RT* > 1 y.	12/31/03	Thereof RT* ≤ 1 y.	Thereof RT* > 1 y.
Bonds (incl. other notes payable)	20,042	1,120	18,922	22,255	2,131	20,124
Commercial papers	1,705	1,705	–	2,287	2,287	–
Bank debt	3,135	443	2,692	5,096	2,083	3,013
Financial liabilities payable to affiliates	128	123	5	359	348	11
Financial liabilities payable to investments accounted for using the equity method and other investments	114	70	44	135	110	25
Other financial liabilities	2,259	1,434	825	1,658	686	972
Financial liabilities	**27,383**	**4,895**	**22,488**	**31,790**	**7,645**	**24,145**
Trade accounts payable	4,751	4,751	–	5,061	5,019	42
Prepayments received	313	313	–	563	563	–
Drafts payable	2	2	–	6	6	–
Accounts payable to affiliates	62	62	–	126	126	–
Accounts payable to investments accounted for using the equity method and other investments	125	125	–	103	103	–
	5,253	**5,253**	**–**	**5,859**	**5,817**	**42**
Other liabilities						
Tax liabilities	648			872		
Social security liabilities	759			716		
Derivatives	3,753			3,211		
Miscellaneous other liabilities	1,323			1,613		
	6,483	**4,559**	**1,924**	**6,412**	**5,275**	**1,137**
	39,119	**14,707**	**24,412**	**44,061**	**18,737**	**25,324**

RT = remaining term.

Accounts payable to associates totaled €231 million.

€20,559 million (previous year: €23,100 million) of long-term financial liabilities were interest-bearing. Bank debt largely stems from former activities of acquired companies. Nominal interest depends on the currency, term and conditions of the agreement and is between 3 % and 11 % p.a. (previous year: between 3 % and 11 %).

In the fiscal year, financial liabilities decreased to €27,383 million. Changes in the scope of consolidation caused them to decrease by –€1,277 million.

Outstanding bonds relate to RWE AG, RWE Finance B.V., RWE Thames Water Plc and its subsidiaries, American Water Inc. and its subsidiaries, as well as to RWE Npower plc. Nominal interest is between 0 % and 8.375 % for public bonds (previous year: between 2.0 % and 8.375 %) and between 0.05 % and 10 % for private placements (previous year: between 0.2 % and 10.0 %), depending on currency, terms, and time of issue.

RWE Finance B.V. bought back €1,143 million of the 5.5 % bond which expires in 2007 (original issue volume: €2,500 million) as well as €718 million of the 5.375 % bond which expires in 2008 (original issue volume: €2,000 million) in exchange for cash or new bonds. Of the total, €1,250 million of the bonds were bought back for cash. A new €650 million ten-year bond was issued with a 4.625 % coupon.

A three-year, €200 million exchangeable bond on HOCHTIEF shares (coupon: 0.875 %) was issued as part of the sale of the investment in HOCHTIEF. An interest-free exchangeable bond on Heidelberger Druckmaschinen shares was issued in connection with the divestment of Heidelberger Druckmaschinen. It has an issue volume of €460 million and expires in three years.

The following is a breakdown of our major bonds as of December 31, 2004:

Issuer	Issue volume	Carrying amount	Coupon in %	Maturity
RWE AG	€600 million	€600 million	Variable	May 2005
RWE AG	€350 million	€350 million	Variable	June 2005
RWE AG	£100 million	€142 million	5.5	December 2005
RWE AG	€150 million	€150 million	4.75	January 2007
RWE AG	€200 million	€190 million	0.875	April 2007
RWE AG	€460 million	€422 million	0.0	June 2007
RWE AG	€100 million	€100 million	5.63	June 2009
RWE AG	€100 million	€100 million	Variable	November 2017
RWE AG	€750 million	€741 million	5.75	February 2033
RWE Finance B.V.	£350 million	€497 million	5.75	April 2006
RWE Finance B.V.	€1,357 million	€1,350 million	5.5	October 2007
RWE Finance B.V.	€1,282 million	€1,277 million	5.375	April 2008
RWE Finance B.V.	CHF 500 million	€304 million	2.0	December 2008
RWE Finance B.V.	£500 million	€709 million	4.625	August 2010
RWE Finance B.V.	€2,200 million	€2,257 million	6.125	October 2012
RWE Finance B.V.	£750 million	€1,057 million	6.375	June 2013
RWE Finance B.V.	€650 million	€661 million	4.625	July 2014
RWE Finance B.V.	€850 million	€855 million	6.25	April 2016
RWE Finance B.V.	€1,200 million	€1,071 million	5.125	July 2018
RWE Finance B.V.	£650 million	€926 million	6.5	April 2021
RWE Finance B.V.	£600 million	€847 million	5.625	December 2023
RWE Finance B.V.	£950 million	€1,341 million	6.25	June 2030
Thames Water Utilities Finance Plc.	£175 million	€248 million	3.375	July 2021
Thames Water Utilities Finance Plc.	£330 million	€468 million	6.75	November 2028
Thames Water Utilities Finance Plc.	£200 million	€284 million	6.5	February 2032
RWE Npower plc	£131 million	€177 million	8.375	August 2006
Pennsylvania – American Water Company	US$ 150 million	€110 million	7.8	September 2026
Other (incl. other notes payable)	Various	€2,808 million	Various	2005 until 2038
Bonds (incl. other notes payable)		**€20,042 million**		

As of December 31, 2004, the bonds (including other notes payable) had a fair value of €22,419 million (previous year: €23,008 million). The fair value of other financial liabilities basically corresponds to the disclosed carrying amounts.

Euro and US dollar commercial papers were issued on the European and US capital markets throughout the reporting period. They had a countervalue of between €1.7 billion and €2.5 billion (previous year: between €2.0 billion and €4.5 billion). The interest rates were in line with interbank levels. Commercial papers in our books as of the cut-off date totaled €1,705 million (previous year: €2,287 million).

Other financial liabilities primarily consist of finance lease obligations. Lease agreements principally relate to capital goods in the electricity and water business.

Minimum lease payments for liabilities arising from finance lease agreements have the following maturities:

Finance leases	**12/31/04**			**12/31/03**		
€million	**Nominal value**	**Discount**	**Present value**	**Nominal value**	**Discount**	**Present value**
Due within 1 year	66	5	61	74	3	71
Due within 1–5 years	303	66	237	295	63	232
Due after 5 years	475	179	296	517	198	319
	844	**250**	**594**	**886**	**264**	**622**

Tax liabilities also contain taxes that group companies have to pay on behalf of third parties. The principal component of other social security liabilities are the amounts payable to social security institutions.

Due to changes in the scope of consolidation, total liabilities declined by €1,877 million. In the case of individual customer-specific construction contracts, there is a balance on the liabilities side of €60 million (previous year: €3 million).

€260 million (previous year: €232 million) of the liabilities are secured by mortgages, and €109 million (previous year: €109 million) by similar rights.

(20) Deferred income

€ million	12/31/04	12/31/03
Advances and contributions in aid of construction and building connection	3,405	3,016
Grants related to non-current assets		
Taxable	33	39
Non-taxable	188	139
Other	544	625
	4,170	**3,819**

Of the total amount of deferred income, €1,613 million (previous year: €2,078 million) are recognized as income after one year.

(21) Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to the shares by the average number of shares. The figure may become diluted by so-called potential shares (above all share options and convertible bonds). When determining diluted earnings per share, stock options issued by RWE as part of the stock option programs are taken into account if they have a diluting effect. The same earnings per share are attributed to both common and preferred shares.

		2004	2003
Net income	€ million	2,137	953
Number of shares outstanding (weighted average)	thousands	562,364	562,322
Earnings per share			
Basic	€	3.80	1.69*
Diluted	€	3.80	1.69*
Dividend per share for RWE AG's 2003 fiscal year	€		1.25
Proposed dividend per share for RWE AG's 2004 fiscal year	€	**1.50**	

* Including goodwill amortization.

(22) Reporting on financial instruments

Financial instruments include non-derivative and derivative financial instruments.

Non-derivative financial assets essentially include non-current financial assets, accounts receivable, securities and cash and cash equivalents. Financial assets available for sale are measured at fair value. Other financial assets are measured at amortized cost. Fair values are derived from their stock-market quotations or are measured on the basis of generally accepted valuation methods. On the liabilities side, non-derivative financial instruments principally include liabilities stated at cost. The balance of non-derivative financial instruments is disclosed in the balance sheet, and the amount of financial assets represents the maximum default risk. If default risks associated with financial assets are identified, they are recognized through allowances.

The RWE Group is a utility enterprise with international operations. Therefore, it is exposed to currency, commodity and interest rate risks in its ordinary business activity. It is the RWE Group's policy to limit such risks via systematic risk management. These risks are thus mitigated through hedges, among other things. Derivative financial instruments are used to hedge the following risks: currency, commodity and interest rate risks from operations as well as from cash investments and financing transactions. The instruments most commonly used are foreign exchange forwards, foreign exchange options, interest rate currency swaps, commodity forwards, commodity options, commodity swaps as well as interest rate swaps.

Our group companies are subjected to stringent risk management. Binding internal directives define the range of action, responsibilities and controls. Accordingly, as a rule, derivative financial instruments may not be used for speculative purposes; they serve only to hedge risks arising from operations. General risk management guidelines have been established for commodities. They stipulate that commodity derivatives may be used to hedge price risks, optimize power plant schedules, and increase margins. Furthermore, commodity derivatives may also be traded, subject to strict limits. The limits are defined by independent organizational units and monitored on a daily basis.

