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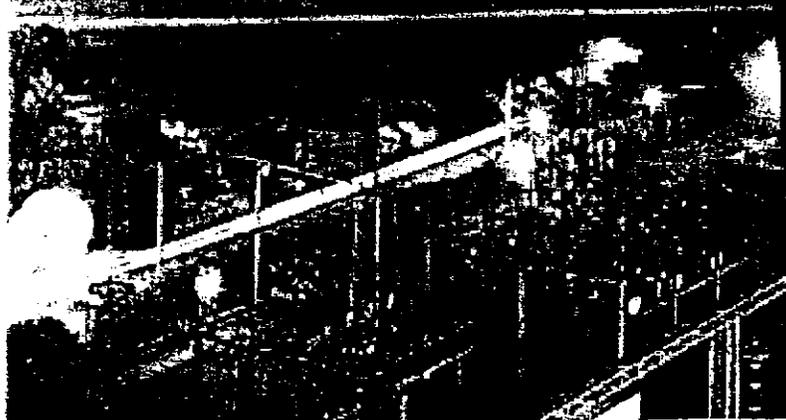
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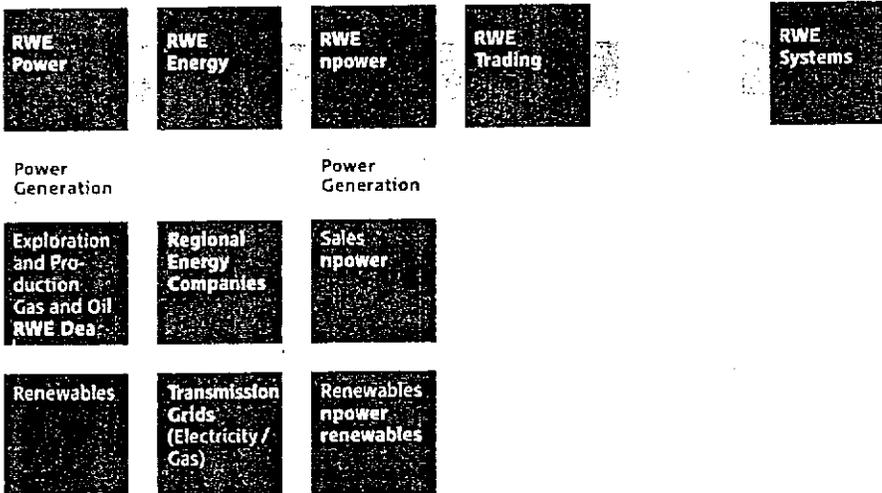
Annual Report 2005



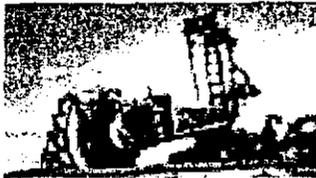
The RWE Group — a brief portrait

We are one of Europe's leading electricity and gas companies. Last year, our 86,000-strong workforce generated some €42 billion in external revenue. Our major power generation, sales and trading markets are in Germany, the UK and Central Eastern Europe. In the future, we will focus even more on the energy business. Therefore, we intend to sell our water activities in the UK and North America by 2007. RWE supplies 20 million customers with electricity and 10 million with gas. Our drinking water and wastewater services are part of the everyday lives of nearly 14 million people in Continental Europe.

RWE AG (Group Centre)



RWE's divisions



RWE Power is Germany's biggest power producer. The company produces lignite and generates electricity from coal, nuclear fuel, gas and renewables. Its subsidiary *RWE Dea* produces gas and oil.



RWE Energy is our sales and grid company for customers in Continental Europe. The company supplies electricity, gas and water from a single source in twelve regions within and outside Germany.



RWE npower is responsible for our UK energy business. The company has an integrated business model. Operations include the generation of electricity from coal, gas, oil and renewables as well as the sale of electricity and gas.



RWE Trading ranks among Europe's leading energy traders. We trade electricity, gas, coal and mineral oil as energy sources in their physical state as well as energy derivatives to hedge price risks.



RWE Thames Water encompasses our water and wastewater management activities outside Continental Europe. We plan to sell this division by the end of 2007, in order to focus even more on our European energy business.



RWE Systems is our internal service provider. Its tasks run the gamut from IT, real estate management and central purchasing to personnel and infrastructure services.

2005 key figures at a glance

- Operating result up 4% and up 8% net of one-off effects
- Net income 4% higher despite impairment loss for American Water
- ROCE target for 2006 (14%) already exceeded
- Net financial debt reduced to €11.4 billion
- €1.75 per share dividend proposal 17% up on previous year

RWE Group		2005	2004	+/- in %
External revenue	€ million	41,819	42,137	-0.8
EBITDA	€ million	8,324	8,400	-0.9
Operating result	€ million	6,201	5,976	3.8
Income from continuing operations before tax	€ million	3,828	3,935	-2.7
Net income	€ million	2,231	2,137	4.4
Recurrent net income ¹	€ million	2,257	1,794	25.8
Return on capital employed (ROCE)	%	14.7	13.5	-
Weighted average cost of capital (WACC) before tax	%	9.0	9.0	-
Value added	€ million	2,408	1,998	20.5
Capital employed	€ million	42,139	44,480	-5.3
Cash flows from operating activities	€ million	5,304	4,928	7.6
Capital expenditure	€ million	4,143	3,737	10.9
Property, plant and equipment	€ million	3,667	3,429	6.9
Financial assets	€ million	476	308	54.5
Free cash flow ²	€ million	1,637	1,499	9.2
Earnings per share	€	3.97	3.80	4.5
Dividend per share	€	1.75 ³	1.50	16.7
		12/31/05	12/31/04	
Net financial debt	€ million	11,438	12,385	-7.6
Workforce ⁴		85,928	97,777	-12.1

