

E ON AG
Form 20-F
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None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2002, 652,341,876 outstanding Ordinary Shares with no par value.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

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* Not for trading, but only in connection with the registration of American Depositary Shares.

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addition, the gas supply charge contains a mechanism whereby any over- or under-recoveries of gas supply cost from prior quarters will be refunded to or recovered from customers through the adjustment factor.

Other Regulations. Integrated resource planning regulations in Kentucky require LG&E, KU and other major utilities to make triennial filings with the Kentucky Public Service Commission of historical and forecasted information relating to forecasted load, capacity margins and demand-side management techniques. The two utilities filed their most recent integrated resource plan in October 2002.

Pursuant to Kentucky law, the Kentucky Public Service Commission has established the service boundaries for LG&E, KU and other utility companies, other than municipal corporations, within which each such supplier has the exclusive right to render retail electric service.

Environmental Matters

U.K. Business

In the U.K., Powergen is subject to national legislation which includes the obligations of the United Kingdom under EU regulations (including those discussed under *E.ON Energie Environmental Matters* above) and international conventions to which the U.K. adheres. These obligations relate principally to emissions from generating facilities to air, notably SO₂, NO_x and dust. Although historically such legislation has primarily affected coal-fired plants, all fossil-fuelled generation may be impacted in the future. Powergen is currently in compliance with all applicable emissions regulations. However, the timing and scale of the costs that Powergen may incur in connection with the most recent developments in this area, including the revision of the EU Large Combustion Plant Directive agreed in October 2001 and implementation of the Kyoto Protocol to the Framework Climate Change Convention, remain unclear at the present time.

Each of Powergen's fossil-fuelled power stations in the U.K. is required to have an Integrated Pollution Control Authorization, issued by a government agency, which regulates releases to the environment and seeks to minimize their impact. The current system of authorizations is to be expanded via a new permitting system to cover a wider range of matters such as noise, waste minimization and energy conservation, reflecting extended requirements now applicable to all new installations. Existing power stations are to be brought under the newly-expanded regime during 2006.

Using the flexibility available to it, Powergen has responded to the requirements imposed by emission controls with a combination of actions, notably the increased use of gas-fired CCGT plants, the use of low sulphur content fuels, the installation of emission abatement equipment and the development of renewable energy systems.

Powergen has operated its own environmental management system since 1991. On January 1, 1999, Powergen U.K. achieved corporate certification to ISO 14001, the international standard for environmental management, for its electricity production, gas operations and associated services. The certificate was renewed on January 1, 2002 for a further three years.

Powergen is also subject to environmental regulations affecting its business, including the registration of equipment possibly contaminated with polychlorinated biphenyls (PCBs) and packaging waste regulations. In May 2000, new PCB regulations were introduced requiring companies to register all equipment that is known to be contaminated with PCBs. In addition, companies must register all other relevant equipment that cannot be reasonably assumed not to contain PCBs. Powergen believes that it has registered all equipment that has any possibility of containing regulated trace amounts (between 50-500 ppm) of PCBs.

In order to comply with applicable packaging waste regulations, Powergen has joined an appropriate recycling scheme. The majority of the waste involved is paper.

U.S. Business

LG&E Energy's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates governing, among other things, air emissions, wastewater discharges, the use,

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handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

The Clean Air Act imposed stringent new SO₂ and NO_x emission limits on electric generating units located in the United States. LG&E had previously installed flue gas desulphurisation equipment on all of its generating units, while KU and WKE met their Phase I SO₂ requirements primarily through installation of flue gas desulphurisation equipment on Ghent Unit 1 and Henderson 1 and 2 respectively. LG&E's combined strategy for Phase II, which commenced January 1, 2000, uses accumulated emissions allowances to defer additional capital expenditures and also includes fuel switching or the installation of additional flue gas desulphurisation equipment. LG&E, KU and WKE met the NO_x emission requirements of the Clean Air Act through installation of low-NO_x burner systems. LG&E Energy's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. LG&E Energy will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the U.S. Environmental Protection Agency (EPA) announced its final NSR Call rule requiring significant additional reductions in NO_x emissions by May 2003, in order to mitigate alleged ozone transport to the Northeast United States. While each of the 19 states covered by the rule is free to allocate its assigned NO_x reductions among various emissions sectors as it deems appropriate, the regulations currently require electric generating units to reduce their NO_x emissions to 0.15 lb./Mmbtu – an 85 percent reduction from 1990 levels. Kentucky revised its State Implementation Plan (SIP) to require reductions in NO_x emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis in June 2002. In related proceedings in response to petitions filed by various Northeast states, in December 1999, the EPA issued a final rule directing similar NO_x reductions from a number of specifically named electric generating units including all LG&E and KU stations in the eastern half of Kentucky. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E Energy generating units are subject to the May 2004 compliance date under these NO_x emissions reduction rules.

LG&E Energy is currently implementing a plan that will add significant NO_x controls to its generating units at LG&E, KU and WKE. Installation of additional NO_x controls will proceed on a gradual basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. LG&E Energy estimates that it will incur total capital costs of approximately \$539 million through mid 2004 (of which approximately \$178 million has been incurred through 2002) to reduce its NO_x emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, LG&E Energy will incur additional operating and maintenance costs in operating new NO_x controls. LG&E Energy believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. With respect to costs incurred at LG&E and KU, in April 2001, the Kentucky Public Service Commission granted recovery of these costs under their environmental surcharge mechanisms.

LG&E Energy is also monitoring several other air quality issues that may potentially impact coal-fired power plants. These include the appeal of the District of Columbia Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement the EPA's regional haze rule and the EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E Energy is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program.

From time to time, LG&E Energy conducts negotiations with the applicable regulatory authorities to finalize cleanup plans or financial responsibility concerning other environmental matters, including remediation steps regarding former LG&E and KU manufactured gas plant sites, a fuel oil discharge at KU's E.W. Brown plant and matters relating to a KU transformer scrap yard.

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CHEMICALS

Overview

In 2001, E.ON streamlined its chemicals business by merging Degussa-Hüls and SKW Trostberg, the chemicals divisions of the former VEBA and VIAG, into a new, more focused company called Degussa AG. For more information on the merger, see Item 5. Operating and Financial Review and Prospects. Degussa had revenues of 11.8 billion and internal operating profit of 0.7 billion in 2002.

In May 2002, E.ON reached a definitive agreement with RAG to sell a portion of E.ON's majority interest in Degussa to RAG and to acquire RAG's more than 18 percent interest in Ruhrgas in a two step transaction. Upon termination of the court proceedings that had temporarily enjoined the Company from acquiring control of Ruhrgas in late January 2003, E.ON completed the first step of the RAG/ Degussa transaction by acquiring RAG's Ruhrgas stake and tendering 37.2 million of its shares in Degussa to RAG at the price of 38 per share, receiving total proceeds of 1.4 billion. Following this transaction and the completion of the tender offer to the other Degussa shareholders, RAG and E.ON each hold a 46.5 percent interest in Degussa, with the remainder being held by the public. The shares of Degussa AG are listed on the Frankfurt Stock Exchange and are part of the MDAX, the performance index of 70 German mid-cap companies. In the second step, E.ON is to sell enough shares to RAG at the above price to give RAG a 50.1 percent interest in Degussa by May 31, 2004. Prior to that time, E.ON and RAG are to operate Degussa under joint control.

