E.ON AG Conference Call -

First Half Results 2005

August 10, 2005

Presentation:

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Please check against delivery

Good afternoon ladies and gentlemen, and welcome to the call on our First Half 2005 results. Since our last conference call of May 12th we have delivered a further improvement in our adjusted EBIT year on year, while progressing further towards our goal of becoming the world's leading power-and-gas company. As Mr. Schipporeit will explain to you in greater detail, E.ON's adjusted EBIT rose by seven per cent to 4.3 billion Euros, and our operating cash flow by five per cent to 2.9 billion Euros, clearly demonstrating our continuing operational focus.

Once again, our adjusted EBIT benefited from cost reductions. In the first half of 2005 we achieved 90 million Euros of further savings, bringing the total achieved since the launch of our 'on.top' program to 680 million Euros. As a result, we are well on track to achieve our target of 1 billion Euros by the end of 2006.

Moreover, our full-year net-income and net-debt numbers will benefit from the sales of Viterra and Ruhrgas Industries, on which we will book capital gains of around three billion Euros on receipt of the proceeds.

I think the message from these strong operating numbers and the high prices for our non-core disposals is very clear: at E.ON, we remain very much focused on maximising both performance and shareholder value.

Similarly, the strategic progress we have made in the last few months confirms that we remain very much focused on becoming the world's leading power-and-gas company, and this is the main topic I would like to address in today's presentation. In doing so I want to cover three main points:

- **First**, I want to comment on the strategic logic of our most recent deals.
- **Second,** I want briefly to explain the main principles of the model that we have suggested as a possible framework for incentive-based regulation in Germany, which is due to be introduced in 2007.

- **Third,** I want to set out the rationale behind our decision to take most of our unfunded pension liabilities off our balance sheet into a fully funded scheme.

Let me turn first of all, then, to the rationale behind our entry into the UK gas-storage market, and our other recent deals.

1. Strategic Progress: UK Gas Storage, North Sea Gas, Distrigaz Nord and NRE

A few days ago, we announced our entry into the UK gas-storage market through our purchase of Holford Gas Storage Limited (HGSL) and its site near Byley in Cheshire for 140 million Euros.

The site will require further investment of around 145 million Euros over the next three years in order to develop one of the UK's largest salt-cavern gas-storage facilities. Unlike countries such as Germany and France, the UK has very limited geological opportunities for such storage sites, and with the UK becoming a net importer of gas UK gas prices are likely to become more volatile in future years. As a result, we think sites such as Byley will increase in value over time. The planned facility will comprise eight separate underground-storage caverns with a total capacity of 165 million cubic metres -- around half the gas used by the entire UK on an average day – and will thus enhance security of supply for the market as a whole, as well as for our own customers and power stations. It will also allow greater intra-day price smoothing. Our site will be one of the fastest-churn sites in the country, and we expect the first phase of capacity to be operational by the winter of 2008, with the rest coming on stream in 2009 and 2010. Through this deal we are strengthening our position as the number two player in the UK market.

Another important step, announced in June, was our decision to raise our stake in the Njord gas-and-oil field in the Norwegian North Sea to thirty percent from fifteen percent. This deal is in line with our objective of building up an equity-gas position covering fifteen-to-twenty percent of E.ON-Ruhrgas' total supply needs, and, given its location, fits very well alongside our entry into the UK gas-storage market.

From 2007, in addition to our share of the oil output, we will produce approximately 600 million cubic metres of gas annually from this field.

Meanwhile, our Central Europe Market Unit has made two important acquisitions.

First, in April, we announced our acquisition of Electrica Moldova in Romania, a power-distribution company with 1.3 million customers and an 11 percent market share. This complements our existing Romanian asset, the gas-distribution and supply company Distrigaz Nord, and gives us further scope for synergies.

Second, we entered the Dutch retail market through our purchase of NRE Energie. With a total of 275,000 power and gas customers, NRE is the fifth-largest retail supplier in Holland, and this first foothold downstream gives us an initial vertical hedge against our existing presence in the Dutch power-generation market.

All four of these deals reinforce our position in markets where we are either already or aim to be a leading player, and demonstrate our ability to grow through targeted profitable investments.

Finally, I want to remind you that we remain in discussions with Gazprom over all aspects of our MoU.

Let me now turn to the blueprint we have proposed for incentive regulation.

2. Regulation: a blueprint for incentivizing investment and productivity improvement

As you are all aware, the authority responsible for regulating energy networks in Germany, The Federal Network Agency, formally took up its powers last month, and will soon be checking the network charges of all operators with more than 100,000 customers to ensure that they are justified by the respective costs. The Federal States will be responsible for regulating operators that have fewer than 100,000 customers. We remain confident that our charges are competitive, and, as a result, we do not expect any significant impact on our profitability in this initial phase of regulation.