Credit risks associated with contractual parties are systematically reviewed on conclusion of the contract and constantly monitored. Furthermore, credit risk is reduced through appropriate forms of collateralizing.

Hedge accounting pursuant to IAS 39 is applied primarily for hedges of net investments in foreign entities as well as for hedges of foreign-currency liabilities and interest rate risks from long-term liabilities.

Fair value hedges
Fair value hedges exist especially to hedge fixed-interest loans and liabilities against market price risks. Instruments used are interest rate swaps and interest rate currency swaps. In the case of fair value hedges, both the derivative as well as the underlying transaction regarding the hedged risk are measured at fair value with an effect on net income.

Cash flow hedges
Cash flow hedges exist primarily to hedge variable-interest loans and liabilities against interest rate risks as well as against foreign currency and price risks from future sales and purchase transactions. Changes in the fair value of hedges used are disclosed as part of equity under other comprehensive income until the underlying transaction is realized. The hedge's contribution to income is transferred from other comprehensive income to the income statement when the underlying transaction is realized.

Hedge of a net investment in a foreign entity
RWE hedges a significant portion of hedges of net investments in foreign entities using bonds with various terms in the appropriate currency as well as with interest rate currency swaps. Every hedge is assigned to an underlying transaction. Currency risks from bonds used for hedging purposes and changes in the fair value of interest rate currency swaps used for hedging purposes are subsumed under the currency translation adjustment disclosed under other comprehensive income.

When interpreting the positive and negative fair values of derivative financial instruments, with the exception of the relatively low commodity trading volumes, it must be taken into account that they are matched by underlying transactions with offsetting risks. All derivative financial instruments are recognized as assets or liabilities. They are stated at fair value regardless of their purpose.

Maturities of derivative interest rate, currency, share price-related or index-related and commodity transactions are based on the maturities of underlying transactions and are thus primarily short-term and medium-term in nature. Maturities of up to 30 years can be agreed upon to hedge foreign currency risks of foreign investments.

The nominal volume of the derivatives outlined below is specified without being offset. It represents the total of all purchase and sales amounts on which the derivatives are based. The level of the nominal volume enables estimates regarding the scope of the use of derivatives, but does not reflect the risk the group is exposed to from the use of derivatives.

We use the value-at-risk method to quantify the interest rate, currency and stock price risks for financial instruments in line with the international banking standard. The maximum expected loss arising from changes in market prices is calculated and continuously checked on the basis of historical market price volatility, a confidence level of 99 %, and a holding period of one day.

Currency risks may exist for financial assets and liabilities in foreign currency. Such risks are counteracted by derivative financial instruments.

Interest rate derivatives used to hedge interest rate risks are nearly exclusively interest rate swaps.

Commodity derivatives are primarily used to hedge electricity, coal, gas and oil prices and margins.

The following derivative transactions were concluded:

	Nominal volume		Remaining term > 1 year		Fair value		Value at risk
€ million	12/31/04	12/31/03	12/31/04	12/31/03	12/31/04	12/31/03	12/31/04
Foreign currency derivatives							
Foreign exchange forwards	4,908	3,304	930	656	–96,1	3.2	38.5
Foreign exchange options	865	611	26	99	–28,6	41.9	2.2
Interest rate currency swaps	16,036	15,940	9,744	10,145	2,023,7	1,266.0	110.6
	21,809	19,855	**10,700**	10,900	**1,899,0**	1,311.1	107.7
Interest rate derivatives	5,134	4,457	4,861	3,415	12,4	–170.4	5.0
Share-price related/index-related derivatives	1,037	191	1,037	191	78,4	67.1	4.2
	27,980	**24,503**	**16,598**	**14,506**	**1,989,8**	**1,207.8**	
Commodity derivatives							
Commodity options	3,274	3,420	1,159	2,277	–19,4	–89.2	
Commodity swaps	5,961	8,202	1,054	1,445	–79,6	154.8	
Energy forwards	16,918	18,232	2,697	4,637	222,9	133.4	
Other commodity derivatives	95	33	67	23	70,2	30.5	
	26,248	**29,887**	**4,977**	**8,382**	**194,1**	**229.5**	
	54,228	**54,390**	**21,575**	**22,888**	**2,183,9**	**1,437.3**	

Derivatives are exposed to default risks equivalent to their positive fair values. These risks are minimized by the high demands on our counterparties' creditworthiness. Default risk exposure was negligible in the fiscal year under review and in the previous fiscal year. Market risks, i.e. risks which result from the fact that the value of a derivative financial instrument changes due to market fluctuations are generally not relevant for assessing the group's net worth, financial or earnings position, due to their hedging purpose.

As a rule, RWE AG centrally handles the refinancing of cash and capital market liabilities that come due. In addition to the extension of current money market programs and short-term debt, some €1.2 billion in capital market debt and €0.1 billion in bank debt will come due in 2005. Capital is generally provided in the form of cash and cash equivalents, current securities totaling €12.5 billion, bilateral bank credit lines and a fully committed syndicated credit line of €4.0 billion, as well as €2.0 billion/US$ 2.7 billion in unused funds from a US$ 5.0 billion global commercial paper program and €2.8 billion in unused funds from a €20 billion debt issuance program. This makes the liquidity risk very low.

(23) Contingent liabilities and financial commitments

€ million	12/31/04	12/31/03
Contingent liabilities resulting from the issue and negotiation of drafts	–	1
Contingent liabilities resulting from general, draft and check guarantees	598	916
Contingent liabilities from warranties	122	1,245
Contingent liabilities from granting collateral for third-party liabilities	145	113
	865	**2,275**

The group had € 718 million in capital commitments (previous year: € 345 million). Moreover, as of December 31, 2004, assurances as regards acquisitions of investments existed in the amount of € 501 million (previous year: € 452 million).

Furthermore, an agreement was reached in accordance with the shareholders' agreement of December 22, 2003 to purchase outstanding shares in RWE Westfalen-Weser-Ems AG, which will be granted to former shareholders of RWE Gas AG in connection with the splitting of RWE Gas AG for € 800 million effective December 31, 2008.The municipal shareholders of Chemnitz-based envia Mitteldeutsche Energie AG have put options on their shares in this company. The financial liability that would arise if they exercised all of the put options totals €780 million.

RAG AG was granted a € 400 million credit line at fair market conditions.

As a rule, under certain conditions, capital commitments vis-à-vis co-shareholders may arise in connection with existing investments. This was not the case in the fiscal year (previous year: € 10 million).

Commitments from operate leases largely refer to long-term rental agreements for power generation and supply plants as well as rent and lease obligations for storage and administration buildings.

Minimum lease payments fall due as follows:

Operate leases € million	**Nominal value 12/31/2004**	**Nominal value 12/31/2003**
Due within 1 year	81	204
Due within 1 – 5 years	252	613
Due after 5 years	314	785
	647	**1,602**

Payment obligations for non-current financial assets amounted to € 61 million (previous year: € 133 million). As in the previous year, there was no joint liability for third-party payment obligations under Sec. 24 of the German Limited Liability Companies Act.

Long-term purchase and service agreements for uranium conversion, enrichment, production and waste management exist in the RWE Power Division. We bear customary commercial liability for long-term contracts in the plant construction business.

We shoulder the legal and contractual liability from our membership in various associations which exist in connection with power plant projects, profit- and loss-pooling agreements, and for the provision of liability cover for nuclear risks, among others.

By signing a mutual benefit agreement, RWE AG and other parent companies of German nuclear power plant operators undertook to provide € 2,244.4 million in funding to liable nuclear power plant operators to ensure that they are able to meet their payment obligations in the event of nuclear damages. RWE AG has a 24.834 % contractual share in the liability, plus 5 % for damage settlement costs.

RWE Group companies are involved in litigation connected with their operations. However, RWE does not expect any major negative repercussions from these litigations on the RWE Group's economic or financial position. Additionally, companies belonging to the RWE Energy Division are directly involved in various administrative and regulatory procedures (including approval procedures) or are directly affected by the results of such procedures.

Minority shareholders initiated several legal proceedings to examine the appropriateness of the conversion ratios and the amount of cash paid in compensation in connection with company restructurings pursuant to German company law. RWE AG is convinced that the conversion ratios and cash compensation calculated on the basis of expert opinions and by independent auditing firms are adequate.

(24) Segment reporting

In the RWE Group, segments are distinguished on the basis of the services provided by the group's divisions. The segmentation of divisions and geographical regions is based on the management reporting system.

RWE Power is the segment comprising the entire Continental European power generation business as well as the group's lignite, gas and petroleum production business. This also includes the activities of the Harpen Group, which specializes in renewables-based and distributed power generation, and the upstream operations of RWE Dea.

RWE Energy is the segment comprising distribution, transmission and sales for the Continental European electricity and gas businesses as well as the Continental European water business. RWE Solutions is also subsumed under RWE Energy.

RWE npower is the segment dedicated to the UK energy business.

RWE Trading is the segment that handles the group's trading operations.

RWE Thames Water is the segment that comprises the group's water operations primarily outside Continental Europe. The US-based water utility American Water is also reported as part of this segment.

Discontinuing operations include the activities of RWE Umwelt, which constituted their own segment in 2003, as well as the operations of Heidelberger Druckmaschinen, which were stated as part of our financial investments in 2003.

Consolidation effects, the Group Center and other activities not allocable to the divisions presented separately are disclosed under "Other/Group Center/consolidation". This primarily includes the general services provided by RWE Systems.