Strategy

Degussa's strategic goal is to strengthen its world leading position in the field of specialty chemicals (based on HSBC research in July 2002) and to play a leading role in the restructuring of the worldwide specialty chemicals industry. Its strategy includes the active management of its portfolio to focus on those specialty chemicals businesses that management believes can deliver strong profitability and growth while at the same time reducing exposure to cyclical business trends.

Portfolio Transformation through Dispositions. In order to focus on the core specialty chemicals business, in 2001 and 2002, Degussa divested operations that had accounted for approximately 90 percent of its non-core sales in 2000. Degussa intends to dispose of its relatively few remaining non-core businesses in a value-enhancing manner within 2003, with the precise timing of these sales to depend on market conditions and other factors. Prior to their disposal, Degussa intends to actively manage these non-core activities with the goal of enhancing profitability.

Portfolio Management through Focusing and Expansion. Degussa intends to focus on selected specialty chemicals activities and to expand them by seeking attractive businesses to acquire. In chosen areas, it intends to search actively for complementary businesses. Degussa will actively manage its other core activities with the goal of increasing profitability.

Business Restructuring and Performance Enhancement. As a complementary strategy, Degussa intends to continue its program of identifying and analyzing the restructuring potential of its businesses, with the goal of improving business processes in all of its core activities. Further fundamental cost cutting and realization of synergies are each expected to play an important role in this effort.

Merger Synergies and Restructuring

The new Degussa began the process of realizing merger synergies through the restructuring of production, facilities and headcount in areas where Degussa-Hüls and SKW Trostberg had overlapping operations. Degussa also consolidated the two companies' headquarters in Düsseldorf, combined certain regional headquarters and embarked on the reduction of overhead expenses. In July 2000, Degussa began the *best@chem* project, a program to qualitatively and quantitatively foster the restructuring activities of its businesses. Responding to business conditions during 2001 and 2002, Degussa introduced further cost-cutting initiatives and expanded the *best@chem* project into an extensive performance improvement program. The *best@chem* program now comprises the following three elements: business combination synergies, restructuring and process optimization.

Through the *best@chem* focus on business combination synergies, Degussa plans to continue to realize cost savings from the merger to form the new Degussa, and also expects to realize synergies from the integration of

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Laporte into Degussa and from a broadening of its technological base. Through a restructuring and improvement of business processes in all of its core activities, as well as a restructuring of the necessary services to be provided to its business units, Degussa hopes to achieve additional cost savings. Degussa's current restructuring plans are expected to result in a total headcount reduction of approximately 4,000 people by 2004. Approximately 2,980 of these 4,000 jobs have been shed to date in a socially responsible manner. The third element of the program, process optimization, is based on the sharing of know-how and expertise throughout the group. The aim of process optimization is to set up networks of experts across organizational boundaries to identify and realize potential savings in various processes.

Degussa's goal is to achieve sustainable improvements in operating profit of 500 million per year via the *best@chem* program by 2004. Degussa expects the *best@chem* initiative to entail non-recurring costs of approximately 500 million during this period, of which 230 million was recorded in 2002. The steps implemented to date have generated a positive effect on earnings before interest and taxes of approximately 265 million by the end of 2002. The Company cannot be certain that the remaining cost savings and improvement in operating profit Degussa anticipates realizing as a result of the *best@chem* program can be achieved. A number of factors could prevent the realization of some or all of these savings, or add to the expenses relating to performance improvement program. These include, among other things, Degussa's inability to restructure its businesses effectively and as planned, higher costs related to achieving the anticipated business combination synergies and requirements for restructuring and reorganization measures materially in excess of those already planned.

Acquisitions and Dispositions

Laporte Acquisition. In December 2000, Degussa purchased 19.6 percent of the U.K. fine chemicals manufacturer Laporte. During the first half of 2001, Degussa acquired the remaining 80.4 percent of Laporte through a public tender offer. The European antitrust authorities approved the transaction under the condition that Degussa sell Laporte's production sites in Zaltbommel, the Netherlands; Hythe, United Kingdom; and Rheinfelden, Germany (persulphate only). Degussa disposed of the Zaltbommel and Rheinfelden operations in 2001 and the beginning of 2002. The Hythe operations were sold in the beginning of 2003, subject to regulatory approval.

In 2001 and 2002, Degussa disposed of non-core businesses that had accounted for approximately 90 percent of its non-core sales in 2000. The principal dispositions in 2002 included the following:

In January 2002, Degussa transferred its gelatin business to the Dutch company Sobel N.V.

In February 2002, Degussa divested its textile additives business, formerly part of the Stockhausen organization, to the Italian group Bozzetto, a subsidiary of the German company Rütgers AG.

In April 2002, Degussa sold the fertilizer manufacturer SKW Piesteritz Holding GmbH (SKW Piesteritz) to a joint venture set up by the Swiss holding company Ameropa and Agrofert Holding a.s. of the Czech Republic.

In June 2002, Degussa sold Degussa Bank GmbH (Degussa Bank) to Allgemeine Deutsche Direktbank AG (Diba), a subsidiary of the Dutch ING Group.

In August 2002, Degussa closed the sale of Viatris, a former part of the Degussa Health Products business ASTA Medica GmbH (ASTA Medica), to the U.S.-based private equity firm Advent International Corporation.

In December 2002, Degussa sold the biopharmaceutical company Zentaris AG (Zentaris) to the Canadian company Æterna Laboratories Inc.

All of these dispositions are accounted for as discontinued operations. For more information on these discontinued operations, see Discontinued Operations Other and Note 4 of the Notes to Consolidated Financial Statements.

Operations

Degussa's strategic management responsibilities lie with its board of management, supported by staff at the Düsseldorf headquarters. Responsibility for management at the operational level rests with Degussa's 23

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decentralized business units, each of which is grouped into one of Degussa's six core divisions. The following chart sets forth Degussa's six divisions divided into business units, together with their respective 2002 sales in millions of euro:

DEGUSSA

Health and Nutrition (1,179)	Construction Chemicals (1,819)	Fine and Industrial Chemicals (2,347)	Performance Chemicals (1,358)	Coatings & Advanced Fillers (2,126)	Specialty Polymers (1,308)
Flavors & Fruit Systems 223	Admixture Systems North America 241	Fine Chemicals 972	Superabsorbents 460	Coatings & Colorants 646	High Performance Polymers 243
BioActives 80	Admixture Systems Europe 345	Bleaching & Water Chemicals 575	Care Specialties 549	Aerosil & Silanes 481	Specialty Acrylics 473
Feed Additives 568	Admixture Systems Asia/Pacific 224	C ₄ Chemistry 545	Oligomers & Silicones 349	Advanced Fillers & Pigments 999	Methacrylates 292
Texturant Systems 308	Construction Systems Americas 374	Catalysts & Initiators 255			Plexiglas 300
	Construction Systems Europe 635				

All other activities are grouped as non-core businesses or services/ development units and are not shown in the table above. The core businesses of Degussa contributed in excess of 90 percent of its total 2002 sales.

