

E.ON AG Analyst Conference

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Presentation:

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Please check against delivery

I'm very happy to be able to provide you with consolidated US GAAP figures for the first time. Our first-half 2000 numbers were, you'll remember, calculated by adding together German GAAP and IAS figures. As you can imagine, converting more than 1,600 Group companies to the new accounting policies was a very complex process. But we completed it within just a few months—and according to plan.

In order to improve comparability between 1999 and 2000, today I'll be presenting you pro-forma figures. These numbers contain the nine-month results of all the companies of the former VEBA and VIAG. The nine-month figures for 1999 were also calculated in accordance with US GAAP.

I'd now like to turn to the Group's current business performance.

E.ON's sales climbed 40 percent to just under €70 billion in the first nine months of 2000. The marked increase is primarily attributable to VEBA Oel's first-time full consolidation of Aral. In addition, Chemicals and Distribution/Logistics posted considerably higher sales. Adjusted for the effect of Aral's full consolidation, sales were still up 24 percent.

At €1.9 billion, Group internal operating profit slipped about 9 percent year-on-year despite the expected sharp decline at our Electricity Division.

Pretax income climbed 55 percent compared with the year-earlier period to €7,070 million. This sharp uptick is mainly due to significant gains from disposals stemming from our strategy to focus on our core businesses. We reported net book gains totaling €4.6 billion compared with €2.2 billion in the first nine months of 1999. These gains result particularly from the divestment of our shareholdings in E-Plus (€3.5 billion) and in Cablecom (€0.8 billion), the Swiss cable TV operator.

We're working to optimize cost structures across all our businesses. Resulting cost-management expenses came to €135 million against €204 million in the year-earlier period. These expenses primarily impacted Electricity and Chemicals and will lead to sustained savings in subsequent years.

Other non-operating earnings for the first three quarters of 2000 amounted to €387 million versus €268 million in the prior year. The increase is principally due to lower provisions at our Electricity Division and VEBA Electronics' earnings for July through September 2000. VEBA Electronics has since been sold.

The Group's tax rate was 43 percent against 34 percent at the same time last year. The share of tax-exempt gains from asset disposals—for instance, from the sale of VEBA's Cable & Wireless stake—was larger last year. This factor was largely responsible for the increase.

At €3.7 billion, Group net income after taxes and minority interests was up 27 percent compared with last year's nine-month figure of €2.9 billion.

I'd now like to turn to the performance of our divisions.

### **Electricity**

E.ON Energie boosted its power supplied by 17 percent. The factors for the increase include the first-time consolidation of the Dutch energy utility EZH and higher volume deliveries to traders. Adjusted for this effect, power supplied was up 12 percent. Higher deliveries to distributors outside Germany, power traders, special-rate customers, and household customers all contributed to the volume increase.

Despite higher sales volumes, the company's sales revenue dipped 6 percent year-on-year owing to the appreciable decline in electricity prices. The collapse of power prices also negatively impacted internal operating profit, which, as expected, slid to €1.3 billion, 31 percent under the prior year's figure.

We're happy to report, however, that since 2Q99 prices for both household and special-rate customers have stabilized. We therefore believe that prices have bottomed out. Regardless of developments on the price side we will step up our cost-cutting program. In the first three quarters of 2000 we've already reduced costs in our Electricity Division by €385 million. For full year 2000 we expect to achieve total cost savings of roughly €430 million.

## **Oil**

VEBA Oel posted an earnings uptick. Internal operating profit at our Oil Division totaled €226 million compared with a loss of €44 million in the year-earlier period. This very favorable performance is mainly the result of appreciably higher crude oil prices and to higher refining and petrochemical margins. Cost-management measures in the refinery division also had a positive effect on earnings.

Internal operating profit was negatively impacted by markedly higher hedging losses as well as by interest payments and amortization of goodwill relating the acquisition of Aral shares. Price wars at the gas pump also weighed on earnings. But as of October Aral is again profitable on an operating basis.

## **Chemicals**

As you're aware, Degussa-Hüls and SKW recently released their nine-month results. So I'll keep my remarks brief.

Our Chemicals Division posted a 30 percent increase in sales to €14.8 billion. At €507 million, internal operating profit rose 34 percent year-on-year.

Overall, Chemicals put in a very good performance on the back of lively global demand in the chemical sector and favorable currency effects. Sales revenues were also positively impacted by higher product prices brought on by sharply higher raw material prices that were passed on to customers.

At Degussa-Hüls, internal operating profit continued to climb vigorously. Synergy effects from the Degussa-Hüls merger positively affected earnings. The implementation of synergies is well under way. At €131 million, three quarters of the €180 million in total planned annual synergies were already realized by September 30, 2000. With the exception of Health & Nutrition, all reporting segments contributed to the earnings uptick.

SKW Trostberg lifted sales in all four divisions. Increased goodwill amortization and interest expenses related to acquisitions negatively affected SKW's internal operating profit.