Segment reporting

Divisions	RWE Power		RWE Energy		RWE npower	
€ million	2004	2003	2004	2003	2004	2003
External revenue	**2,919**	**4,077**	**22,450**	**21,842**	**5,605**	**5,552**
Internal revenue	5,668	5,173	706	555	0	89
Total revenue	8,587	9,250	23,156	22,397	5,605	5,641
Operating result	**1,742**	**1,682**	**2,192**	**2,046**	**604**	**714**
Income from operating activities = segment result	2,493	3,305	1,978	1,405	261	126
Income from operating investments	72	63	239	153	–1	1
Income from associates accounted for using the equity method	39	–15	193	33	–1	1
Depreciation and amortization	758	1,022	946	1,070	423	538
Operating depreciation and amortization	790	1,012	974	857	93	137
Goodwill amortization and impairment losses	0	65	0	232	0	254
Impairment losses	73	67	50	47	0	104
Other major non-cash expenses relating to the segment result	644	656	1,946	2,068	85	209
EBITDA	**2,460**	**2,631**	**2,927**	**2,750**	**698**	**850**
Capital employed (as per the value management concept)	7,565	10,176	12,668	12,409	7,045	7,559
Carrying amount of shares in equity companies	198	291	1,863	1,915	0	20
Segment assets	9,853	10,703	18,957	17,871	10,027	13,661
Segment liabilities	16,764	17,281	12,948	12,757	2,204	5,309
Capital expenditure on intangible assets and property, plant and equipment	662	1,065	947	1,000	150	215

Region	Germany		Rest of Europe		Americas	
€ million	2004	2003	2004	2003	2004	2003
External revenue	23,101	22,444	15,432	15,178	2,605	4,603
Segment assets	27,834	30,284	34,030	35,102	10,592	12,079
Capital expenditure on intangible assets and property, plant and equipment	1,405	1,787	1,458	1,712	529	794

RWE Trading		RWE Thames Water		Discontinuing operations		Other/Group Center/ consolidation		Group	
2004	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**
3,822	**2,444**	**4,065**	**4,249**	**3,189**	**5,602**	**87**	**109**	**42,137**	**43,875**
5,057	3,307	0	0	23	37	–11,454	–9,161	0	0
8,879	5,751	4,065	4,249	3,212	5,639	–11,367	–9,052	42,137	43,875
104	**59**	**1,389**	**1,374**	**110**	**–42**	**–165**	**–282**	**5,976**	**5,551**
67	4	1,063	863	–200	–834	–88	–168	5,574	4,701
–3	4	114	65	1	–67	–10	–14	412	205
2	1	91	40	–24	–68	–2	14	298	6
4	6	704	1,069	209	422	81	79	3,125	4,206
4	4	704	709	177	325	94	86	2,836	3,130
0	2	200	360	292	71	0	1	492	985
0	0	200	0	304	47	13	40	640	305
91	60	171	272	331	1,287	472	879	3,740	5,431
111	**59**	**1,979**	**2,018**	**286**	**350**	**–61**	**–182**	**8,400**	**8,476**
575	–8	19,723	21,076	2,242	4,720	–2,899	–1,971	46,919	53,961
8	7	302	276	260	363	34	802	2,665	3,674
7,118	2,639	24,145	25,335	1,757	6,194	1,204	1,800	73,061	78,203
5,844	2,258	3,348	3,701	869	3,249	6,283	6,433	48,260	50,988
4	3	1,465	1,549	161	299	40	231	3,429	4,362

Asia		Australia		Africa		Group	
2004	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**
618	1,243	177	120	204	287	42,137	43,875
580	600	25	118	0	20	73,061	78,203
37	67	0	2	0	0	3,429	4,362

Notes on segment data
Internal revenue reflects the level of revenue between segments. It is priced at arm’s length. The segment revenue is the sum of external and inter-segment revenue.

Depreciation and amortization concern intangible assets and property, plant and equipment.

The definition of capital employed is derived from the value management concept. These figures are compatible with the operating result, which is also used for control purposes within the group (cf. page 186 et seqq). In addition to capital employed, the divisions’ segment assets and liabilities are also disclosed. The following is a reconciliation of segment assets and segment liabilities to gross assets and gross liabilities:

€ million	12/31/04	12/31/03
Gross assets (as per the balance sheet)	93,370	99,142
Non-current financial assets	–5,887	–6,778
Current marketable securities	–11,013	–9,615
Financial accounts receivable	–166	–221
Deferred tax assets	–3,243	–4,325
Segment assets	**73,061**	**78,203**

€ million	12/31/04	12/31/03
Gross liabilities (as per the balance sheet)	82,177	90,077
Tax provisions	–2,400	–2,773
Financial liabilities	–27,383	–31,790
Deferred tax liabilities	–4,134	–4,526
Segment liabilities	**48,260**	**50,988**

Capital expenditure includes capital expenditure on intangible assets and property, plant and equipment.

Income from associates accounted for using the equity method covers income and expenses from profit- and loss-pooling agreements, investments, and amortization and impairment losses on goodwill as well as on shares in companies accounted for using the equity method.

Operating result

€million	2004	2003
Income from operating activities	5,574	4,701
+ Income from investments	846	300
– Non-operating result	444	–550
Operating result	**5,976**	**5,551**

The reconciliation addresses the following points:
Income from investments includes all expenses and income that have arisen in connection with operating investments. Income from investments thus constitutes an integral part of the group's operating activity.

Income and expenses that are unusual from a business perspective, or are the result of exceptional events, prejudice the assessment of ongoing operating activities. They are reclassified as part of the non-operating result. The amortization of goodwill has been abolished as part of the new rules for accounting for business combinations. Accordingly, the non-operating result no longer needs to be adjusted for goodwill amortization. Discontinuing goodwill amortization caused the non-operating result to increase by €985 million. The discontinuation of goodwill amortization caused the operating result of investments accounted for using the equity method to rise by €125 million. In cases where an impairment loss is recognized, it is included in the non-operating result. Goodwill impairment losses caused by the divestment of the environmental services business resulted in the non-operating result for the period under review declining by €292 million. A decrease of an additional €200 million stemmed from negative changes in the economic environment of parts of RWE Thames Water's international water business. Furthermore, in fiscal 2003, the release of negative goodwill was disclosed as part of the non-operating result.

In the year under review, the group's income from operating activities and income from investments were adjusted by the non-operating result of €444 million (previous year: –€550 million).

Gains on disposals included in the non-operating result in the year under review amount to €678 million and principally relate to the divestment of Heidelberger Druckmaschinen, Motor-Columbus/Atel, the remaining stake in CONSOL and of the investment in HOCHTIEF. Capital gains in the previous year amounted to €1,024 million and primarily related to the disposal of shares in CONSOL and the 40% stake in Stadtwerke Leipzig.

(25) Notes to the cash flow statement

The cash flow statement classifies cash flows according to operating, investing and financing activities. Cash and cash equivalents in the cash flow statement correspond to total cash and cash equivalents on the balance sheet. Cash and cash equivalents consist of cash on hand, demand deposits, and fixed-interest marketable securities with a maturity of three months or less from the date of acquisition.

Cash flows from the acquisition and sale of consolidated companies are included in cash flows from investing activities. Effects of foreign exchange rate changes are stated separately.

Cash flows from operating activities include, inter alia:

- Cash flows from interest income of € 1,108 million (previous year: € 1,023 million) and cash flows used for interest expenses of € 2,257 million (previous year: € 2,249 million).
- € 1,050 million in taxes on income paid minus refunds (previous year: € 755 million).
- Cash flows from investments (dividends) of € 346 million (previous year: € 339 million), net of the portion stemming from accounting using the equity method that does not have an effect on cash flows.

Cash flows from financing activities include € 703 million (previous year: € 619 million) which were paid out to RWE shareholders, and € 236 million (previous year: € 276 million) which were distributed among minority shareholders. Newly assumed financial debt totaled € 2,087 million (previous year: € 8,498 million) and was contrasted by repayments of € 5,114 million (previous year: € 5,964 million).

Changes in the scope of consolidation resulted in a net change in cash and cash equivalents of –€ 128 million (previous year: –€ 22 million).

No cash and cash equivalents (previous year: € 27 million) stemming from acquisitions are offset against capital expenditure on financial assets. Divested cash and cash equivalents of € 128 million (previous year: € 49 million) are included in income from divestments.

Changes in the scope of consolidation of major first-time consolidations and deconsolidations resulted in a decrease in net financial debt of € 0.9 billion (previous year: increase of € 3.4 billion).

There are no restrictions on the disposal of cash and cash equivalents.

The table below shows the group's net financial debt.

€ million	12/31/04	12/31/03
Cash and cash equivalents	1,526	2,181
Current marketable securities	11,013	9,615
Non-current marketable securities and other loans	1,339	1,037
Other financial assets	1,120	1,119
Financial assets	**14,998**	**13,952**
Bonds, other notes payable and bank debt	23,177	27,351
Commercial papers	1,705	2,287
Other financial debt	2,501	2,152
Financial liabilities	**27,383**	**31,790**
Net financial debt	**12,385**	**17,838**

Other financial debt includes financial liabilities to affiliates, investments accounted for using the equity method and other investments as well as other financial liabilities.

Net financial debt is the difference between financial assets and financial liabilities.

(26) Related party disclosures

Allianz AG is RWE's material related party. The stake in RWE AG held by Münchener Rückversicherungs-Gesellschaft AG was reduced in fiscal 2004. As a result, this company ceased to be a related party.

RWE AG/RWE Veolia Berlinwasser Beteiligungs AG, which is a major associate, is also a related party that is of special importance. In the 2004 fiscal year, business transactions concluded with major related parties led to the following items in the financial statements:

	Berlinwasser Group		Allianz Group	
€ million	2004	2003	2004	2003
Revenue	0	1	2	2
Supplies and services received	0	4	17	19
Receivables	1	5	2	4
Payables	0	–	0	84

Services procured from the Allianz Group were primarily insurance services.