Health & Nutrition

Degussa's health & nutrition division concentrates on the development, production and marketing of high quality health food components and additives for both human and animal nutrition. It consists of the business units Flavors & Fruit Systems, BioActives, Feed Additives and Texturant Systems.

Flavors & Fruit Systems. The Flavors & Fruit Systems business unit produces flavors for soft drinks, ready-cooked meals, confectionery, milk products and snacks. The unit's proprietary technology for high pressure CO₂ extraction is used primarily for the decaffeination of teas. The business unit also produces ready for use fruit preparations, primarily for the manufacture of confectionery, baked goods and preserves. The business unit's principal global competitors are IFF, Givaudan, Quest and the recently merged operations of Haarmann & Reimer and Dragoco. In 2002, the business unit's sales were 223 million.

BioActives. This business unit produces products with nutritional and/or physiological effects, including enzyme systems, probiotics, phospholipids, extracts and creatine. The unit is expecting strong growth because of the trend in the food processing industry to increasingly supplement staple food products with products that contain health-promoting components. Ch. Hansen, Indena, Hauser, Bauer and Orafit are its global primary competitors. Sales of the BioActives business unit in 2002 amounted to 80 million.

Feed Additives. The Feed Additives business is the world's only producer of all three amino acids used as additives in livestock feed: methionine, lysine and threonine. It also manufactures vitamin B3, calcium formiate for pork and veal farmers, and Mepron M85, a methionine derivative. The unit believes it is the global market leader, based on annual volumes, for its main product methionine, an essential amino acid which is primarily used in raising poultry. The business unit's main competitors are Novus, Adisseo and Ajinomoto. In 2002, the Feed Additives business unit had sales of \$568 million.

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Texturant Systems. Texturizing agents give processed food products form and stability. The principal products produced by this business unit are lecithin, carrageenan, pectin, xanthane and alginates, which are used for milk-based products, confectionery and bakery products, ready-made dishes, sauces, meat products, dressings, drinks and animal feed. The business unit believes it is one of the world's leading producers (based on sales) of lecithins, which are used as emulsifiers for food products. The unit's main global competitors are Danisco, FMC, CP Kelco and Rhodia. In 2002, sales of the Texturant Systems business unit amounted to 308 million.

Construction Chemicals

Degussa's Construction Chemicals division offers innovative products and technologies for the construction of new buildings and the repair and modernization of existing buildings. Its core competencies include concrete admixtures, tunnel and underground construction, cement-bound products, waterproofing and coating systems, and paints and lacquers. In addition, it offers a broad product range of tile adhesives, heat insulation and products for industrial and sport floors. With its system of customer-specific products and project-related application counseling, the business division can offer a complete range of services for the construction industry. The Construction Chemicals division believes it is among the world's leaders in chemical products for use in construction (on the basis of sales).

The division subdivides its range of products into two application-oriented segments: admixture systems and construction systems. Since construction is a local activity that is strongly influenced by local market requirements and situations, the division is further subdivided into geographical units in each of the two business segments. The geographical business units in the admixture systems segment focus on North America, Europe and the Asia/ Pacific region, while those in the construction systems segment focus on the Americas and Europe. The Construction Chemicals division supplies its products from approximately 120 plants in about 50 countries. The division's main competitors are Sika, Fosroc, W.R. Grace and RPM. In 2002, the Construction Chemicals division contributed sales of 1,819 million.

Fine & Industrial Chemicals

The Fine & Industrial Chemicals division supplies high quality chemicals for use as starting materials and intermediates in the pharmaceutical and agricultural chemicals industries and other areas, such as water treatment. It offers a wide range of high quality chemical materials and ingredients for pharmaceuticals and agrochemicals, pulp and paper, water treatment, mining, plastics and fuels. It includes the Fine Chemicals, Bleaching & Water Chemicals, C₄ Chemistry and Catalysts & Initiators business units.

Fine Chemicals. The Fine Chemicals business unit produces and markets high quality intermediate products. The main products are organic and inorganic intermediates, used mainly for the synthesis of pharmaceutical substances, as well as in crop protection, cosmetics and high performance polymers. The most important application areas for these products are in the pharmaceutical and agricultural industries for use as intermediates and starting materials. Degussa believes it is one of the leading suppliers of fine chemicals in Europe and North America (both based on sales). Through the acquisition of Laporte, Degussa strengthened its fine chemicals business, especially in the area of exclusive synthesis. The main competitors of this business unit are Lonza, DSM, Clariant, Cambrex, Rhodia and Bayer. In 2002, Fine Chemicals sales amounted to 972 million.

Bleaching & Water Chemicals. The main products of the Bleaching & Water Chemicals business unit are the ecologically safe bleaching and oxidizing agent hydrogen peroxide, auxiliaries for the paper industry, flocculants, and cyanide for the gold mining industry. With an annual capacity of approximately 500,000 metric tons, Degussa has the second largest hydrogen peroxide production capacity worldwide. Hydrogen peroxide is primarily used as a bleaching agent in the pulp and paper and textile industries, as well as for the production of bleaching active detergent raw materials. Flocculants are used in the treatment of municipal and industrial waste water, the manufacture of paper, the oil industry and the extraction of valuable minerals. With cyanides, Degussa believes it is among the market leaders in the area of mining chemicals (based on sales). The main competitors of this business unit are Solvay, Ciba and SN Floerger. In 2002, the Bleaching & Water Chemicals unit's sales amounted to 575 million.

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C₄ Chemistry. The C₄ Chemistry business unit operates through Oxeno Olefinchemie GmbH (Oxeno). Oxeno produces oxo alcohols and derivatives as well as C₄-olefins and derivatives for both internal and external use. Oxeno's products are used in the production of a wide variety of products such as hair spray, floor coverings, anti-knocking agents for gasoline, adhesives and various types of plastics. Oxeno believes it is one of Europe's leading producers (based on capacity and sales) of oxo alcohols, which include alcohols for plasticizers used primarily in PVC production, and believes it is the European market leader (on the basis of capacity and sales) of n-Butene-1. In the isononanol sector, Oxeno has developed its own process and increased its annual capacity from 140,000 to 200,000 metric tons by building a new isononanol plant in 2002. The unit's main competitors are Shell, Lyondell and BASF. In 2002, the business unit had sales of 545 million.