1 Net income excluding the non-operating result and excluding non-recurrent effects in the financial result and in the tax expense

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

3 Dividend proposal for RWE AG's 2005 fiscal year, subject to approval by the April 13, 2006 Annual General Meeting.

4 Full time equivalent.

*»Security of supply is a huge
commitment that must be fulfilled
anew every single day.*

*24 hours a day | 365 days. That's our
mission. RWE — there for you.«*

To Our Investors

Executive Board Report

Consolidated Financial Statements
Additional Information

Icon legend:



Cross reference



Navigation around www.rwe.com



Negligible amount

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* Part of the Review of Operations



Harry Roels, born in the Netherlands in 1948, obtained a degree in physical chemistry in 1971. 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. Group-level responsibilities: Corporate Development, Legal/Board Affairs, Group Corporate Information Office, Energy and Environmental Policy, Communications, Executive Resources Development, Mergers & Acquisitions, Auditing.



Dr. Klaus Stürany, born in 1946 in Wehda (Hesse), studied mathematics. From 1997 to 1999 Spokesman of the Board of Management of CEAG AG. Since December 1999 Executive Vice-President of RWE AG. Group-level responsibilities: Controlling, Finance, Risk Management, Investor Relations, Accounting, Tax, Insurance.

Dear Investors,

Today my letter will focus on strategic issues. The reason for this is the planned sale of our water business outside Continental Europe. We will continue to be active as a water utility only in the regions in which we have a strong presence with our energy business. I am sure that many of you were surprised by the news of the divestment. This is why I would like to reiterate some of the reasons for the sale as well as the opportunities this pivotal step offers us.

Electricity and gas supply in Europe are our long-established core competencies. We strengthened them considerably in the last few years, turning RWE into a much more focused and market-oriented company. In the future, we want to concentrate on these core competencies even more. This is where we will achieve the highest returns in the long run, as evidenced by the value contributed by RWE Power and RWE Energy. As a result, the regulated water business is less important as a stabilizing factor in our Group portfolio today than it was during the difficult initial phase of the German energy market's deregulation. Furthermore, even without the water activities in the UK and North America, we still generate one out of every three euros of our Group's operating result from stable, regulated business. And there is another major reason for the sale: The water business requires very high, non-discretionary expenditure on property, plant and equipment, which often exceeds operating cash flow. Without the water business we will have greater financial flexibility when considering investment in power plants, gas and electricity grids and our ability to increase your dividend. In addition, we believe that the increased financial strength of our water business is not fully reflected in RWE's share price. Water activities are currently valued higher as stand-alone companies.



Jan Zilius, born in 1946 in Marburg, studied law. Joined the RWE Group in 1990, initially as Executive Vice-President and Labour Director of RWE Rheinbraun AG. Since April 1998 Executive Vice-President of RWE AG. Since February 2005 also CEO of RWE Power AG.



Berthold A. Bonekamp, born in 1950 in Billerbeck (Coesfeld County), 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.



Alwin Fitting, born in 1953 in Westhofen (Rhine-Hesse). Has worked in the RWE Group since 1974. Trained master electrician. In 1996 appointed Chairman of the Combined Works Council of RWE Energie AG. Since 2000 Executive Vice-President and Labour Director of RWE Power AG. Since August 2005 Executive Vice-President and Labour Director of RWE AG. Group-level responsibilities: human Resources Management, Security.

When announcing the sale, we also explained how we intend to use the proceeds. Depending on the progress of each of the sales processes, we plan to pay to you, our investors, an increased dividend for both this and the next financial year. We have summarized the relevant details on page 34 of this annual report.

After the divestment, we will have additional room for manoeuvre, which we can use to grow our business profitably through acquisitions on Europe's energy market. In recent months, many investors have asked me how we intend to focus our acquisitions and whether we believe we can make acquisitions at reasonable prices, given the numerous bidders for European energy activities. In response, I would like to emphasize two points:

First, our strategic map is clear and limited to regions offering a relatively high degree of stability. It mainly consists of our existing core markets in Germany, the UK and RWE's four markets in Central Eastern Europe to date: Poland, the Czech Republic, Hungary and Slovakia. Regions of potential interest to us must be within the reach of these markets. Here I would like to highlight the Netherlands as well as the future EU member states in Central Eastern Europe. In which elements of the value chain that we do not yet occupy do we intend to establish a presence? Power generation tops our list of priorities. Our main competitive advantage is that we can build and operate power stations as well as market electricity effectively. Exporting our power plant management expertise that has proven itself in Germany and the UK to new markets will open the door to new opportunities for generating

profitable growth. This also holds true for the distribution and sales of electricity and gas to end customers in industry, commerce and households. We also intend to grow our business with supraregional gas pipelines, gas storage facilities and liquefied natural gas (LNG). Due to the increasing deregulation of the European gas sector and mounting demand, we anticipate new opportunities in these sectors for experienced gas companies such as RWE.

This brings me to the second point: the bidding process for the acquisition of stakes in electricity and gas companies. Consolidation of the energy market has regained steam. This is a European process that does not stop at country borders. If we want to rank among the leading utilities, we must take advantage of this development. Even though more can be achieved, RWE is one of the most competitive electricity and gas companies with multi-regional operations in Europe. We are thus well-equipped to play a major role as the consolidation process unfolds. After all, we want your company to be positioned among the top five utilities in Europe's energy landscape in the future as well, especially in terms of earnings and innovation ability. This also includes our ability to adjust to new situations in the market despite the size of our company. This skill is and must remain one of our core competencies besides electricity and gas. It is the prerequisite for being a reliable partner to our customers in RWE's various regions over the long term, while remaining an attractive employer of talented and committed staff members.