Receivables from the Allianz Group were primarily bank balances on Dresdner Bank accounts. Payables to the Allianz Group were primarily financial liabilities to Dresdner Bank.

Furthermore, €708 million in loans have been granted to the Berlinwasser Group (previous year: €653 million).

All business transactions were completed at arm's length prices.

Furthermore, the RWE Energy Division includes investments in municipal enterprises accounted for using the equity method—especially in municipal utilities. Supplies and services delivered to these companies, some of which attained considerable orders of magnitude, were subject to arm's length conditions, which on principle do not differ from those applied to supplies and services provided to other municipal enterprises in which no share investments are held.

No material business transactions were concluded between the RWE Group and related persons.

(27) Information on concessions

A number of concession agreements have been entered into in the fields of electricity, gas and water by RWE Group companies and governmental authorities.

Electricity concession agreements regulate the usage of public roads, ways and sites for the laying and operation of utility lines as well as for electric plants and equipment for the supply of electric power. In municipal regions, there is a general obligation to provide network connections and supply electricity to everyone. Electricity concession agreements are generally limited to a term of 20 years. There is an obligation to construct and maintain necessary plants during the terms of the concession agreements. When the concession agreements expire, there is a legal obligation to transfer ownership of the local electricity distribution facilities in exchange for cash or another form of compensation.

Water concession agreements contain provisions for the right and obligation to provide water and wastewater services, operate the associated infrastructure such as water utility plants as well as to implement capital expenditure. Concessions in the water business generally have terms of up to 50 years.

Gas concession agreements contain provisions for the usage of public roadways for the direct supply of gas to end consumers as well as for the construction and maintenance of gas utility plants. There are also statutory connection obligations. In the gas business, concession agreements generally have terms of 20 years. When the concession agreements expire, there is a legal obligation to transfer ownership of the network in exchange for appropriate compensation.

(28) Special comments pursuant to Sec. 292a of the German Commercial Code

Deviating accounting policies
Accounting policies and consolidation methods applied in accordance with IFRS differ from those mandated by the German Commercial Code primarily as regards the following items:

- **Intangible assets**

IFRS stipulate the recognition of internally generated intangible non-current assets if the prerequisites of capitalization are met. Pursuant to the German Commercial Code, capitalization is not allowed.

In compliance with IFRS, the RWE Group stopped amortizing goodwill on January 1, 2004 in accordance with IFRS 3 in combination with IAS 36 (2004). Goodwill is now subjected to an impairment test once a year and whenever there is an indication of an impairment. According to the German Commercial Code, goodwill must be capitalized and amortized or offset against retained earnings.

- **Non-current and current marketable securities**

According to IFRS, marketable securities classified as “available for sale” must be measured at fair value. The RWE Group discloses changes in fair values without an effect on net income as part of other comprehensive income. Once realized, the change in fair value is excluded from other comprehensive income with an effect on net income. According to the German Commercial Code, marketable securities are measured at amortized cost.

■ **Derivative financial instruments**
Derivative financial instruments that are not used for hedging purposes must be marked to market with an effect on net income pursuant to IFRS. In accordance with the German Commercial Code, derivative financial instruments that are not used for hedging purposes are to be valued based on the imparity principle. IFRS criteria for hedge accounting and related items deviate from those of the German Commercial Code.

■ **Inventories**
Unlike under the German Commercial Code, according to IFRS, lower valuations may on principle only take the sales market into consideration.

■ **Customer-specific construction contracts**
Under IFRS, gains should be recognized pro-rata by reference to the percentage of completion method. As a rule, under the German Commercial Code, gains on construction contracts may only be realized once the entire contract has been completed and accepted.

■ **Deferred taxes**
Pursuant to IFRS, deferred taxes must be determined for all temporary differences between the tax bases in accordance with tax laws and the carrying amounts in the consolidated balance sheet in accordance with financial reporting rules. Unlike under the German Commercial Code, deferred taxes must be accrued for quasi-permanent differences and tax loss carryforwards. In accordance with the German Commercial Code, deferred taxes must be determined on all timing differences between the recognition of income in the financial statements for financial reporting purposes and their recognition in the tax computations using the so-called timing concept.

■ **Provisions for pensions and similar obligations**
According to IFRS, provisions for pensions are stated using the projected unit credit method. Increases of pension benefits expected in the future are considered in addition to benefits accumulated as of the balance-sheet date. Under the German Commercial Code, the measurement of provisions for pensions is exclusively determined by the conditions prevalent at the balance-sheet date. Future salary, wage and pension increases may not be taken into account.

■ **Other long-term provisions**
Under IFRS, provisions are recognized if the probability of the event is 50 % or higher. Provisions are recognized only in cases where there is an obligation to a third party. They are measured at their settlement amounts. Future events that may have an influence on the settlement amount of long-term provisions must be taken into account. Long-term provisions must be discounted at an interest rate in line with the terms of the provisions and adjusted to account for the associated risks.

Under the German Commercial Code, provisions may be recognized for expenses in exceptional cases where there is no obligation to a third party (they are then referred to as provisions for expenses). Provisions must be stated as would be deemed appropriate using reasonable commercial judgement as of the balance-sheet date. They may only be discounted insofar as the underlying liability has an interest component.

- **Capital consolidation**

Under IFRS 3, which has been applied by the RWE Group since January 1, 2004, business combinations are generally accounted for using the purchase method. Identifiable acquired assets, liabilities and contingent liabilities must be fully remeasured, regardless of cost or the minority interest.

Under the German Commercial Code, the pooling-of-interest-method can be used besides the purchase method. The purchase methods known as the "book value method" and the "revaluation method" are permissible under the German Commercial Code when measuring acquired assets and liabilities.

- **Foreign currency translation**

Under IFRS, monetary items in foreign currency are translated at the exchange rate valid as of the balance-sheet date. Translation differences are recognized with an effect on net income according to IFRS. Under the German Commercial Code, monetary items in foreign currency are measured at the lower or higher exchange rate as of the balance-sheet date according to the imparity principle.

Application of Sec. 264, § 3 and of Sec. 264b of the German Commercial Code

The following German subsidiaries made use of the exemption clause included in Sec. 264, § 3 and Sec. 264b of the German Commercial Code:

Berliner Licht- und Signaltechnik GmbH, Berlin
BGE Beteiligungs-Gesellschaft für Energieunternehmen mbH, Essen
Fahrleitungsbau GmbH, Essen
„Fundus" Wohnungsbau und Wohnungsverwaltung GmbH, Cologne
GBV Dreizehnte Gesellschaft für Beteiligungsverwaltung mbH & Co. KG, Essen
GBV Fünfte Gesellschaft für Beteiligungsverwaltung mbH, Essen
GBV Neunte Gesellschaft für Beteiligungsverwaltung mbH, Essen
GBV Siebte Gesellschaft für Beteiligungsverwaltung mbH, Essen
GIO Gesellschaft für Informationsverarbeitung und Organisationsberatung mbH, Dortmund
IDS Gesellschaft für Informations-, Datenübertragungs- und Steuerungssysteme mbH, Ettlingen
OIE Aktiengesellschaft, Idar-Oberstein
Rheinbraun Immobilien GmbH, Cologne
Rheinische Baustoffwerke GmbH, Bergheim
RWE Energy Aktiengesellschaft, Dortmund
RWE Kundenservice GmbH, Bochum
RWE Plus Beteiligungsgesellschaft Mitte mbH, Essen
RWE Plus Beteiligungsgesellschaft Zentrale mbH, Essen
RWE Power Aktiengesellschaft, Essen/Cologne
RWE Rhein-Ruhr Aktiengesellschaft, Essen
RWE Rhein-Ruhr Netzservice GmbH, Siegen
RWE Rhein-Ruhr Verteilnetz GmbH, Wesel
RWE Solutions Aktiengesellschaft, Neu-Isenburg
RWE Solutions Beteiligungsgesellschaft mbH, Alzenau
RWE Systems AG, Dortmund
RWE Systems Computing GmbH, Dortmund
RWE Systems Consulting GmbH, Essen
RWE Systems Development GmbH & Co. KG, Dortmund
RWE Systems Immobilien Alzenau GmbH, Alzenau
RWE Systems Immobilien GmbH u. Co. KG, Essen
RWE Trading GmbH, Essen
RWE Transportnetz Gas GmbH, Essen
RWE Transportnetz Strom GmbH, Dortmund
SAG Dandl GmbH, Boos
SAG Energieversorgungslösungen GmbH, Langen
SAG Montagegesellschaft mbH, Berlin
SAG Netz- und Energietechnik GmbH, Langen
Speicher Breitbrunn/Eggstätt RWE Dea & Mobil, Hamburg
Thames Water Aqua Holdings GmbH, Essen
Thames Water Aqua International GmbH, Essen
Thyssengas GmbH, Duisburg
Turbo-Service GmbH Rotating Equipment Solutions, Regensburg
Utag Umwelttechnik GmbH, Essen
VEW Immobiliengesellschaft Castrop-Rauxel mbH, Castrop-Rauxel

Additional information

Information on the members of the Executive Board and Supervisory Board pursuant to Section 285, No. 10 of the German Commercial Code is provided on pages 189 to 192.