Catalysts & Initiators. Degussa formed the business unit Catalysts & Initiators by combining Laporte's catalysts and initiators business and Degussa's catalysts business. The main products of this business unit are precious and activated metal catalysts used for speeding up reactions in the pharmaceutical, chemical and petrochemical industries. In the initiators business, the unit offers organic peroxides and persulphates for polymer manufacture and a wide range of products for polymer processing as well as initiator-based specialties. Principal competitors are Akzo Nobel, AtoFina, Engelhard and Südchemie. In 2002, the Catalysts & Initiators business unit contributed sales of 255 million.

Performance Chemicals

This division concentrates on applied chemistry and superabsorbent polymers. The principal applications are additives for polyurethane foaming agents, paints and inks, as well as special raw materials for body care, laundry softeners and diapers.

Superabsorbents. Degussa believes it is a leading producer in both Europe and the United States of superabsorbent polymers, which are cross-linked polymers that store and do not release liquid, even under pressure. Superabsorbent polymers are used by the hygiene industry in products such as diapers. In addition, applications have been developed in the production of waterproof cables, and in the packaging, landscaping and forestry industries. With a total capacity of approximately 250,000 tons per year, the Superabsorbents business unit believes it is the world's second largest producer of superabsorbents. The unit's biggest competitors are BASF, Nippon Shokubai and Dow Chemical. In 2002, the Superabsorbents business unit's sales amounted to 460 million.

Care Specialties. The Care Specialties business unit primarily produces surfactants. Surfactants, or surface-active agents, control processes on surfaces such as those between oil and water or liquid and air. They permit a wide range of product applications. The business unit develops, produces and sells mild, skin-sensitive raw materials and active ingredients for use in an extensive range of health care products, cosmetics and household cleaning and care products, including detergents, cleaning and polishing agents and fabric care products. The business unit believes it is the world leader in the production (measured by sales) of surfactant chemistry and quaternary derivatives, which are used in the production of products such as laundry softeners. The unit's main competitors are ICI, Croda, Cognis and Solvay. In 2002, sales of the Care Specialties business unit were 549 million.

Oligomers & Silicones. The Oligomers & Silicones business unit produces and sells additives, processing aids and intermediates based on organically modified silicones and organic oligomers on a worldwide basis. The products of this business include polyurethane additives, industrial specialties and paint and coating additives. Polyurethane additives are used in the production of flexible and rigid foams for a variety of industries including furniture, automotive and refrigerator manufacturing. Industrial specialties are used as separating agents and coatings, such as coatings for self-adhesive products such as labels, adhesive tapes and insulating materials, as well as defoamers and emulsifiers, such as silicone emulsifiers for the improvement of texture and applicability of cosmetics and hair conditioners. Paint and coating additives are used as surface and dispersing additives in water-based, eco-friendly paints and varnishes to create smooth and scratch-resistant surfaces. The unit also produces additives for UV-hardening printing inks. The business unit's main competitors are Crompton, Air Products and OSI. The Oligomers & Silicones business unit had sales of 349 million in 2002.

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This division offers fine-particled reinforcing and surface enhancing materials and systems used in various applications, such as tires and anti-caking agents, as well as silanes, resins, cross-linking agents and colorants for the paints and coatings industries. These materials are generally used to increase the value of the products in which they are used, which include tires, silicone rubber and low emission and age-resistant coatings systems.

Coatings & Colorants. The Coatings & Colorants business unit offers a wide range of cross-linking agents, resins and colorants. Cross-linking agents and their derivatives are isophoron-based and serve as specialty solvents for industrial uses. Resins are varnish and glue polyesters. The unit's products are principally sold to manufacturers for use in consumer and industrial products such as coatings, adhesives and plastic moldings. The colorants business supplies paint pastes and coating mixing systems to leading manufacturers of paints and coatings for construction and industrial purposes. The business unit believes it is among the world leaders in the market for coating raw materials (based on sales). The main competitors for the business unit are Bayer, BASF, Dow Chemicals and Ciba and, in the field of colorants, CPS. In 2002, the business unit had sales of 646 million.

Aerosil & Silanes. The Aerosil & Silanes business unit makes products such as chloro- and organosilanes and fumed silica (Aerosil). Chlorosilanes are used in the semiconductor and telecommunications industries, and are also used by the unit in its production of Aerosil and organosilanes. Aerosil is a strengthening filler used in, among other things, silicon-rubber and plastics, or as a thickening agent in paint and coatings; it also improves the free flow properties of fire extinguisher powders and salt. Organosilanes have a wide range of applications, including, for example, in the façade protection industry. In organosilanes, the unit believes it holds a leading market position in Europe (based on capacity and sales). The unit also believes it is the world leader in the production of Aerosil (based on capacity and sales). The unit's main competitors are Crompton, Shin Etsu, Corning, Cabot and Wacker. In 2002, the business unit's sales amounted to 481 million.

Advanced Fillers & Pigments. The Advanced Fillers & Pigments business unit manufactures industrial carbon black, precipitated silica and rubber-silanes. These products are mainly used to reinforce rubber in tires but are also used in many other rubber products. An important application is the so-called "green" tire, which with its lower rolling resistance reduces fuel consumption and thus environmental pollution. Industrial carbon black as well as precipitated silica are also used in plastics, coatings and paint dyes. As of April 1, 2002, Degussa transferred its carbon black activities in North America to a 50-50 joint-venture with Engineered Carbons of the U.S. The unit believes it is a global market leader in the area of rubber reinforcement (based on volumes). Its main competitors are Cabot, Columbian, Rhodia, PPG and Crompton. The business unit had sales of 999 million in 2002.

Specialty Polymers

This division manufactures high quality plastics with a methyl-methacrylate base and C₁₂-polyamides. Its products are characterized by particular temperature, weathering and chemical resistances, and have good transparency and form stability properties. The most important markets for these products are the medical sector, the electrical and electronics industries, and the aircraft, automobile and construction industries.

High Performance Polymers. The High Performance Polymers business unit develops customized components and innovative systems and produces the necessary specialty polyamides and polyesters. C₁₂-polyamides are primarily used for components which require a high resistance, such as durable, abrasion- and weather-resistant wire coatings. The business unit focuses on the automotive, electrical and telecommunications industries. Its main competitors are AtoFina, Ube and EMS. In 2002, the unit contributed sales of 243 million.

Specialty Acrylics. The main products of this business unit are pharma polymers, bonding agents and functional polymers, such as oil additives used in the pharmaceutical, varnish, plastics and oil processing industries. Functional polymers are designed to ensure that lubricants and oils have the correct flowing properties and are effectively used in oil and transmission and hydraulic fluids, as well as in heat sealing varnishes for packaging foil, road markings and on high traffic industrial flooring. Pharma polymers are designed to ensure that active ingredients are released at exactly the right time and in the right location in the human body. The unit's main competitors are Infineum, Lubrizol and Rohm & Haas. In 2002, sales of the unit amounted to 473 million.