## **Telecommunications**

At €583 million, our Telecommunications Division cut its operating loss by 7 percent. The disposal of shareholdings with high startup losses—particularly Otelo and E-Plus—had a positive impact. Interest income on sales proceeds also helped improve earnings. By contrast, earnings were burdened by considerably higher customer acquisition costs owing to the burgeoning cellular phone market.

Our telecommunications shareholdings—Germany's VIAG Interkom, Austria's ONE, and France's Bouygues Telecom as well as Switzerland's Orange Communications (which we sold in November)—all continued their vigorous growth.

## **Real Estate**

In our Real Estate Division Viterra boosted sales 8 percent to €832 million. Residential Development and Residential Services were the main contributors.

At €53 million, Viterra's internal operating profit was still off about 50 percent from last year's nine-month figure of €106 million. The reasons for the decrease include higher maintenance and modernization expenditures at Residential Investment, higher personnel and interest expenses at Residential Development, and the sale of fewer housing units.

## **Other Activities**

Distribution/Logistics (Stinnes, VEBA Electronics, and Klöckner) grew sales and earnings considerably compared with the previous year's figures. Stinnes's European overland transport, air and sea freight, and chemicals units in particular contributed to the earnings increase.

Klößner continued its positive performance from the first half of the year and grew sales and internal operating profit considerably. VEBA Electronics boosted sales and internal operating profit markedly. Only first-half figures for VEBA Electronics are fully included. E.ON sold the activities managed by VEBA Electronics to a group of European and American investors.

Our Aluminum Division (VAW aluminium) boosted sales distinctly, particularly owing to higher raw aluminum prices and to higher sales volumes. Sharply higher raw material prices had a dampening effect on internal operating profit.

In our Packaging Division Schmalbach-Lubeca posted higher sales and internal operating profit. In July 2000 E.ON folded its Schmalbach-Lubeca stake into the newly formed AV Packaging, in which E.ON continues to hold a 49 percent minority stake. AV Packaging is accounted for at equity in E.ON's Financial Statements beginning October 1, 2000.

Silicon Wafers benefited from buoyant demand in the semiconductor industry, which enabled it to considerably reduce its operating loss compared with the year-earlier period.

I'd like to say a few words about our expectations for full year 2000.

### **Outlook**

Owing to considerable net book gains from divestments, pretax income for full year 2000 will come in far ahead of last year's figures. We expect full-year Group internal operating profit to improve slightly on the Group's nine-month performance.

In Electricity there have been preliminary indications of a trend shift in power prices. We continue to anticipate, however, that Electricity's full-year 2000 internal operating profit will come in markedly below the prior year's showing.

Our Oil Division's performance will benefit from higher crude oil prices, the strong dollar, and higher refining margins. Despite slim margins at the pump, we therefore expect Oil's internal operating profit to be considerably higher year-on-year.

In Chemicals we anticipate rising global demand for our products owing to the continued favorable economic climate. Overall, we expect Chemicals' internal operating profit to distinctly exceed the prior year's performance.

In Telecommunications we continue to anticipate considerable startup losses, but on a level that is lower than in the prior year. The elimination of startup losses via disposals and interest earnings on sales proceeds will more than offset markedly higher customer acquisition costs resulting from the vigorous growth in the mobile communications market.

We continue to expect that Real Estate's full-year internal operating profit will surpass the previous year's showing.

We anticipate that our Other Activities will post higher—in some cases quite considerably higher—internal operating profits compared with the prior year.

In conclusion I'd like to say a few words on two topics.

**Goodwill effects**

The first is the goodwill effects related to the VEBA-VIAG merger. Prior to the tie-up we told you that we anticipated merger-related goodwill of about €6 billion. Amortized over 20 years, this would have reduced E.ON Group internal operating profit by about €300 million annually.

Over €5 billion of the Group's total goodwill is attributable to the former VIAG's telecommunications division. The sale of Orange SA in November has already reduced this figure by about €1 billion. Moreover, exercising the put option on our VIAG Interkom interest would reduce merger-related goodwill to less than €1 billion. Amortized over 20 years, the remaining negative impact on the Group's earnings would be negligible.

In other words, despite using purchase accounting, our post-merger balance sheet is almost goodwill-free. From today's perspective, this will increase the level of our long-term future earnings by almost €300 million annually.

These effects result from US GAAP's focus on actual market values. This approach means that hidden reserves will be disclosed in our Financial Statements. This, in turn, will or would result in E.ON reporting only very small gains on its disposals of the former VIAG's telecommunications activities. We're glad to accept these reduced gains considering the long-term earnings improvement I discussed a moment ago, particularly because the change in accounting policy doesn't affect the cash influx and the gains from disposals reflected in the individual financial statements.

**ROCE**

As part of the post-merger integration process we've refined the former VEBA's and VIAG's value-based controlling systems. Our goal was to find a metric that was tailor-made for our core energy and specialty chemicals businesses. In future, the E.ON Group will use return on capital employed (ROCE) as its primary measurement of economic performance. E.ON's 2000 Annual Report will contain segmented ROCE. This guarantees a high degree of transparency and increases comprehensibility. ROCE is the most common performance metric in our core businesses and will therefore facilitate comparisons with our competition.