Compensation model for the Executive and Supervisory Boards
Compensation of Executive Board members has a fixed and variable component (short-term compensation components). In the current fiscal year we changed the method for determining the variable component. In the future, total compensation will consist of a fixed component accounting for about 40 % and a variable component accounting for some 60 %. The variable component breaks down into a company bonus accounting for 70 % and an individual bonus accounting for 30 %. The company bonus is based equally on the figures budgeted for value added to the core business and free cash flow I for the fiscal year in question. The budgeted figure represents full achievement of the target. The company bonus can amount to a maximum of 150 %. The individual bonus is based on the performance targets agreed on at the beginning of the fiscal year. The maximum degree to which this target can be achieved is 120 %. Executive Board members may convert the variable compensation into a benefit commitment backed by reinsurance coverage.

In addition, members of the Executive Board receive a variable compensation component providing a long-term incentive in the form of stock appreciation rights (SARs) as part of the Long Term Incentive Plan (LTIP). This program replaced the stock option plan in 2002. For details on the old stock option plan and on the LTIP, please refer to the commentary on the equity (cf. pages 149 and 151).

Furthermore, the Executive Board members' compensation package includes pension commitments (direct commitments) and non-cash compensation. Non-cash compensation principally consists of sums reflecting the use of company cars according to German fiscal guidelines.

Criteria for determining compensation include the Executive Board's tasks and performance as well as the company's business situation, performance and prospects for the future.

The remuneration paid to members of the Executive Board for the year under review is as follows:

Executive Board compensation in 2004	Fixed compensation in 2004 €'000	Variable compensation in 2004 €'000	Options exercised from the ESOP/LTIP in 2004[1] €'000	Total in 2004 €'000	Retroactive variable compensation 2003 €'000	Stock option plan 2001–2001A tranche		LTIP 2002–2004 tranche	
						Quantity	Intrinsic value[2] on 12/31/04 €'000	Quantity	Intrinsic value[2] on 12/31/04 €'000
Roels	1,400	2,623	0	4,023	800	0	0	855,700	7,541
Bonekamp (since April 1, 2004)	375	692	636	1,703	0	80,000	0	237,200	1,611
Maichel	680	1,222	0	1,902	300	80,000	0	318,200	2,612
Sturany	1,000	1,510	954	3,464	600	120,000	0	490,800	4,097
Zilius	680	1,243	636	2,559	450	80,000	0	307,200	2,467
Total	**4,135**	**7,290**	**2,226**	**13,651**	**2,150**	**360,000**	**0**	**2,209,100**	**18,328**

1 In compliance with the directors dealings report; ESOP = executive stock option plan.

2 Some of the waiting periods have not yet expired. In some cases, the exercise hurdles have not yet been reached.

€1,425,000 of the Executive Board's compensation in fiscal 2004 was paid by subsidiaries for mandates exercised for them.

Non-cash emoluments paid to members of the Executive Board totaled € 195,000. Furthermore, Executive Board members received € 516,000 for the exercise of Supervisory Board mandates at subsidiaries. In accordance with their contracts, these payments will be credited to them in 2004 together with the variable component. € 459,000 in sums paid were credited in fiscal 2004.

In fiscal 2004, the Executive Board received €11,620,000 in short-term compensation components as well as €2,226,000 in long-term compensation components.

Pensions	**Age**	**Expected annual pension benefit at 60*** Thousands
Roels	56	400
Bonekamp (since April 1, 2004)	54	324
Maichel	55	337
Sturany	58	279
Zilius	58	302

* Based on compensation qualifying for pension as of December 31, 2004.

The service cost of pension commitments in the fiscal year totaled € 1,962,000. As of December 31, 2004, the present value of the defined benefit obligation was € 18,088,000.

Former members of the Executive Board and their surviving dependants received € 13,582,000, of which € 2,881,000 came from subsidiaries. This includes € 75,000 in compensation for mandates exercised at subsidiaries as well as € 1,360,000 from the exercise of options from the AOP-F and LTIP programs, which must be disclosed in the directors dealing report since the individuals are members of the Supervisory Board. € 111,116,000 have been accrued for defined benefit obligations to former members of the Executive Board and their surviving dependants, of which € 23,452,000 were set aside at subsidiaries.

As of the balance-sheet date, due to their participation in RWE AG's stock option plan, former members of the Executive Board held 320,000 non-transferable options on RWE AG common shares. They also held 137,500 SARs from the long term incentive plan.

The compensation of the Supervisory Board is set forth in the bylaws and is determined by the Annual General Meeting. Supervisory Board members receive a fixed compensation of € 40,000 for their services at the end of each fiscal year. The compensation increases by € 225 for every € 0.01 by which the dividend exceeds € 0.10 per common share. The Chairman of the Supervisory Board receives three times the aforementioned sums paid to ordinary members, and his deputy receives twice these amounts. If a committee has been active at least once in a fiscal year, the committee chairman receives twice the aforementioned sums, and committee members receive one-and-a-half times the aforementioned sums. If a member of the Supervisory Board holds several offices concurrently, he or she only receives compensation for the highest-paid position. Out-of-pocket expenses are refunded. Furthermore, some members of the Supervisory Board received compensation for mandates exercised at subsidiaries.

Compensation paid to the Supervisory Board breaks down as follows:

Supervisory Board compensation in 2004 €'000	Fixed compensation	Variable compensation	Total
Dr. Fischer (as of 11/9/04)	11	9	20
Dr. Neuber (deceased)	97	77	174
Dr. Achleitner	60	47	107
Bsirske	80	63	143
Donisch (as of 8/16/04)	15	12	27
Drescher	60	47	107
Hiltenkamp	60	47	107
Holl	60	47	107
Huber	40	32	72
Dr. Kuhnt	60	47	107
Dr. Langemeyer	60	47	107
Pitz (until 5/11/04)	22	17	39
Dr. Reiniger	40	32	72
Reppien	60	47	107
Dr. Schneider	60	47	107
Südhofer	60	47	107
Tigges	46	36	82
Prof. Van Miert	40	32	72
von Boehm-Bezing	80	63	143
von Rothkirch	40	32	72
Wefers (as of 1/1/04)	40	32	72
Winkel	60	47	107
Total	**1,151**	**907**	**2,058**

Additionally, Supervisory Board members were paid a fixed €262,000 for the exercise of Supervisory Board mandates at subsidiaries in fiscal 2004.

No lines of credit or advances were paid to Executive Board members in the year under review. €8,000 in interest-free employee loans complying with applicable guidelines to employee representatives on the Supervisory Board were outstanding as of December 31, 2004. In the fiscal year, €4,000 were repaid on schedule.

The Economic Advisory Board was paid €565,000 of which €53,000 came from subsidiaries.

Declarations regarding the German Corporate Governance Code required to comply with Sec. 161 of the German Stock Corporation Act relating to RWE AG and its listed German subsidiaries have been issued and made available to shareholders.

Event after the balance-sheet date

RWE Thames Water saw no need to refer to the competition commission the Final Determination established by the Office of Water Services (OFWAT) for the next five-year regulatory period.

More detailed information on this event is presented on page 63 in the review of operations.

This report contains individual forward-looking statements concerning the future course of business such as forecasts on the development of the economic and political environment as well as on our own business. These statements are based on carefully made assumptions on our part. However, due to remaining risks and uncertainties, we cannot guarantee that they will turn out to be correct in part or in their entirety.

Auditors’ report

We have audited the consolidated financial statements of RWE Aktiengesellschaft, consisting of the income statement, the balance sheet, the cash flow statement, the statement of changes in equity as well as the notes to the financial statements for the fiscal year from January 1 to December 31, 2004. The preparation and the content of the consolidated financial statements according to the International Financial Reporting Standards of the IASB (IFRS) are the responsibility of the company’s Executive Board. Our responsibility is to express an opinion, based on our audit, on whether the consolidated financial statements are in accordance with IFRS.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (IDW), and additionally observed the International Standards on Auditing (ISA). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatements. Knowledge of the business activities and the economic and legal environment of the company and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements are examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Executive Board, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the RWE Group for the fiscal year in accordance with IFRS.

Our audit, which according to German auditing regulations, also extends to the combined review of operations of the company and the group prepared by the Executive Board for the fiscal year from January 1 to December 31, 2004, has not led to any reservations. In our opinion, on the whole, the combined review of operations, together with the other information in the consolidated financial statements, provides a suitable understanding of the group’s position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the combined review of operations for the fiscal year from January 1 to December 31, 2004 satisfy the conditions required for the company’s exemption from its duty to prepare consolidated financial statements and the group review of operations in accordance with German accounting law.