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Methacrylates. The Methacrylates business unit supplies bulk and performance monomers, as well as molding compounds. Bulk and performance monomers are used for the production of synthetic resins in weather resistant paints and varnishes. The unit uses methyl methacrylate (MMA) to manufacture polymethyl methacrylate (PMMA) molding compounds (also known as acrylic glass). The business unit markets its PMMA molding compounds primarily under the well-known brand name Plexiglas®. PMMA is used in products such as bathtubs, roofing materials and automobile headlights. Methacrylates are also used by the pharmaceutical industry to control the release of active ingredients in pills or capsules to allow medication to be taken only once a day. Degussa believes that it was one of the leading producers of MMA and PMMA in 2002 (based on volumes) in Europe and the United States. Competitors include Ineos and AtoFina. In 2002, the business unit contributed sales of 292 million.

Plexiglas. The Plexiglas business unit supplies plastic products based on acrylic glass (Plexiglas®) for glazing, special uses such as transparent noise barriers, and sanitary applications. In addition, it provides specialty products for technical applications, such as rigid foams used for sports equipment and the interior trim of passenger aircraft. The main competitors are Ineos and AtoFina. In 2002, the Plexiglas business unit had sales of 300 million.

Non-core Activities

In 2001 and 2002, Degussa disposed of non-core businesses that had accounted for approximately 90 percent of its non-core sales in 2000. Degussa's most important remaining non-core activities are the Metallurgical Chemicals business, which offers additives for the steel and casting industry and Oxxynova, whose products are used for the production of polyester. Degussa intends to complete the divestment of these activities by the end of 2003, with the precise timing depending on market conditions and other factors. Prior to disposal, Degussa intends to actively manage its non-core activities with the goal of enhancing their profitability.

Environmental Matters

Degussa is subject to a variety of laws and regulations governing the protection of the environment in each country in which it operates, including those related to the construction and operation of production sites, the use, storage, handling, discharge or disposal of toxic, volatile or otherwise hazardous materials used in its manufacturing processes, and the monitoring of emissions and waste. These laws and regulations pertain both to Degussa's present operations and to past waste disposal practices and discharges of hazardous materials.

The primary countries in which Degussa operates are Germany and the United States, though it also has facilities in a number of other countries throughout the world. As an illustration of the environmental regulatory regime under which Degussa operates, the most significant environmental laws affecting its German operations are described below. The Water Resources Management Act (*Wasserhaushaltsgesetz*) provides principles for managing inland water resources and, in particular, securing the quality of drinking water. It requires that the best available technology be used for purification of waste water. Degussa believes that it meets all the specified standards such as concentration limits set by this Act for residual water contaminants. For its waste water emissions, Degussa is charged fees in accordance with the Waste Water Charges Act (*Abwasserabgabengesetz*). Such charges are based on the content of harmful substances and other parameters like nitrogen content. The Federal Pollution Control Act (*Bundesimmissionsschutzgesetz*) and its implementing ordinances regulate emissions of pollutants from processing units and industrial plants. The Ordinance on Large Combustion Plants (*Großfeuerungsanlagen-Verordnung*) sets emission limits for each type of plant for all major air pollutants, such as sulfur dioxide, nitrogen oxides and dust. The Major Incident Regulation (*Störfall-Verordnung*) classifies the accident potential of installations and sets standards for safety management. Degussa believes that all of its plants comply with these regulations. The Recycling Act (*Kreislaufwirtschaftsgesetz*) regulates waste management. It aims at waste avoidance and reuse of waste. Degussa believes that it has set up environmentally sound production cycles in compliance with these regulations. The Chemicals Act (*Chemikaliengesetz*) includes provisions for the protection of humans and the environment from the harmful effects of dangerous chemical substances. Various ordinances classify dangerous substances and handling procedures. The Genetic Engineering Act (*Gentechnikgesetz*) establishes the legal framework within which genetic engineering can take place. The Act on Transportation of Dangerous Goods (*Gesetz zur Beförderung gefährlicher Güter*) sets standards for the safety of

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transportation and avoidance of accidents due to a release of dangerous substances. The Federal Soil Protection Act (*Bundesbodenschutzgesetz*) deals with the prevention of soil and groundwater contaminations and the remediation of contaminated soil.

Any failure to comply with present or future environmental laws or regulations could result in fines being imposed on Degussa, suspension of production or alteration of manufacturing processes. Such laws or regulations could also require Degussa to perform expensive remediation or to incur other expenses to comply with environmental regulation. Degussa believes that its domestic and international manufacturing facilities are currently in material compliance with the laws and regulations with respect to environmental matters applicable in the relevant jurisdictions. In order to ensure compliance, the Degussa board has introduced a set of ESHQ (*environmental protection, safety, health, quality*) requirements which are binding on all operating units. The proper implementation of this system is checked by means of regular internal audits.

The individual business units of Degussa conduct their environmental activities independently, while the management of the Degussa group sets general guidelines. Degussa actively participates in the worldwide initiative *Responsible Care*, a chemical industry commitment to continuously improve performance in health, safety and the environment. In addition, many of Degussa's domestic subsidiaries participate in the European Eco-Management and Audit Scheme (*EMAS*). The EMAS program includes the development of a management system clearly assigning environmental protection responsibilities, the completion of both internal and external environmental audits, the formation of specific environmental objectives and programs for plants and subsidiaries, the publication of environmental reviews, the evaluation of environmental procedures by an independent expert and, upon successful completion of the program, the registration of the site. By year-end 2002, a total of 21 sites had been inspected and certified under this three-year program. Furthermore, an increasing number of Degussa sites operate environmental management systems which are certified under ISO (International Standards Organization) 14001 or are in the process of certification. All relevant activities are expected to be covered by year-end 2004.

In 2002, Degussa invested 41 million in facilities and processes relating to environmental control, and, in addition, had other environmental-related expenditures of 248 million.

Degussa has established and continues to establish provisions for environmental liabilities where management believes that it is probable that a liability will be incurred and the amount of the liability can be reasonably estimated. Degussa adjusts accruals as new remediation commitments are made and as information becomes available which changes estimates previously made. Based on information currently available to it, Degussa believes that, taking into account its current level of environmental provisions, projected environmental liabilities will not have a material adverse effect on its financial position or results of operations.

Research and Development

In 2002, Degussa spent 343 million on research and development (*R&D*) for its core operations. As a percentage of sales, R&D expenditures for the chemicals division were 3.1 percent in 2002, compared with 3.2 percent in 2001. R&D at Degussa is primarily conducted by each of the business units, which pursue projects according to their respective competitive goals and needs. A localized approach to R&D is intended to ensure that new products are developed to respond as closely as possible to the individual unit's markets, customers and their needs. Degussa also has centralized R&D and innovation management which initiates and oversees strategically important projects and coordinates the exchange of information among business units. Creavis plays a role by reviewing ideas and projects and evaluating the corresponding business opportunities. Creavis is also responsible for Degussa's venture activities, such as its investment in venture capital funds and cooperation with start-up companies. Degussa is particularly focused on developing new product and market segments with high growth and earnings potential, an area in which Creavis continues to play an important role. Degussa employed 3,250 people in R&D activities for its core operations in 2002.