We will travel this route with discipline and moderation, making sure we grow through acquisitions only if they meet our ambitious strategic and financial criteria. Evidence of the fact that we take this seriously can be seen in several privatization rounds in Central Eastern Europe, from which we withdrew our bids early on owing to exorbitant prices. We are not in a rush. We will probably not receive the proceeds from the planned sale of our water activities until 2007. As a result, we are not under pressure to reinvest in the short term. Furthermore, increasing returns to our investors always remains an option.

RWE, your company, is thus working with undiminished energy to secure its future competitive position. I am convinced that we will make good progress. This year, however, we will concentrate on preparing for the disposal of our water activities. You can justifiably expect from us that we secure a reasonable price.

I am also convinced about the robustness of our financial development. Last year, we improved our operating result by 8%, net of special items. Despite an impairment in connection with the sale of American Water, we increased net income by 4% and will propose to the Annual General Meeting that the dividend be raised by 17%. Our equity capital rose by 17%. The new fiscal year got off to a good start as well. We expect a further improvement in the operating result and believe we stand a good chance of achieving the goals for 2006 that you are familiar with.

Our solid business prospects are clearly reflected in RWE's share price. At 59%, the total return of our ordinary shares exceeded that of the comparison indices DAX, Dow Jones EURO STOXX 50 and Dow Jones STOXX Utilities.



However, 2005 was also characterized by an increasingly intense debate on energy prices—both by politicians and the public at large. RWE participates openly and actively in this discussion. Our business is complex. This is why transparency is all the more important. It is the only way we can lastingly counter the displeasure about rising energy prices, which I can personally understand. It is also important that we continue the intense dialogue regarding Europe's future energy policy in light of our greatest ambition: security of supply. Here objectivity is indispensable. After all, we need a broad energy mix that includes all fuel sources free of ideological considerations. In this context, one must not lose sight of the *balance between security of supply, economic reason and environmental compatibility.*

We are committed to fulfilling our mission as a utility in our regions. It is against this backdrop that we were all the more concerned about the weather disaster in the northwest of Germany at the end of November and the consequences it had for our customers. I sincerely *regret the serious inconvenience caused by the power outages.* But I am also proud of the hundreds and hundreds of employees, who were on duty, working tirelessly day and night during those November days to re-establish the supply of electricity to our customers. That was a real team effort, which demonstrated that we take our pledge to supply electricity seriously at all times. Seven days a week, around the clock.

Therefore, I would like to take this opportunity to say a personal word of thanks to all of our employees for their commitment and reliability. Working as one team, I am optimistic about being able to successfully tackle the challenges of the new fiscal year.

Sincerely yours,

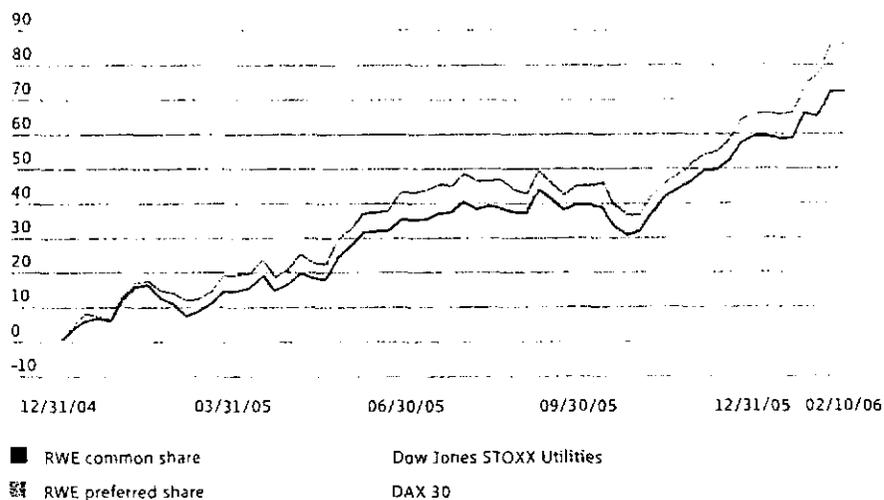
H. J. M. Roels
CEO of RWE AG

Essen, February 14, 2006

Shares and bonds continue exceptional performance

RWE shares posted another substantial gain in value. Our common stock delivered a total return of 59%, with preferred shares recording an even higher return of 65%. By comparison, the DAX was up 27%. Our ratings remained high on the credit markets.

Performance of RWE shares compared with the DAX 30 and the Dow Jones STOXX Utilities Indices
in %



The DAX achieved its highest yearend close since 2000.

DAX achieves 27% gain. In the first few months of 2005, the German Stock Exchange traded sideways, characterized by the steep climb in oil prices. A strong upward trend began in May. Main drivers were merger speculation in several sectors, improved export possibilities owing to the decline of the euro, and the early elections for the Bundestag, Germany's lower house of parliament. On September 9, 2005, the German lead index, DAX 30, surpassed the psychologically important 5,000-point mark for the first time in three years. Political uncertainty following the elections to Germany's lower house of parliament on September 18 only had a short-lived impact on the positive sentiment. The DAX was buoyed by more widespread optimism among foreign investors above all in the fourth quarter. It closed the month of December at 5,408 points, recording the highest yearend close in five years. The DAX's performance places it in the premier group of indices on an international level.

RWE shares outperform benchmark indices again.