Essen, Germany, February 16, 2005

PwC Deutsche Revision
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

P. Albrecht Wirtschaftsprüfer (German Certified Public Auditor)	Dr. N. Schwieters Wirtschaftsprüfer (German Certified Public Auditor)

Material Investments as of December 31, 2004

I. Affiliates	Investment in acc. with Sec. 16 of the German Stock Corpo-ration Act %	Equity of the last fiscal year €'000	Net income/ loss of the last fiscal year €'000	External revenue 2004 FY € million	Employees[1] 2004 FY average
RWE Aktiengesellschaft, Essen		**4,980,361**	**1,243,605**	**–**	**331**
RWE Power					
RWE Power Aktiengesellschaft, Essen and Cologne	100	2,116,974	–[2]	6,173	12,883
Harpen Aktiengesellschaft, Dortmund	95	207,280	17,083	67	133
Kernkraftwerke Lippe-Ems GmbH, Lingen (Ems)	99	165,545	–[2]	251	291
Kernkraftwerk Gundremmingen GmbH, Gundremmingen	75	79,619	3,200	149	684
Mátrai Erömü Rt. (MÁTRA), Visonta/Hungary	51	176,711	30,063	198	2,682
RWE Dea AG, Hamburg	100	1,323,905	–[2]	706	719
RWE Energy					
RWE Energy Aktiengesellschaft, Dortmund	100	970,867	–[2]	6,124	497
Budapesti Elektromos Müvek Rt. (ELMÜ), Budapest/Hungary	55	344,770	69,434	743	1,911
Emscher Lippe Energie GmbH, Gelsenkirchen	79	90,440	20,894	366	666
envia Mitteldeutsche Energie AG, Chemnitz	64	915,799	99,208	2,200	2,630
Észak-magyarországi Áramszolgáltató Rt. (ÉMÁSZ), Miskolc/Hungary	54	137,807	11,809	293	1,155
EWV Energie- und Wasser-Versorgung GmbH, Stolberg	54	39,366	14,170	232	376
Jihomoravská plynárenská a.s., Brno/Czech Republic	50	207,443	19,670	427	1,102
Koblenzer Elektrizitätswerk und Verkehrs-AG, Koblenz	58	82,540	19,454	253	560
Lechwerke Aktiengesellschaft, Augsburg	90	213,036	53,153	712	1,236
MITGAS Mitteldeutsche Gasversorgung GmbH, Halle	60	94,007	21,131	506	299
rhenag Rheinische Energie AG, Cologne	100	151,502	37,317	177	340
RWE NUKEM GmbH, Alzenau	100	36,684	–[2]	151	288
RWE Obragas N.V., Helmond/Netherlands	100	40,326	24,951	250	149
RWE Rhein-Ruhr Aktiengesellschaft, Essen	100	238,405	–[2]	4,543	4,999
RWE Solutions Aktiengesellschaft, Neu-Isenburg	100	183,985	–[2]	1,558	225
RWE Transportnetz Gas GmbH, Essen	100	55	–[2]	262	77
RWE Transportnetz Strom GmbH, Dortmund	100	553,025	–[2]	3,096	405
RWE Westfalen-Weser-Ems Aktiengesellschaft, Dortmund	80	283,185	–[2]	4,149	2,556
RWW Rheinisch-Westfälische Wasserwerksgesellschaft mbH, Mülheim/Ruhr	80	64,247	5,715	101	506
SAG Energieversorgungslösungen GmbH, Langen	100	11,025	–[2]	171	1,119
SAG Netz- und Energietechnik GmbH, Langen	100	38,288	–[2]	262	2,146

1 Converted to full time equivalent (1 FTE = 1 full-time equivalent).
2 Profit- and loss-pooling agreement.

	Investment in acc. with Sec. 16 of the German Stock Corporation Act %	Equity of the last fiscal year € '000	Net income/ loss of the last fiscal year € '000	External revenue 2004 FY € million	Employees[1] 2004 FY average
RWE Energy					
STOEN S.A., Warsaw/Poland	85	177,393	29,479	346	1,512
Süwag Energie AG, Frankfurt/Main	78	263,309	48,000	1,048	1,577
Transgas a.s., Prague/Czech Republic	100	1,379,192	238,318	1,714	1,293
Thyssengas GmbH, Duisburg	100	179,695	–[2]	322	12
VSE Aktiengesellschaft, Saarbrücken	69	133,236	14,358	237	377
RWE npower					
RWE Npower Holdings plc, Swindon/UK[3]	100	749,722	73,101	5,605	9,353
RWE Trading					
RWE Trading GmbH, Essen	100	238,765	–[2]	7,841	468
SSM Coal B.V., Rotterdam/Netherlands SSM Coal Group[3] with 21 subsidiaries in Germany, Europe, Australia and the USA	100	49,047	25,975	1,188	166
RWE Thames Water					
RWE Thames Water Plc, London/UK[3]	100	2,326,613	220,035	2,278	8,540
American Water Works Company, Inc., Wilmington/Delaware/USA AWW Group[3] with 60 subsidiaries in the USA and Canada	100	3,766,050	50,518	1,479	6,009
Proyectos e Instalaciones de Desalación, S.A., Madrid/Spain Pridesa/Ondagua Group[3] with 10 subsidiaries in Spain	100	32,534	2,617	103	752
RWE Umwelt					
RWE Umwelt Aktiengesellschaft, Viersen	100	528,853	–[2]	–	225
RWE Umwelt Nord GmbH & Co. KG, Preetz	100	28,449	7,300	81	704
RWE Umwelt Ost GmbH, Halle	100	8,420	–[2]	113	935
RWE Umwelt Rheinland GmbH, Cologne	100	163,563	–[2]	214	769
RWE Umwelt Süd GmbH, Villingen-Schwenningen	100	1,025	–[2]	134	825
RWE Umwelt Südwest GmbH, Wiesbaden	100	22,521	–[2]	73	571
RWE Umwelt Westfalen-Ruhr GmbH, Essen	100	66,982	–[2]	144	823
RWE Umwelt West GmbH, Grevenbroich	100	172,760	–[2]	203	754
Other subsidiaries					
RWE Finance B.V., Zwolle/Netherlands	100	10,923	2,067	–	–
RWE Systems Aktiengesellschaft, Dortmund	100	150,507	–[2]	1,667	1,330

1 Converted to full time equivalent (1 FTE = 1 full-time equivalent).

2 Profit- and loss-pooling agreement.

3 Data from the group financial statements.

II. Entities accounted for using the equity method	Investment in acc. with Sec. 16 of the German Stock Corporation Act %	Equity of the last fiscal year €'000	Net income/ loss of the last fiscal year €'000
RWE Power			
TCP Petcoke Corporation, Dover/Delaware/USA[3]	50	9,450	12,746
Grosskraftwerk Mannheim Aktiengesellschaft, Mannheim	40	114,141	6,647
RWE Energy			
Cegedel S.A., Luxemburg/Luxemburg[3]	30	286,875	18,413
Fővárosi Gázmüvek Rt., Budapest/Hungary	33	147,024	17,050
GEW RheinEnergie AG, Cologne	20	564,045	149,725
Kärntner Energieholding Beteiligungs-GmbH, Klagenfurt, Austria[3]	49	124,710	34,608
Kommunale Energie- und Wasserversorgung Neunkirchen AG, Neunkirchen	29	72,005	9,367
Niederrheinische Versorgung und Verkehr AG, Mönchengladbach[3]	50	437,353	45,375
Stadtwerke Duisburg AG, Duisburg	20	148,223	37,510
Stadtwerke Düsseldorf AG, Düsseldorf	20	348,582	39,410
Stadtwerke Essen AG, Essen	29	113,454	17,480
TIGÁZ Tiszántúli Gázszolgáltató Rt., Hajdúszoboszló/Hungary	44	138,404	7,145
RWE Thames Water			
RWE-Veolia Berlinwasser Beteiligungs AG, Berlin	50	314,203	12,187

III. Other investments			
RWE Energy			
Stadtwerke Chemnitz AG, Chemnitz	19	255,562	13,713
Others			
RAG Aktiengesellschaft, Essen[3]	30	2,296,300	–60,100

RWE's value management: return-oriented control of the company

Increasing shareholder value lies at the heart of our strategy. Additional value is created when the return on capital employed (ROCE) exceeds capital costs. ROCE reflects the pure operating return of a company or business area. It is calculated by dividing the operating result by capital employed.

We calculate our cost of capital as a weighted average cost of equity and external capital. Equity capital costs cover the market's company-specific expectation of returns when investing in an RWE share over and above that of a risk-free investment. External capital costs are linked to long-term financing conditions in the RWE Group and allow interest on external capital to be classified as tax deductible (tax shield). We calculate the Group's cost of outside capital by applying a pre-tax cost rate of 6.0 %. The cost of equity capital is derived on the basis of an interest rate of 5.5 %, which is customary for a risk-free investment, plus risk charges specific to the division or the Group. We do not derive the relationship between equity and external capital from the amounts carried on the balance sheet, but assume a ratio of 30:70 instead. In 2004, the RWE Group's cost of capital was thus 9.0 % before taxes.

Relative value added is the difference between ROCE and capital cost. Multiplying this figure by the capital employed results in the absolute value added, which we employ as a central management benchmark. The higher the value added, the more attractive a particular activity is for our portfolio. It is the most important criterion for evaluating capital expenditure. Value added – in addition to free cash flow – is also our yardstick for determining bonus payments for RWE Group executives.

RWE Group—capital costs	
Risk-free interest rate	5.5 %
Market premium	5.0 %
Beta factor	0.7
Cost of equity after taxes	9.0 %
Cost of debt before taxes	6.0 %
Tax rate for debt	26.4 %
Tax shield	–1.6 %
Cost of debt after taxes	4.4 %
Proportion of equity	30 %
Proportion of debt	70 %
Capital costs after taxes	**5.8 %**
Tax rate for blanket conversion	35 %
Capital costs before taxes	**9.0 %**

Change in method for calculating value added (ROCE)

In accordance with new IFRS accounting policies, we stopped amortizing goodwill as of January 1, 2004. Instead, we perform annual impairment tests. This has led to several changes in our value management concept. In the future, instead of determining capital employed on the basis of historical cost, it will be determined based on their net carrying amounts, which are used in impairment tests. We apply the same method to RWE npower's customer base. However, we will start taking impairment losses into account when determining capital employed from 2005 onwards. Although the change already affects the consolidated financial statements for 2004, we have commented on the figures based on the old method in the review of operations. This guarantees comparability with the previous year. These figures are displayed in the first table on page 188. On this basis, ROCE at the Group level was 12.8 %. Absolute value added amounted to €1,778 million based on capital employed of €46,919 million. The second table on page 188 shows the figures calculated using the new approach. On this basis, capital employed totals €44,480 million. By applying the new method, capital employed dropped by €2,439 million. This causes a corresponding rise in ROCE (to 13.5 %) and value added (to €1,998 million) at the Group level.