Other

Due to the wide range of products and businesses in the Degussa group, a discussion of the sources and availability of raw materials for the chemicals division is not meaningful, and individual product source and

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availability information is therefore not presented. The prices of some of the raw materials used by the Degussa group are subject to volatility, although raw material price changes have not had a material effect on the Company's chemical activities in the past. Degussa believes that the worldwide supply of raw materials for its products is satisfactory, and does not anticipate material disruptions to its businesses due to prolonged unavailability of raw materials or high prices. Group-wide, Degussa's activities are not significantly affected by seasonal factors, although individual products and businesses may be subject to seasonal variations.

Due to the wide range of products and businesses in the Degussa group, a discussion of the marketing channels used by Degussa is not meaningful. Each of Degussa's business units is responsible for its own marketing and sales activities, which vary according to geographical location and industry standards and practices.

Because Degussa's business units produce a wide variety of products, production capacity is not meaningful to most of these product areas and production capacity data are therefore not presented.

REAL ESTATE

Overview

E.ON's real estate subsidiary Vitera is one of the largest real estate groups in Germany in terms of its residential portfolio, with revenues of 1.2 billion and internal operating profit of 203 million in 2002. Vitera is engaged in the businesses of residential real estate and real estate development and in other real estate-related businesses.

Strategy

In 2002, Vitera reviewed its strategy and decided to focus on the core business residential real estate and the start-up business real estate development. The residential real estate business comprises in particular the wholesale purchase, management and retail sale of residential housing. The real estate development business focuses on office buildings and apartment houses in the principal metropolitan areas of Germany, as well as Prague and Warsaw. Vitera aims to phase out or dispose of its other businesses during the course of 2003, subject to market conditions.

Residential Real Estate

The residential real estate business is Vitera's main activity. Vitera's operating companies in this area are Vitera Wohnen AG (Vitera Wohnen), Deutschbau Wohnungsbaugesellschaft mbH (Deutschbau) and Vitera Rhein-Main GmbH (Vitera Rhein-Main). Vitera is Germany's largest private owner of residential property on the basis of housing units, with a property portfolio of approximately 165,000 housing units at year-end 2002. Vitera Wohnen is responsible for some 101,500 housing units in the Rhein-Ruhr area. Vitera Rhein-Main serves some 22,600 housing units in the Rhine-Main area. Deutschbau, in which Vitera holds a 50 percent shareholding, was fully consolidated for the first time as of January 1, 2002, and is responsible for some 40,900 housing units in the remaining parts of Germany.

The residential real estate business comprises the purchase of larger housing portfolios, the rental and management of the housing stock and the sale of housing units, preferably to tenants and private investors. Vitera increased the number of housing units sold from approximately 6,700 units in 2001 to approximately 9,900 units in 2002. At year-end 2002, Vitera's residential real estate units had an approximately 97.5 percent occupancy rate based on total rentable space.

E.ON's real estate activities originated in the 1930s in order to provide subsidized housing primarily in the Ruhr area for workers in the coal and steel industries. Today, some 69 percent of the housing stock is located in North Rhine-Westphalia. As a result of its historical origins, approximately 59 percent of Vitera's housing units at year-end 2002 were built prior to 1961. Vitera believes that its housing units are in reasonably good condition and intends to further improve the quality and profitability of its rental housing through selective maintenance and modernization. In 2002, Vitera incurred capital expenditures of 39 million, as well as maintenance and modernization costs of 208 million, in its residential real estate business for the improvement of its existing

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housing portfolio. It has spent approximately 153 million per year, on average, over the past seven years on maintenance and modernization of its housing stock and does not expect such expenses to increase significantly.

As of January 1, 2002, Viterra purchased an 86.3 percent shareholding in Frankfurter Siedlungsgesellschaft GmbH (FSG), which owns approximately 10,000 housing units in the Rhine-Main region. After selling a 0.2 percent shareholding to a third party investor in December 2002, Viterra acquired an additional 13.7 percent interest in FSG in January 2003. As of January 1, 2003, the housing stocks of FSG and Wohnbau Rhein-Main AG are being managed by Viterra's new subsidiary Viterra Rhein-Main.

In the past, the majority of Viterra's housing was built with low interest rate public financing and with low interest rate financing from third parties in exchange for perpetual tenancy rights (*Belegungsrechte*). As a result, approximately 46 percent of Viterra's housing units are subject to a wide variety of rent controls, some governmental and some contractually imposed by third parties with perpetual tenancy rights. Although some of these rent controls expire over time, their existence and the geographical concentration of the housing units impose practical restrictions on the ability of Viterra to dispose of substantial quantities of the housing units on reasonable terms.

Because of the original purpose to provide subsidized housing for workers in the coal and steel industries, companies like E.ON were initially granted nonprofit status for their real estate activities. In 1990, however, these activities became taxable as a result of a change in German income tax law. In connection with the change in taxable status, former nonprofit real estate companies have become entitled to certain depreciation deductions under German income tax law, subject to conditions and restrictions. These deductions depend, among other conditions, upon the level of profits from certain rental properties and capital expenditures on rental properties. These depreciation deductions are accounted for when they are realized on the tax return.

Changing their former opinion, the German tax authorities in the meantime came to the conclusion that the additional depreciation has to be taxed as a dividend while a profit and loss sharing agreement is in effect. E.ON, however, believes that this conclusion is not compatible with the concept of group taxation and the basic principles of German corporate tax law and has therefore challenged the tax authorities. Following three favorable precedent-setting cases in lower tax courts, in 2001 E.ON released the provision it had previously established to cover the related liability, which totaled 527 million. In December 2002, the federal tax court confirmed the favorable decisions of the lower courts. However, the final tax assessments for E.ON have not yet been made.

Viterra's financing of residential investments is primarily done through third-party mortgage financing and intra-Group borrowings.

Real Estate Development

Viterra's real estate development business unit, Viterra Development GmbH, focuses on the development of office buildings and apartment houses. It conducts all aspects of real estate development, including land acquisition, planning, rental and sale of the completed units to investors. The actual construction is executed by third-party general contractors. The business unit focuses on the principal metropolitan areas in Germany (Berlin, Frankfurt, Munich, Hamburg and Düsseldorf), as well as on projects in Prague and Warsaw. Viterra intends to expand its real estate development business in the future, concentrating its activities on mid-size projects.

Viterra's commercial real estate business unit currently holds approximately 90 commercial units, 10 of which are logistic properties. 43 units accounted for 97 percent of the portfolio in value terms at the end of 2002.

Other Activities

Viterra's other activities comprise the residential development business and the residential services business.