RWE common stock generates 59% return. RWE's common shares again clearly bested the market's performance in the fiscal year being reviewed. They closed 2005 at €62.55, exceeding the prior year's closing price by 54%. Including the dividend, this corresponds to a total return of 59%. Our common stock substantially outperformed the Dow Jones STOXX Utilities index (+30%) as well. RWE's preferred share price increased even more, rising by 59% to €54.44, a total return of 65%. The encouraging development in RWE's share price was primarily due to the positive earnings outlook of the German electricity generation business. The announcement of our intention to sell the water business and focus even more on the European energy market in the future also led to a significant rise in our share price. However, debate surrounding the German energy market's future political framework gave rise to some unease.

In early 2006 the stock market's upward trend continued. On February 1 the DAX surpassed the 5,700-point mark again for the first time since August 2001. RWE shares also maintained their momentum. In early February, RWE's common stock occasionally traded above €68.

Weighting of RWE stocks and RWE bonds in important indices as of December 31, 2005

Stock index	Weighting	Bond index	Weighting
DAX	5.0%	iBoxx Euro Utilities	9.6%
Dow Jones EURO STOXX 50	1.6%	iTraxx Europe Energy	5.0%
Dow Jones STOXX	0.5%	MSCI Euro Credit Corporate	1.4%
Dow Jones STOXX Utilities	8.6%	MSCI Eurosterling Credit Corporate	3.5%

Long-term return of RWE shares considerably higher than the market. Long-term investors who invested €10,000 in RWE ten years ago and reinvested their dividends saw their investments grow to €30,416 (common shares) or €36,498 (preferred shares) by December 31, 2005. This corresponds to an annual average return of 11.8% and 13.8% respectively. The DAX advanced 9.1% per annum over the same period of time.

Comparative performance of RWE shares and important indices up to the end of 2005 in % p. a.	1 year	5 years	10 years
RWE common share	58.6	8.8	11.8
RWE preferred share	65.0	13.4	13.8
DAX 30	27.1	-3.4	9.1
Dow Jones EURO STOXX 50	24.3	-3.6	11.3
Dow Jones EUROPE STOXX 50	24.2	-3.7	10.5
Dow Jones STOXX	26.7	-0.6	10.6
Dow Jones STOXX Utilities	29.9	6.0	12.8
REXP ¹	4.1	5.9	5.9

¹ Index for the performance of government securities on the German bond market.

RWE share indicators ¹		2005	2004	2003	2002	2001 TFY ²
Earnings per share ³	€	3.97	3.80	1.69	1.87	1.10
Cash flows from operating activities per share	€	9.43	8.76	9.41	10.55	1.82
Dividend per share	€	1.75 ⁴	1.50	1.25	1.10 ⁵	1.00 ⁶
Common share prices						
End of fiscal year	€	62.55	40.70	31.37	24.70	42.20
High	€	63.24	43.50	31.97	43.80	49.95
Low	€	41.10	29.70	17.68	24.12	37.10
Preferred share prices						
End of fiscal year	€	54.44	34.21	27.95	20.75	31.25
High	€	55.09	36.94	28.20	34.49	38.50
Low	€	34.79	25.96	16.48	20.01	26.20
Dividend payment	€ million	984 ⁴	844	703	619	562 ⁶
Number of shares at end of fiscal year	million	562.4	562.4	562.4	562.4	570.0
Common shares	million	523.4	523.4	523.4	523.4	531.0
Preferred shares	million	39.0	39.0	39.0	39.0	39.0
Market capitalization at end of fiscal year	€ billion	34.9	22.6	17.5	13.7	23.6

1 In relation to the weighted average number of shares outstanding.
 2 Truncated fiscal year for the Group from July to December 2001.
 3 Due to the change in IFRS, figures after 2003 no longer include goodwill amortization.
 4 Dividend proposal for RWE's 2005 fiscal year, subject to the approval of the April 13, 2006 AGM.
 5 Includes € 0.10 bonus.
 6 Dividend for RWE AG's 2001 fiscal year (January to December).

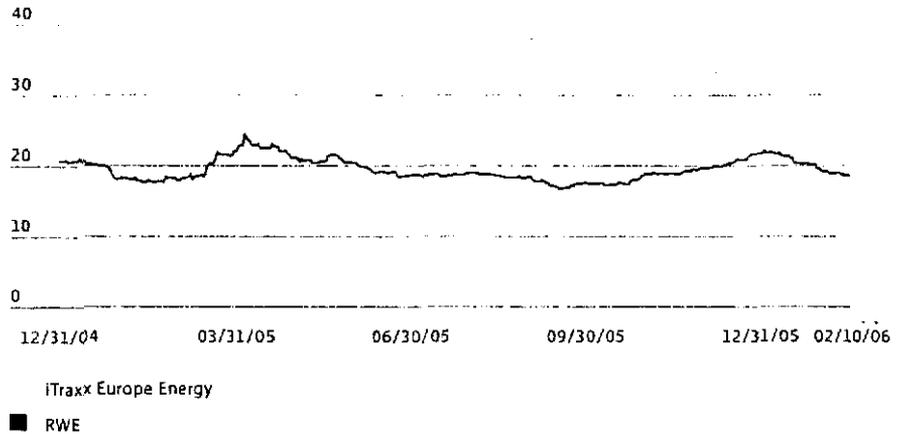
We will propose to the AGM to pay a dividend of €1.75 per share for fiscal 2005.



17% rise in dividend payment. The Supervisory and Executive Boards will propose a dividend of €1.75 per share for fiscal 2005 to the Annual General Meeting on April 13, 2006. This represents an increase of 17% compared with the previous year. Using recurrent net income* as a yardstick, our payout ratio is 44%. Based on the closing share prices in 2005, this corresponds to a 2.8% dividend yield on common shares and a 3.2% yield on preferred shares.