As you are all equally aware, however, the cost-plus methodology being used by the regulator for the time being to evaluate network charges will soon be replaced by a form of incentive regulation, as required by the Energy Industry Act. This will apply to power-transmission networks, and power-and-gas distribution networks, but not *a priori* to gas-transmission networks, as in this case operators may obtain a derogation if they can provide evidence of competition.

The purpose of incentive-based regulation is to promote productivity increases from which customers benefit in the form of correspondingly lower prices, and The Federal Network Agency is about to start a consulting process with interested parties with a view to developing an incentive regulation system by mid-2006.

Against this backdrop E.ON, acting together with two well-known consultancies, E-Bridge and the Brattle Group, has proposed its productivity-enhancement model ("Pro+"), and you have by now, I hope, had a chance to study the slides on this subject that we published earlier today. Our model envisages different methodologies for treating capital and operating expenses, as the two cannot be treated in the same way.

Capital costs vary between companies because different networks are in different phases of the investment cycle.

Any system of incentive regulation based on <u>average</u> capital costs would therefore lead those network operators with earlier investment needs than others to defer capital expenditure, so putting at risk the reliability of their networks and hence their service to customers. With this in mind, under E.ON's "Pro+" model each network operator would submit its own investment budget to The Federal Network Agency at the beginning of each regulatory period. The regulator would check the budget, and the expenses allowed would then be included in the network charges, thus giving operators the certainty they need to invest.

The regulator could create incentives by rewarding companies for a more efficient delivery of their investment budgets, with the resulting savings shared with customers.

In contrast to capital costs, we think **operating expenses** can be effectively regulated on an average basis. In this case, the cap for allowable revenues would ultimately be lowered in line with the average productivity gain of all similar network operators, thus giving rise to competition and to a win-win situation for customers and companies alike: customers benefit in the form of lower prices, while each operator is incentivized to increase its productivity to an above-average extent because it is allowed to keep any gains from outperformance. Before the system could function in this manner, however, we think a period of adjustment would be necessary to take account of any differences in existing efficiency levels so as not to discriminate against those operators that are already relatively efficient.

E.ON suggests starting with incentive regulation in early 2007, and by presenting our "Pro+" model in advance of this debate we want to contribute constructively to policy discussion and formulation. We are optimistic that positive discussion of "Pro+" will follow.

And while I am on this subject, let me also say that E.ON stands ready to contribute in an equally constructive manner to the debate over one of the most pressing public-policy challenges facing Germany and other western European countries today, namely how to secure long-term energy supplies on a sustainable basis. In particular, the role that nuclear power can play as part of a balanced national energy policy is a topic the Board of E.ON discussed in depth on its strategy retreat earlier this year, and one that we would be very willing to share our views on with interested governments, particularly in Germany and the UK.

As a responsible company with a long-term commitment to the markets we serve, we are always prepared to engage with governments and other relevant public authorities.

Let me now turn to our announcement this morning on our pension liabilities.

3. Funding the pension liabilities

As you have seen earlier today, E.ON has decided to finance most of its unfunded pension liabilities through a contractual trust arrangement (CTA), and Mr. Schipporeit will elaborate in a moment on this decision.

For my part, I would simply like to say that this represents a further step in the ongoing review of our balance sheet.

Earlier this year we announced that we would be increasing our dividend payout ratio by 2007 to between fifty and sixty percent, and that we would be returning the full value of the Degussa stake to our shareholders. These decisions represented the start of our balance-sheet review, and today's announcement is a continuation of that process.

Going forward, we shall keep our balance sheet under review, and shall keep you fully informed as events unfold.

Conclusion

In conclusion let me emphasize again three points:

- **First,** It is clear from our first-half results that we remain committed to 'performance', and we aim to achieve further operational improvements over the remainder of the year. Our Market Units are performing well and we are confident of achieving another record year in terms of the adjusted EBIT of our core energy business.
- **Second,** we continue to make good progress strategically, while remaining focused on the key drivers of our existing business. Our recent deals take us further towards our vision of being the world's leading power-and-gas company, while our pro-active contribution to the debate over incentive regulation in Germany, and our willingness

to engage in debate over the future of nuclear power in Germany and the UK, show our commitment to providing the best possible service at lowest possible cost.

- **Third,** today's decision to fund most of our outstanding pension liabilities is a further step towards optimizing our balance sheet, but it is not the end of the story.

With these remarks I will now hand over to Mr. Schipporeit, but will remain on the call to answer your questions later on.

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