The market for residential real estate development in Germany has suffered from significant weakness for the last few years. Notwithstanding significant restructuring efforts, Viterra's residential development business could not improve its profitability in 2002. Management has therefore determined to phase out Viterra's development of one- and two-family houses by the end of 2003 and to transfer its apartment house development operations to the real estate development business unit described above.

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Viterra's residential services business provides real estate-related services (primarily heat and water submetering services and contracting services) for administrators and private and institutional owners of residential and commercial property through Viterra Energy Services and Viterra Contracting GmbH. Management believes that these businesses have not provided significant synergies with Viterra's other real estate businesses and has therefore decided to dispose of these operations during the course of 2003, subject to market conditions. In early 2003, Viterra reached an agreement to sell its contracting business to Mabanft GmbH, subject to regulatory approvals. Viterra aims to dispose of Viterra Energy Services through a multi-step auction process during the course of 2003.

Viterra Energy Services is accounted for as a discontinued operation in the Consolidated Financial Statements. For more detail on discontinued operations, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.

DISCONTINUED OPERATIONS

In 2002 and 2001, the Company discontinued the operations of its oil and distribution/logistics segments and of its aluminum and silicon wafer segments, respectively. These segments are accounted for as discontinued operations in accordance with U.S. GAAP. In addition, as noted above, Degussa and Viterra have either disposed of or have classified certain businesses as held for sale in 2002. E.ON therefore also considers these businesses to be discontinued operations. Under U.S. GAAP, results of all such discontinued operations must be shown separately, net of taxes and minority interests, under (Loss) income from discontinued operations in E.ON's Consolidated Statements of Income. For details, see Note 4 of the Notes to Consolidated Financial Statements.

Oil

VEBA Oel is active in the oil and gas exploration and production, oil processing and marketing and petrochemicals businesses. This includes the production of hydrocarbons, refining of crude oil, production of petrochemicals and the marketing of petroleum products and petrochemicals.

In July 2001, E.ON and BP entered into an agreement pursuant to which BP agreed to acquire a 51.0 percent stake in VEBA Oel by way of a capital increase. The agreement also provided E.ON with a put option that allowed it to sell the remaining 49.0 percent interest in VEBA Oel to BP at any time from April 1, 2002 for 2.8 billion, subject to certain purchase price adjustments. In December 2001, the German Federal Cartel Office (*Bundeskartellamt*) cleared the transaction. The capital increase took place in February 2002, giving BP majority control of VEBA Oel as of February 1, 2002. The aggregate consideration paid by BP for the capital increase was approximately 2.9 billion. In addition, 1.9 billion in shareholder loans from the E.ON Group to VEBA Oel were repaid. As of June 30, 2002, E.ON exercised the put option. E.ON has received 2.8 billion for its VEBA Oel shares plus the aforementioned repayment of the shareholder loans. During 2003, E.ON expects the contractual purchase price adjustment to be finalized. The portion of VEBA Oel's 2002 results included in Income (loss) from discontinued operations, net in E.ON's 2002 Consolidated Statement of Income amounted to 1.8 billion of income. In 2002, VEBA Oel had revenues of 1.7 billion and E.ON realized a gain on the disposal of 1.4 billion. For details, see Note 4 of the Notes to Consolidated Financial Statements.

Distribution/ Logistics

Stinnes is active in logistics services in the following areas: transportation, chemicals and materials. In transportation logistics, Stinnes operates primarily through Schenker AG, which provides air freight, sea freight, rail and road transportation, comprehensive exhibition logistics and transportation services and logistical services for industry, trade and the public sector. Stinnes also owns the Swedish transportation and logistics company BTL AB. The chemicals logistics services of Stinnes's subsidiary, Brenntag AG, include the procurement, transport and storage of chemicals, mixing and repackaging into smaller containers and the re-acceptance of empty containers. Brenntag supplements the sale of chemicals with application-specific advice, particularly with respect to specialty chemicals. In the materials business, Stinnes's subsidiary, Stinnes Interfer AG, procures,

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processes and distributes a wide variety of steel products as well as industrial minerals (special ores and fillers) and metals and metallurgical products (alloys, alloy briquettes, carburizing agents and pig iron).

In July 2002, E.ON agreed to sell its 65.4 percent interest in Stinnes to DB in connection with a cash tender offer DB later made to all Stinnes shareholders at a price of 32.75 per share. E.ON received cash proceeds of 1.6 billion upon completion of the tender, and Stinnes was deconsolidated as of September 30, 2002. The portion of Stinnes's 2002 results included in Income (loss) from discontinued operations, net in E.ON's 2002 Consolidated Statement of Income amounted to 603 million of income. In 2002, Stinnes had revenues of 8.8 billion and E.ON realized a gain on the disposal of 588 million. For details, see Note 4 of the Notes to Consolidated Financial Statements.

Aluminum

VAW, which became a wholly owned subsidiary of E.ON following the VEBA-VIAG merger, is one of Europe's major aluminum companies. VAW is active in the production and processing of aluminum into innovative high-quality aluminum products. It focuses its activities on the fabrication of semi-finished and finished products for packaging and for specially selected technical applications in the automotive, printing and construction industries. VAW has four principal business segments: primary materials, rolled products, flexible packaging and automotive products.

In March 2002, E.ON sold VAW to the Norwegian company Norsk Hydro ASA for the aggregate price of 3.1 billion, including financial liabilities and pension provisions totaling 1.2 billion. The portion of VAW's 2001 results included in Income (loss) from discontinued operations, net in E.ON's 2001 Consolidated Statement of Income amounted to 274 million of income. The income in 2002 consists of income from discontinued operations of 34 million and E.ON realized a gain on disposal of 893 million. The net gain on disposal of 893 million does not include the reversal of VAW's negative goodwill of 191 million, as this amount was required to be recognized as income from a change in accounting principles upon adoption of SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142), on January 1, 2002. For details, see Note 4 of the Notes to Consolidated Financial Statements.

Silicon Wafers

MEMC is a worldwide manufacturer of silicon wafers for the semiconductor device industry. On September 30, 2001, in accordance with its strategy of disposing of non-core assets, E.ON agreed to sell its 71.8 percent interest in MEMC to Texas Pacific Group, a San Francisco-based financial investor, for a symbolic price, which includes the assumption of shareholder loans made by E.ON. The purchase price may be increased to a maximum of \$150 million if MEMC substantially improves its earnings performance in 2002. Final determination of such purchase price increase, if any, is not expected before the second quarter of 2003.

The transaction was completed on November 13, 2001. The portion of MEMC's 2001 results included in Income (loss) from discontinued operations, net in E.ON's 2001 Consolidated Statement of Income amounted to 810 million of losses. For details, see Note 4 of the Notes to Consolidated Financial Statements.