International shareholder structure. Shareholders outside Germany currently hold about 27% of RWE's capital (end of 2004: 24%). Our shareholder base in North America and the UK rose from a combined 17% to 19%. The remaining 8% is predominantly held in Continental Europe. Including big German investors, 53% of RWE's capital is held by institutional investors, 31% by municipalities and 16% by private and employee shareholders. The RWE common share's free float amounts to 89%.

Development of RWE's five-year credit default swap (CDS) compared with the CDS sector index iTraxx Europe Energy
in basis points



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



Issues of energy policy and the planned sale of the water division were the main topics in communications with investors and analysts.

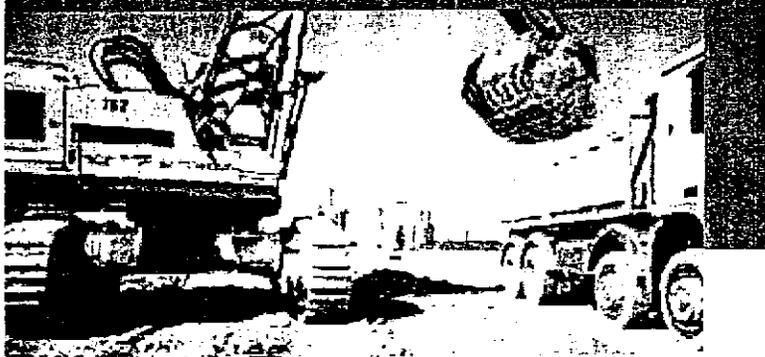
Low credit default swap prices. In 2005 sentiment on the world's credit markets was characterized by interest-related fears. Moreover, negative news from the US automotive sector led to uncertainty on the bond market. This was reflected in higher spreads for corporate bonds, which also affected RWE bonds. In contrast, prices paid on the market to hedge RWE's credit risk via credit default swaps* (CDSs) remained largely stable. Our consistently solid financial situation and strong Single A credit rating* made a large contribution to this cause. Therefore, at the end of the fiscal year, the five-year CDS for RWE was just one basis point above the level achieved at the end of 2004. In the same period, the iTraxx Europe Energy, the European CDS sector index, fell by three basis points.

RWE receives awards for investor relations work. In 2005 our communications work focused on commenting on current affairs in the field of energy policy as well as the planned sale of our North American and UK water activities. We assisted investors and analysts in making realistic assessments regarding these topics by providing information and arranging discussions with RWE specialists. We met with investors in 32 financial centres during 50 road shows and ten conferences as well as numerous one-on-one discussions during which we made presentations and answered questions. In so doing, we expanded the activities for our bond investors considerably.

We received yet another award for the quality of our communications work. Among other things, RWE was ranked first in the European utilities category in the two major investor relations market surveys conducted among investors and analysts by Thomson Financial Extel and the trade magazine "Institutional Investor."

There for you—24 hours | 365 days

»Tomorrow's security of supply starts today.«



RWE Power

2006–2010:
€1.8 billion in capital expenditure
on average every year

It is earmarked primarily to build new power plants in Germany and expand RWE Dea's oil and gas production in the years ahead.



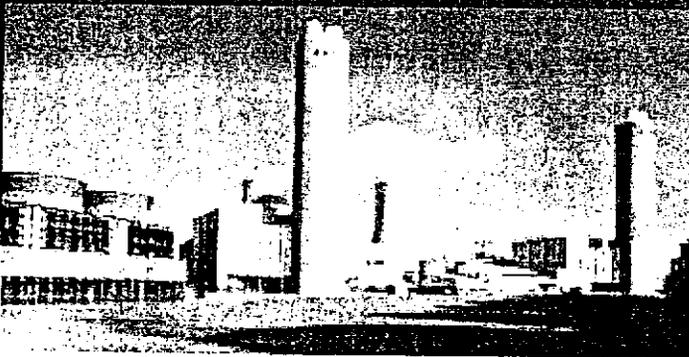
RWE Energy

2006–2010:
€1.1 billion in capital expenditure
on average every year

Security of supply requires care:
we constantly modernize and expand our
electricity and gas grids.

Today's decisions determine tomorrow's world: RWE has a long-standing tradition of investing in the future. Be it the world's largest hydroelectric power station in 1905 or Germany's longest high-voltage line in the 1920s, be it the most modern lignite power plant of present times or the first major offshore wind farm in the UK—we have always worked hard to rise to the challenges of the future.

Today we are laying the groundwork for the security of supply tomorrow—by investing in high-performance power plants and grids as well as in our most valuable asset: our employees. This ensures that we will continue to be a reliable regional partner to our customers. Around the clock, every day of the year.



RWE npower

2006–2010:

€600 million in capital expenditure
on average every year

In the UK we are modernizing our power plant portfolio, reducing emissions in the process.



RWE Energy



Gas cross border station (CZE)



Grid surveillance approach flight



Ruhrwasserwerk (Ruhr waterworks)
Mülheim an der Ruhr (GER)

There for you. RWE Energy

*» Bird's eye view: monitoring
grids by helicopter. «*

Through endless power lines, crossing thousands of high-voltage pylons: supply security exists when energy safely reaches its point of use. Today we monitor our grids with helicopters as well. Technical defects and construction work below the lines can be detected and evaluated better from above. The forces of nature are difficult to predict—but surveillance flights ensure that maintenance problems don't fall through the cracks. This is a mission we aspire to fulfil in our gas and water business as well.