RWE Group—determining ROCE in 2004[1]

		Old method	New method
Operating result	€ million	**5,976**	**5,976**
+ Interest from sales financing	€ million	25	25
Operating result (for ROCE calculation)	€ million	**6,001**	**6,001**
Intangible assets/property, plant and equipment[2,3]	€ million	53,095	53,095
+ Investments including loans	€ million	5,144	5,144
+ Accumulated goodwill amortization and impairment losses[4]	€ million	2,699	246
+ Inventories	€ million	2,570	2,570
+ Trade accounts receivable	€ million	7,741	7,741
+ Other assets incl. prepaid expenses	€ million	5,906	5,906
– Non-interest-bearing provisions[5]	€ million	–10,939	–10,939
– Non-interest-bearing liabilities[6]	€ million	–18,618	–18,618
+ Adjustments to average capital employed[7]	€ million	–679	–665
Capital employed	€ million	**46,919**	**44,480**
ROCE	%	12.8	13.5
Relative value added	%	3.8	4.5
Absolute value added	€ million	1,778	1,998

1 Balance sheet items each with average figures for December 31, 2003/2004.

2 RWE npower's figure was adjusted to account for deferred tax liabilities relating to the capitalized customer base and the bond premium.

3 Adjustment of assets capitalized in acc. with IAS 16.15 since these assets do not employ capital (non-current assets: –€138 million; inventories: –€95 million).

4 Includes €389 million in depreciation on RWE npower's customer base calculated using the old method, minus attributable deferred taxes and impairment losses of €246 million.

5 Including tax provisions and other provisions (excluding long-term provisions of €2,004 million).

6 Including trade liabilities, other liabilities by adjusting the addition of the gain on the sale of residential properties by RWE Systems, deferred income, prepayments received, bills payable and deferred tax liabilities of the Water Division amounting to €2,920 million.

7 Including adjustments made to average capital employed due to first-time deconsolidations during the fiscal year (especially Heidelberger Druckmaschinen).

Key figures for value management in fiscal 2004 – Old method –	Operating result € million	Capital employed € million	ROCE %	Capital costs %	Relative value added %	Absolute value added in 2004 € million	Absolute value added in 2003 € million
RWE Power	1,742	7,565	23.0	10.5	12.5	948	614
RWE Energy	2,192	12,668	17.3	10.0	7.3	925	805
RWE npower	604	7,045	8.6	10.0	–1.4	–100	–42
RWE Trading[1]	104	575	–	–	–	46	60
RWE Thames Water	1,389	19,723	7.0	8.0	–1.0	–189	–312
Discontinuing activities							
RWE Umwelt	76	1,272	6.0	10.0	–4.0	–51	–71
Heidelberger Druckmaschinen	59[2]	970	6.1	14.0	–7.9	–76	–486
Other/consolidation	–165	–2,899	–	–	–	275	214
RWE Group	**6,001**	**46,919**	**12.8**	**9.0**	**3.8**	**1,778**	**781**

– New method –							Deviation of value added new/old method
RWE Power	1,742	7,406	23.5	10.5	13.0	964	16
RWE Energy	2,192	11,963	18.3	10.0	8.3	996	71
RWE npower	604	6,378	9.5	10.0	–0,5	–33	67
RWE Trading[1]	104	573	–	–	–	47	1
RWE Thames Water	1,389	18,971	7.3	8.0	–0.7	–129	60
Discontinuing activities							
RWE Umwelt	76	1,173	6.5	10.0	–3.5	–41	10
Heidelberger Druckmaschinen	59[2]	917	6.5	14.0	–7.5	–69	7
Other/consolidation	–165	–2,901	–	–	–	263	–12
RWE Group	**6,001**	**44,480**	**13.5**	**9.0**	**4.5**	**1,998**	**220**

1 RWE Trading is monitored using the RORAC concept (return on risk-adjusted capital).

2 Includes €25 million in interest from sales financing at Heidelberger Druckmaschinen (previous year: €87million).

Change in capital costs at RWE Thames Water

We will introduce another change to the value management concept in fiscal 2005. It affects RWE Thames Water. The capital cost rate will be reduced from 8.0 % to 7.5 % since the planned sale of our water business in areas outside RWE's core regions, including numerous newly developing countries, will further reduce risk. In addition, the global decrease in long-term interest rates will cause the returns realizable in the regulated business to decline. Based on our current risk profile, we decided not to reduce specific capital costs for the other divisions. In so doing, we are taking into consideration the uncertainty stemming from the regulation of the German energy industry and the introduction of CO_2 emissions trading.

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Chairman of the Board of
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- AXA Konzern AG
- Hapag-Lloyd AG
- HSH Nordbank AG
- Amvescap Plc
- DekaBank Deutsche Girozentrale
- KfW

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- Hapag-Lloyd AG
- RAG AG
- ThyssenKrupp AG
- TUI AG (Chairman)
- Landwirtschaftliche Rentenbank

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Berlin
Deputy Chairman
Chairman of ver.di Vereinte
Dienstleistungsgewerkschaft
- Deutsche Lufthansa AG
- IBM Central Holding GmbH

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- Allianz Global Investors AG
- Allianz Immobilien GmbH (Chairman)
- Bayer AG
- MAN AG

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- RWE Energy AG

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- Gesellschaft für Wirtschaftsförderung Duisburg mbH
- STEAG Fernwärme GmbH

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Osnabrück Rural District
- Georgsmarienhütte GmbH
- Georgsmarienhütte Holding GmbH

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Trade Union Secretary of IG Metall
- Audi AG
- Heidelberger Druckmaschinen AG
- Siemens AG

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- Allianz Versicherungs-AG
- Dresdner Bank AG
- Hapag-Lloyd AG
- HOCHTIEF AG
- mg technologies ag
- TUI AG
- Société Electrique de l'Our S.A.

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- Harpen AG
- KEB Holding AG (Chairman)
- Klinikum Dortmund gGmbH (Chairman)
- Ruhrdigital Besitz-GmbH & Co. KG (Chairman)
- Schüchtermann Schiller'sche Kliniken KG
- Sparkasse Dortmund (Chairman)

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Mayor of the City of Mülheim/Ruhr

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- Heidelberger Druckmaschinen AG

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- Entwicklungsgesellschaft Universitätsviertel Essen mbH (Chairman)
- Essener Wirtschaftsförderungsgesellschaft mbH (Chairman)
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- Messe Essen GmbH (Chairman)
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- RWE Power AG
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M.A. in mining engineering

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- RWE Power AG

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- Member of comparable domestic and foreign supervisory bodies of commercial enterprises.

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Dr. Friedel Neuber (Chairman) – deceased on October 23, 2004 –
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Dr. Paul Achleitner
Burkhard Drescher – until December 31, 2004 –
Josef Pitz – until May 11, 2004 –
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Dr. Manfred Schneider
Uwe Tigges – since September 17, 2004 –
Erwin Winkel
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Sec. 27, Par. 3 of the German Co-Determination Act (MitbestG)
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Uwe Tigges

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- Member of comparable domestic and foreign supervisory bodies of commercial enterprises.

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Duisburg-Essen University, Essen Campus

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Attorney-at-law

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Marcus Wallenberg
Stockholm
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Director Emeritus of the Energy Industry
Institute at Cologne University

Wilhelm Werhahn
Neuss
Personally liable partner in
Wilh. Werhahn KG

Dr. Wolfgang Ziemann
Essen
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Former Executive Vice-President of RWE AG

Group Business Committee

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CEO of RWE AG

Berthold A. Bonekamp
CEO of RWE Energy AG
Executive Vice-President of RWE AG

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CEO of RWE Power AG and
Executive Vice-President of RWE AG
– until February 22, 2005 –

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Jan Zilius
Executive Vice-President of RWE AG

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CEO of RWE Thames Water Plc

Brian Count
Chairman of the Board of Directors of RWE Trading GmbH

Andrew Duff
CEO of RWE Npower Holdings plc

Dr. Georg Schöning
CEO of RWE Dea Aktiengesellschaft

Dr. Arndt Neuhaus
Director of Group Corporate Development at RWE AG

Glossary

BAFA price
Germany's Federal Office of Economic and Export Control (BAFA) uses reports made by hard coal buyers to determine the price paid in Germany for hard coal including all costs incurred from the German border to the buyer. The price of power plant hard coal is published by BAFA quarterly and annually in shipping tons and tons of hard coal units.

Barrel Brent (bbl)
International unit of measurement for trading petroleum. A barrel corresponds to 158.987 liters. The price of a barrel of Brent, a petroleum distillate traded in Rotterdam, is a reference value for petroleum products. The price of a barrel of Brent is set every day and is quoted in US dollars. The abbreviation "bbl" stands for "blue barrel."

Base load
Basic electricity requirement. Available regardless of all load fluctuations. In Germany base load power is primarily provided by nuclear power plants and lignite power stations. In the UK nuclear and hard coal plants provide base load power.

Commercial paper
Tradable, unsecured bearer bond issued only for short-term debt financing. Commercial papers are revolving credit facilities with terms typically ranging from a day to twelve months.

Commodity
Term used for a standardized, tradable good.

Credit default swap (CDS)
Financial derivative for trading default risks associated with debt financing. The party seeking to hedge such risks pays an annual fee to the principal and receives a contractually agreed sum, e.g., in the event that the underlying credit is not repaid. Credit default swaps only cover the risk of default.