There for you – RWE npower

»Supply security has many facets. Customer proximity is one of them.«



RWE npower



Employee in the Peterlee call centre (UK)



Serving private customers



Gas boiler in operation



Supply security can also be obtained through an affordable "insurance policy": RWE npower's "gas boiler breakdown service" provides rapid and flexible assistance in remedying problems. In the event of boiler malfunction, a simple call is all it takes for a technician to come around—24 hours | 365 days a year. This gives our UK customers peace of mind at a fixed price—and a warm home around the clock.

More focus on energy

Fiscal 2005 was marked by continuity and change. Our Continental European power and gas businesses continued their positive earnings trends. This is reflected in the further improvement of the operating result, which rose by 4% year on year and by 8% net of one-off effects. The 2005 financial year was also a year in which new courses were charted: in early November, we announced our plan to sell our UK and North American water operations by 2007 in order to focus our resources even more where they add the most value—in our core business, energy.

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Strategy and structure

Our goal is to rank among Europe's leading energy companies in the future.

Clear strategic goal in sight. RWE already ranks among Europe's leading integrated electricity and gas companies. And we intend to maintain this status. The economic environment in the years ahead is unlikely to become any easier. We expect fierce competition and growing customer needs as well as complex political and regulatory conditions. At the same time, European gas and electricity markets continue to converge. Our multiregional company offers us additional prospects in this context. We want to secure our good market position and take advantage of opportunities for growth in this challenging environment. To this end, we have established five strategic maxims:

- We are concentrating our activities predominantly on electricity and gas.
- We are focusing on our European core markets.
- We intend to occupy leading market positions wherever we have business operations.
- We strive to be successful in all elements of the value chain and supply our customers with electricity and gas from a single source ("integrated business model").
- We aim to increase the value of our company.

Our focus on energy in select European markets will enable growth and stability.

Focusing on electricity and gas. In early November 2005, we made the strategic decision to withdraw from the water sector in the UK and North America. This will enable us to focus our core competencies on Europe's converging electricity and gas markets. Water will remain part of our business model wherever we already offer our Continental European customers integrated electricity, gas and water services.

Focusing on Europe's core markets. Our regional focus stretches from the UK to Eastern Europe. This is where we intend to safeguard and further expand market shares. Concentrating on these countries enables us to establish a well-balanced presence in mature and growing markets as well as a wide diversification of business risks. In light of the long investment cycles prevalent in our fields of business, we are only active in markets offering attractive earnings prospects as well as a reliable business and regulatory environment over the long term.

Leading market positions. Our major power generation, trading and sales markets are currently in Germany, the UK and Central Eastern Europe. In these markets, in terms of sales, we rank among the top three suppliers of at least one of our main

In our main markets, we rank among the top three suppliers of at least one of our products.

products, i. e. electricity or gas. The advantage lies in the fact that leading market positions translate into volume and cost benefits. This enables us to enhance our company's value even in a competitive environment.

Market positions	Electricity	Gas
Germany	No. 1	No. 2
UK	No. 3	No. 3
Central Eastern Europe	No. 2 in Hungary No. 3 in Slovakia Starting position in Poland	No. 1 in the Czech Republic Leading position in Hungary
Europe	No. 3	No. 6

Integrated business model. Our operations are vertically integrated, i. e. we cover all of the major elements of the value chain. In the electricity business, for instance, we are not just power producers, but traders, grid operators and a sales company as well. Our vertical alignment affords us greater flexibility in offsetting market fluctuations at the individual stages of the value chain and enables us to realize synergies. Thanks to our horizontal integration, e. g. the sale of electricity and gas via one and the same Group company, we achieve additional synergies. We have bundled our power and gas grids at the distribution network level and placed them under single companies as well. Furthermore, since these sales and distribution grid companies have a regional orientation, we can establish and nurture very close ties to our customers.

Active along the entire energy value chain

	Upstream Power Generation	Gas and Oil Production	Energy Trading	Supraregional and Regional Electricity and Gas Grids	Electricity and Gas Sales
Continental Europe	RWE Power	RWE Dea	RWE Trading	RWE Energy	
UK	RWE npower				RWE npower

We want to continue to increase the value of our company by enhancing efficiency, making long-term investments, and making selective acquisitions.

Growing the value of our company sustainably. Increasing the value of our business in the interests of our investors takes centre stage in RWE's strategy. Our aim is to raise our enterprise value using three levers:

- The first lever entails constantly optimizing our existing business. Projects pursued in this area fall under the heading "operating excellence." They are designed to make business processes more efficient, reduce costs, and identify key value drivers in order to put potential for improvement into action.

- Second, value can be increased over the long term only if we invest in the future at the right time. If we want to continue to achieve stable and attractive returns in the next few years, we must make investments today to safeguard our market positions tomorrow. Here the focus lies on our power plant and grid operations as well as on our oil and gas production activities.
- The third lever involves making select acquisitions that create value. We constantly sift through options for expanding our existing portfolio via acquisitions. In so doing, we adhere to our strict strategic and financial acquisition criteria. Acquired activities must at least earn their cost of capital no later than in the third year of their full inclusion. Moreover, these activities may not jeopardize our goal of maintaining a strong Single A credit rating. However, given present market conditions, patience is of the order. Privatization in Eastern Europe is progressing at a moderate pace. Potential for external growth is limited in other regions and other bidders are exhibiting keen interest.

Value added and free cash flow are the yardsticks of the performance-oriented compensation of RWE's executives.



Value management* as a central controlling instrument. We always gauge the success of our divisions based on their return on capital employed, minus the cost of capital. This results in the value added. This, in addition to free cash flow and further, individually agreed goals, is a yardstick for determining the performance-linked compensation of our executives and salaried employees. Regular reviews of target agreements make transparent the contribution made by each area and its management to the success of the business.

Divisions. Six divisions oversee the RWE Group's operations and subordinate business units.

- **RWE Power** encompasses our Continental European power generation activities, including lignite production, as well as RWE Dea's gas and oil production.
- **RWE Energy** is our sales and grid company for Continental Europe and supplies customers in this region with electricity, gas and water. Six integrated regional companies operate under this division in Germany, with another six active in our other Continental European markets. Independent companies handle supraregional electricity and gas grid operations as well as the storage of gas.
- **RWE npower** is responsible for power generation as well as electricity and gas sales on the UK market.
- **RWE Trading** is our energy trading arm, acting as our hub for all tradable commodities such as electricity, gas, coal and oil.
- **RWE Thames Water** encompasses the water business outside Continental Europe. We intend to divest this activity by the end of 2007.
- **RWE Systems** provides internal services for the other RWE companies.

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events

RWE Power and RWE Trading are combined in our financial reporting. RWE Systems is included in "Other, consolidation."

RWE AG performs central management tasks. The operating companies are involved when fundamental decisions are made.



RWE AG, the Group Centre, is the RWE Group's management holding company, which as such carries out management tasks, e.g. corporate development, mergers & acquisitions, finance, controlling, executive development and communications. Fundamental strategic and operating decisions are prepared by the Group Business Committee* (GBC). The GBC consists of the Group Executive Board, the CEOs of our operating companies (excluding RWE Systems) and of RWE Dea as well as of the Head of Corporate Development.

The RWE Group's area of strategic focus



■ Markets in which RWE has a presence

Economic environment and events

Economic environment

World economy defies rising oil prices. The global economy stayed its course for growth in 2005. Although the upswing recently lost steam, the world economy remained strong, increasing gross domestic product (GDP) by approximately 3% in real terms. Despite the dampening effect of oil prices, the economy had significant room for manoeuvre in terms of liquidity, an increase in the asset base, and largely solid corporate earnings.

Germany's economy posted 0.9% real growth in 2005. The UK, our second-largest market, recorded a rise of 1.8%.

Slowing growth on RWE core markets. The economic upturn displayed in Eurozone countries continued, albeit at a moderate pace. High oil prices and the difficult situation on various labour markets dampened consumer and investor spending. Initially, growth in orders received from abroad merely improved industrial capacity utilization. Only from the third quarter onwards did foreign demand stimulate investing activity. The economic trend regained some momentum. All in all, real GDP in the Eurozone was up 1.2% year on year.

Germany's economic development lagged the European average. GDP advanced by 0.9%. Positive stimuli from foreign trade were unable to energize the domestic economy to a noteworthy extent. Consumers continued to display restrained spending. Due to tight budgets, the state was also unable to produce any major stimulus. Domestic demand was buoyed by the increase in capital expenditure on equipment.

The UK economy cooled down. Investment growth and consumer spending were initially weak in 2005, owing to interest rate hikes introduced in the previous year. By lowering the base rate, the UK central bank (Bank of England) provided for a more positive economic environment in the second half of the year. Nevertheless, GDP only rose by 1.8% in 2005, as compared with 3.2% a year earlier.

The economies of Central Eastern Europe also suffered a slowdown in growth. The industry-specific boom in some of these countries resulting from their accession to the European Union in 2004 slowed slightly. Positive stimuli came from expansionary monetary policy and improved conditions for foreign trade. Slovakia recorded the strongest growth among RWE markets in Central Eastern Europe, posting a rise of 5.1%. GDP in the Czech Republic rose by 4.8%, with Hungary and Poland reporting increases of 3.7% and 3.4% respectively.

The US economy's upward trend was very robust on the back of 3.5% GDP growth, despite interest rate increases and higher oil prices. The natural disasters that occurred in the third quarter did not have a noteworthy impact on the economy, since they only affected production capacity to a limited extent. Favourable conditions on the capital market, high corporate profits and the strong labour market continued to have a positive effect.

However, fluctuations in the economic cycle have little effect on our business trend. Energy consumption generally shows relatively small reactions to changes in GDP. Economic dynamism is primarily reflected in demand from industrial enterprises. Household energy consumption predominantly depends on temperatures. The economy has even less of an effect on the water sector.

In our core markets, electricity consumption recorded a slight rise. In some regions, gas demand declined.

Electricity consumption slightly higher. Energy consumption in our core markets increased marginally vis-à-vis the previous year. While moderate economic growth was reflected in additional demand, weather conditions, which were a little milder in Continental Europe, and higher energy prices dampened demand.

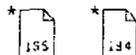
Demand for electricity in Germany was up roughly 1%. This was primarily due to the export-driven resurgence of industrial production. In contrast, demand for electricity for heating purposes was slightly down because temperatures were a little milder than in the prior year. Gas consumption was almost unchanged from 2004.

Energy consumption growth in the UK lost momentum. Electricity usage was up 1% due to marginal cyclical stimuli and weather effects. Unlike on the Continent, average temperatures in the UK were slightly down on the previous year, thus marginally restimulating demand for heating power. In contrast, gas consumption slipped by about 2%, despite positive cyclical effects. This was mainly due to the fact that gas usage in power production operations decreased owing to high gas prices.

Positive economic developments in our Central Eastern European markets stimulated power consumption. As in Germany, this was contrasted by weather effects, which curtailed demand. Electricity consumption was up 1% in Hungary and Slovakia. In Poland, it was roughly on par with the year-earlier level. Demand for gas in our main Central Eastern European market, the Czech Republic, was down 2%. Owing to high gas prices, numerous companies and households reduced consumption or switched to alternative fuels. By contrast, gas usage in Hungary advanced by 3%.