Credit rating
Standardized assessment of the risk exposure and creditworthiness of issuers of securities and the securities themselves. Credit ratings are performed by specialists, which are generally recognized agencies.

Debt issuance program
Contractual master and model documents for the issuance of bonds on the domestic and foreign market. It can be used as a flexible financing vehicle. The bonds can have terms of 2 to 30 years.

European Energy Exchange (EEX)
The German energy exchange, headquartered in Leipzig.

Equity accounting
Method for accounting for entities whose assets and liabilities cannot entirely be included in the consolidated financial statements by fully consolidating the entity. In such cases, the carrying amount of the investment is recorded on the basis of the development of the share held in the entity's equity. This change is recorded in the income statement of the company which owns the entity.

European Carbon Index
Reference price for CO_2 certificates based on information from market participants, published by the EEX on every trading day. The index was introduced due to the EU-wide emissions trading system, which started in 2005.

Exchangeable bond
Entitles the bondholder to exchange bonds for shares in a company in which the issuer holds a stake. At maturity, the bondholder normally has the option of exchanging the bond for cash at nominal value or exchanging it for shares at a pre-defined ratio.

Fair value
Price at which an asset or service passes from a knowledgeable willing seller to a knowledgeable willing buyer on an efficient market, taking all factors influencing the price into account.

Forward contract
Contract between parties for the future purchase/sale of a commodity whose price is agreed in advance. Forward contracts are negotiated by contracting parties individually and are not quoted publicly on the stock exchange.

Global Compact
A UN initiative in cooperation with the private sector to promote sustainable growth. It is based on a catalogue of ten fundamental principles relating to human rights, labor, the environment and anti-corruption initiatives.

HCU
Acronym for hard coal unit. Reference value for the assessment of the energy content of various energy carriers. One kilogram HCU corresponds to 29,308 kilojoules.

Kilowatt
Unit of measurement of electric output. Conversion of other output units:
1 megawatt = 10^3 kilowatts,
1 gigawatt = 10^6 kilowatts,
1 terawatt = 10^9 kilowatts.

Metric ton
Equals 1,000 kilograms.

Oil equivalent
Unit for measuring energy, abbreviated to "oe." Corresponds to the thermal energy content of 1 kilogram of crude oil.

Option contracts
A buyer holding an option is entitled (but not obliged) to sell or purchase an asset at a pre-determined price within a set time period or at a specified date.

Other comprehensive income
Other comprehensive income covers changes in equity resulting from the fair valuation of financial instruments available for sale and derivatives in cash flow hedges. This item also subsumes the differences in currency translation that do not affect income.

Over-the-counter (OTC) trading
Free trade that is not conducted on an exchange (off-exchange trading). OTC trades can be tailored to the trading parties' specific risk-related requirements.

Peak load
During peak consumption periods on the power grid, hydro-storage power stations, pumped storage power plants and open-cycle gas turbine power stations are used to meet the peaks.

Performance
Development of the value of a financial investment over time.

Prototype Carbon Fund
Fund with resources earmarked for promoting the use of renewable energy especially in developing and newly developing countries.

Spot market
Market on which temporary imbalances between electricity sales and purchases are eliminated through physical contracts or forward positions.

Spread
Difference between the buying and selling price. As regards bonds, the spread represents the difference in yield on bonds from different issuers.

Technical Guideline for Residential Waste (TASi)
Legal directive in Germany that defines technical standards for the dumping of residential waste. On expiry of the transitional deadlines, starting in 2005, only waste that has been pretreated using thermal or mechanical-biological processes may be dumped in landfills.

Value-at-risk method
Method for measuring the loss that might result from a commercial position, assuming a certain probability.

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Imprint

RWE Aktiengesellschaft
Opernplatz 1
45128 Essen
Germany

Phone +49 (0) 201 12-00
Fax +49 (0) 201 12-15199
E-Mail contact@rwe.com

Investor Relations:
Phone +49 (0) 201 12-15025
Fax +49 (0) 201 12-15265
E-Mail invest@rwe.com

Corporate Communications:
Phone +49 (0) 201 12-15250
Fax +49 (0) 201 12-15094

For annual reports, interim reports and other information on RWE, please visit us on the Web at www.rwe.com or call our shareholder hotline:

Phone 01801 451280 (callers in Germany)
Phone +49 1801 451280 (callers outside Germany, excluding the USA)
Phone 011 49 1801 451280 (from the USA)

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Five-year overview RWE Group		2004	2003	2002	2001 TFY[1]	2000/ 2001
External revenue	€ million	**42,137**	**43,875**	**46,633**	**33,301**	**62,878**
Income						
EBITDA	€ million	8,400	8,476	7,241	3,637	6,575
Operating result	€ million	5,976	5,551	4,504	2,029	3,953
Income before tax	€ million	3,935[2]	2,123	2,722	1,143	2,238
Net income (RWE share in net income)	€ million	2,137[2]	953	1,050	621	1,264
Previous years excl. goodwill amortization	€ million	2,137[2]	1,938	1,830	859	1,638
Earnings per share	€	3.80[2]	1.69	1.87	1.10	2.24
Previous years excl. goodwill amortization	€	3.80[2]	3.45	3.25	1.53	2.90
Return on equity	%	23.8	10.4	13.5	7.3	17.3
Return on revenue	%	15.1	10.2	10.7	6.4	6.1
Value management[3]						
Return on capital employed (ROCE)	%	12.8	10.4	10.4	11.1	11.5
Value added	€ million	1,778	781	395	307	770
Capital employed	€ million	46,919	53,961	44,293	37,860	37,757
Cash flow/capital expenditure/ depreciation and amortization						
Cash flows from operating activities	€ million	4,928	5,289	5,933	1,021	3,814
Free cash flow[4]	€ million	1,499	927	1,838	–1,274	296
Capital expenditure incl. acquisitions	€ million	3,737	9,762	16,985	3,706	13,408
Property, plant and equipment	€ million	3,429	4,362	4,095	2,295	3,518
Depreciation, amortization and asset disposals	€ million	7,051	6,819	6,655	3,144	6,664
Goodwill amortization	€ million	–[2]	985	780	238	374
Free cash flow per share	€	2.67	1.65	3.27	–2.27	0.52
Workforce						
Workforce at end of fiscal year	FTE[5]	97,777	127,028	131,765	155,634	162,347
Asset/capital structure[6]						
Non-current assets	€ million	58,630	62,406	61,577	49,182	54,589
Current assets	€ million	31,497	32,411	31,103	33,868	24,781
Deferred tax assets	€ million	3,243	4,325	7,593	8,399	8,056
Balance sheet equity	€ million	11,193	9,065	8,924	11,129	10,843
Long-term provisions	€ million	28,131	29,399	32,637	33,227	32,643
Other long-term debt	€ million	29,761	27,402	25,181	14,567	12,622
Short-term provisions and debt	€ million	20,151	28,750	26,965	26,320	26,189
Deferred tax liabilities	€ million	4,134	4,526	6,566	6,206	5,129
Balance sheet total	€ million	93,370	99,142	100,273	91,449	87,426
Net financial debt/assets	€ million	–12,385	–17,838	–15,494	–1,126	135
Capital-to-assets ratio	%	12.0	9.1	8.9	12.2	12.4

Five-year overview RWE Aktiengesellschaft		2004	2003	2002	2001 TFY[1]	2000/ 2001
Dividends						
Dividends	€ million	844	703	619	562	563
Dividend per share	€	1.50[7]	1.25	1.10[8]	1.00	1.00
Market capitalization/rating						
Market capitalization at end of fiscal year	€ billion	22.6	17.5	13.7	23.6	26.3
Long-term credit rating						
Moody's		A1	A1	A1	Aa3	Aa3
(outlook)		(negative)	(negative)	(negative)	(negative)	
Standard & Poor's		A+	A+	A+	AA–	AA–
(outlook)		(negative)	(negative)	(stable)	(negative)	

1 Truncated fiscal year (July to December).

2 As a result of the change in International Financial Reporting Standards, the figure for 2004 does not include goodwill amortization.

3 Calculated using the old method. By applying the new method (cf. comments on p. 187), which was introduced in 2004, capital employed totaled € 44,480 million. This results in the following figures: ROCE 13.5 %; value added: € 1,998 million.

4 Cash flows from operating activities minus capital expenditure on property, plant and equipment/intangible assets.

5 Converted to full time equivalent.

6 Balance sheet structure in accordance with IAS 1 as of December 31, 2004.

7 RWE AG dividend proposed for fiscal 2004, subject to AGM approval on April 14, 2005.

8 Including bonus.

Financial Calendar 2005/2006*

04/14/2005	Annual General Meeting
04/15/2005	Ex-dividend date
05/12/2005	Interim report for the first quarter of 2005 with analyst conference call
08/11/2005	Interim report for the first half of 2005 – Press conference – Analyst conference call
11/16/2005	Interim report for the first three quarters of 2005 with analyst conference call
02/23/2006	Annual report for fiscal 2005 – Press conference – Analyst conference
04/13/2006	Annual General Meeting
04/18/2006	Ex-dividend date
05/16/2006	Interim report for the first quarter of 2006 with analyst conference call
08/10/2006	Interim report for the first half of 2006 – Press conference – Analyst conference
11/09/2006	Interim report for the first three quarters of 2006 with analyst conference call

* All events will be broadcast live on the Internet and can thus be followed by the public at large, investors and analysts simultaneously. We will keep the recordings on our Web site for at least three months.

◁ Five-year overview

RWE Aktiengesellschaft
Opernplatz 1
45128 Essen
Germany
T +49 (0) 201/12-00
F +49 (0) 201/12-1 51 99
I www.rwe.com