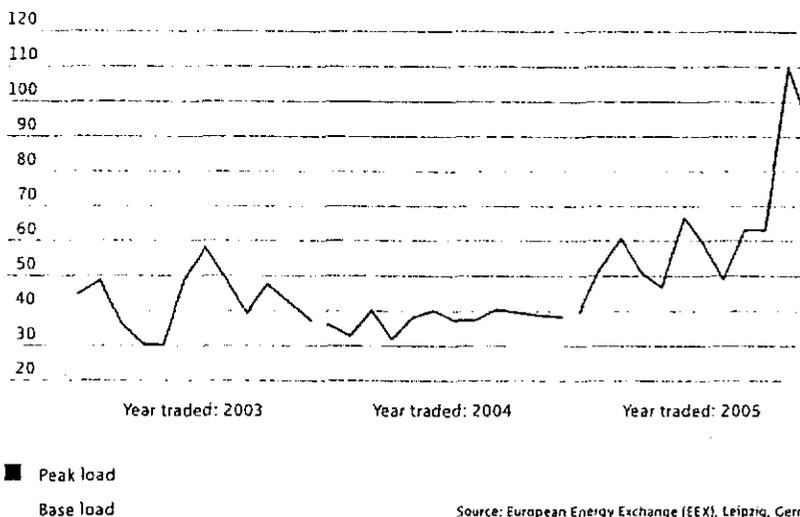
Rising electricity prices—a Europe-wide trend. Europe's electricity markets were marked by rapidly rising prices in 2005. One of the main drivers was the addition of a major cost factor in power production arising from the introduction of CO₂ emissions trading. This development was exacerbated by high prices on the fuel markets.

High fuel prices and the emissions trading scheme caused electricity prices to rise throughout Europe. Tight capacity was also a factor.



The average annual base-load power price was up 61% to €46 / MWh in spot trading* on the German-based European Energy Exchange (EEX*). Spot prices for peak-load electricity averaged €63 / MWh—up 67% year on year. Spot trading was significantly affected by higher fuel costs, CO₂ emissions trading and tight capacity. Power plant outages in Germany and some of its neighbouring countries caused prices to jump again towards the end of the year.

Development of wholesale electricity spot prices in Germany
in € / MWh



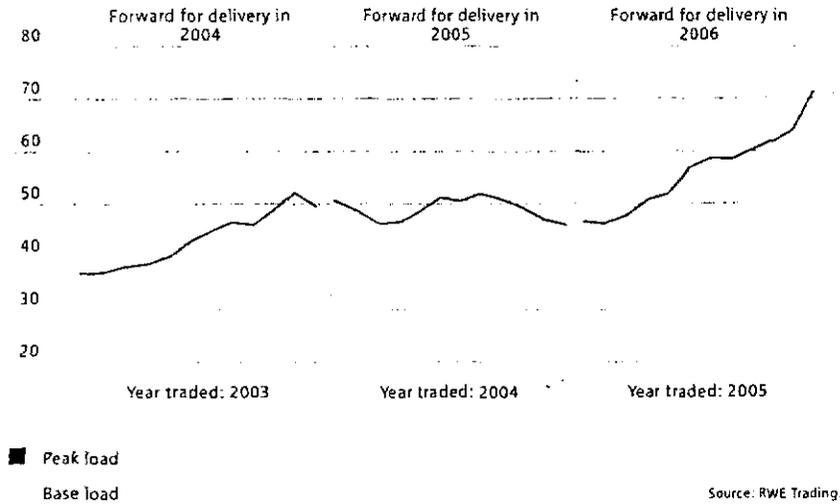
The same factors had an impact on German forward trading* markets as well. Wholesale forward contracts also became more expensive, albeit not to the same extent as on the spot market*. Base-load electricity deliveries scheduled for the following year were sold for an average of €41.3 / MWh in 2005. This was 23% more than the same type of forward contracts fetched in the previous year. One-year peak-load forwards rose by 15% to €56.3 / MWh. However, these contracts will not have an effect on the result until 2006, i. e. once these contractual amounts of electricity have been delivered. In fiscal 2005, the earnings situation of our German power generation operations (RWE Power) was still characterized by the forward prices of the 2003 and 2004 trading periods.



The electricity price trend in the German end customer and distributor segments reflected the rise in wholesale prices. Utilities lifted tariffs owing to the significant rise in power procurement costs. Furthermore, they passed through the heavier burdens arising from laws which subsidize renewables-based energy and combined heat and power* technology. Prices paid by households and small commercial operations in Germany were up an average of 4%. Industrial enterprises saw prices increase by nearly 12%. However, excluding state surcharges, prices for household customers were some 13% below the level recorded in 1998, the year in which the deregulation of Germany's energy market began. Average net electricity prices for industrial customers were 16% lower in 2005 than they were in 1998.

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



UK electricity price growth was higher than the EU average. The substantial increase in gas prices was the main driver.

UK electricity prices rise far above European average. In the UK, electricity prices posted an even steeper climb than in Germany. This is principally due to the considerable rise in gas prices in the UK. Gas-fired power stations have a much larger influence on electricity prices in the UK than in most Continental European markets. The high gas prices caused UK utilities to step up the use of hard coal power plants, leading to an increase in demand for CO₂ certificates. This made a substantial contribution to the increase in prices of traded emissions allowances. Spot prices for base-load and peak-load power averaged for the year were each up 70% on the previous year's level. These prices rose extremely towards the end of the year. The main cause for this was the expectation of a cold winter coupled with scarce power plant capacity.

Development of wholesale electricity spot prices in the UK
in £/MWh