Other

During 2002, Degussa divested several non-core businesses. For details on the dispositions, see Chemicals Acquisitions and Dispositions. The portion of the results of these divested operations included in Income (loss) from discontinued operations, net in E.ON's 2002 Consolidated Statement of Income amounted to a loss of 84 million in 2002. In 2002, the divested Degussa non-core businesses had revenues of 410 million and E.ON realized an aggregate loss on their disposal of 93 million. For further information, see Note 4 of the Notes to Consolidated Financial Statements.

In accordance with its strategy of focusing on its core business of residential real estate, Viterra has decided to divest its 100 percent interest in Viterra Energy Services, which provides heat and water submetering services for administrators and owners of residential and commercial property. Viterra currently expects to sell Viterra Energy Services in the course of 2003 and accordingly has classified Viterra Energy Services as an asset held for

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sale in the Consolidated Financial Statements. In 2002, Viterro Energy Services had revenues of 456 million. For further information, see Note 4 of the Notes to Consolidated Financial Statements.

OPERATING ENVIRONMENT

As Germany's fourth-largest industrial group on the basis of market capitalization, all social, political and economic developments and conditions in Germany affect E.ON. Labor costs, corporate taxes and employee benefit expenses in Germany are high and weekly working hours are shorter compared with most other EU member states, the United States and Japan. Nonetheless, many factors, including monetary and political stability, high environmental protection and standards and a well-educated, highly qualified workforce continue to positively affect Germany's competitive position in world trade.

By virtue of its operations outside the European Monetary Union (EMU), the Group is also subject to the risks normally associated with cross-border business transactions and business activities, particularly those relating to exchange rate fluctuations. In addition, because most of the Group's operations are based in Europe, both the development of the European market and the entry of certain eastern European countries into the EU will continue to create new opportunities and challenges for E.ON.

ECONOMIC BACKGROUND

Germany

During 2002, the general economic situation deteriorated worldwide. The German Council of Economic Advisers considers all three major economic areas—the EU, the United States and Japan—to be in a fragile condition. As a consequence of sluggish worldwide economic conditions, German export performance remained weak, hurting the economy. In addition, domestic demand was poor compared to 2001. As a result, the German economy had the worst performance in the Eurozone in 2002. The real gross domestic product rose by only 0.2 percent, compared with an increase of 0.6 percent in 2001. Capital spending by businesses decreased by 6.4 percent, mainly due to a recession in the construction industry, while the level of investment in machinery and equipment fell by 8.4 percent. Other investment—especially in computer software—grew by 2.5 percent. The German economy gained some momentum in the second part of 2002, as consumption and exports increased slightly. A growth rate of 1.0 percent in 2003 is expected by the Council of Economic Advisers.

Long-term interest rates in the Eurozone decreased by 0.1 percentage points in 2002. In December 2002, the European Central Bank reduced each of its deposit facility and margin lending rates by 0.5 percentage points, to 3.75 percent and 1.75 percent, respectively, noting that it did not believe that the reduction would increase inflationary pressures in the Eurozone.

Germany's competitive position in world trade continues to benefit from many factors, including monetary stability, a reputation for quality and recent productivity gains. In 2002, Germany achieved a surplus in export and services in real terms of 97.5 billion, compared with a surplus of 62 billion in 2001. However, the higher surplus resulted from lower imports rather than higher exports. Also, due to weak economic growth and lack of structural reforms, unemployment remained high in Germany in 2002. The reasons for unemployment are predominantly of a structural nature and include, among other factors, extensive regulation of the labor market and high labor costs (compared with the rest of the EU and the United States).

Both chambers of the German legislature (*Bundestag* and *Bundesrat*) approved the Tax Reduction Act (*Steuersenkungsgesetz*) in July 2000. The Act came into effect on January 1, 2001. The Act provides tax relief for families, private households and businesses. The top marginal income tax rate will be lowered from 53 percent in 1999 to 42 percent by 2005.

The Tax Reduction Act replaced the corporate imputation system with a classic corporate tax system (*Halbeinkünfteverfahren*). The 30 percent corporate income tax rate on distributed earnings and the 40 percent corporate income tax rate on non-distributed profits were both reduced to 25 percent. The corporate income tax liability remains subject to a solidarity surcharge of 5.5 percent.

On February 21, 2003, the Reduction of Tax Benefits and Exemptions Act (*Steuervergünstigungsabbaugesetz*) passed the *Bundestag*. If enacted in its current form, the Reduction of Tax Benefits and Exemptions

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Act would introduce a number of changes that could adversely affect E.ON. These changes include, *inter alia*, a limitation on the use of loss carryforwards. Under the current proposal, only loss carryforwards of up to 100,000 would be deductible from profits without limitation. Loss carryforwards exceeding 100,000 could only be used to offset half of a taxpayer's annual profits. In addition, the corporate income tax credit that reflects the rate differential between distributed and retained earnings under the former corporate imputation system and was granted to corporations with such retained earnings in an amount equal to 1/6 of each dividend distribution for a transitional period, would be limited for each year to 1/14 of the aggregate amount of corporate income tax credits available to such corporations on December 31, 2002. Furthermore, taxpayers would no longer be allowed to use the so-called LIFO method (last-in, first-out) to evaluate similar assets of inventory, with the exception of non-iron metals. The option to set-up provisions for expenses regarding work-related anniversaries would also be abolished. Finally, the basic subsidy for the construction or purchase of a house or apartment used for the taxpayer's own living purposes (*Eigenheimzulage*) would be significantly reduced. This tax reform legislation still requires the approval of the *Bundesrat* to become effective. The opposition parties, which hold the majority in the *Bundesrat*, have already announced that they will not approve the legislative proposal in its current form. It is therefore currently impossible to predict whether (or in what form) the Reduction of Tax Benefits and Exemptions Act will pass into law.

The Flood Victims Solidarity Act (*Flutopfersolidaritätsgesetz*), passed in response to severe flooding in Germany during the summer of 2002, increased Germany's corporate tax rate to 26.5 percent for 2003 only.

In 1999, the German legislature introduced an environmental tax reform. The introductory step, which took effect as of April 1, 1999, introduced a new tax on electricity consumption of 1.02 cent per kWh and an increase in tax rates of 3.07 cent per liter for gasoline, 2.05 cent per liter for heating oil and 0.16 cent per kWh for natural gas. These energy tax revenues are used to reduce the contribution rate for the government social security pension system. In November 1999, a second step introduced a yearly increase of 3.07 cent per liter of gasoline and 0.26 cent per kWh of electricity for the years 2000 to 2003. Accordingly, as of each of January 1, 2000, January 1, 2001, January 1, 2002, and January 1, 2003, the tax on gasoline rose by 3.07 cent per liter and the tax on electricity by 0.26 cent per kWh. In addition, the environmental tax reform includes an indirect tax preference for low sulfur gasoline from November 2001. A special tax on heavy fuel oil used for power generation was abolished and all uses are now taxed at 25.0 per ton. In 2002, the German legislature revised the exemption policy for industry. The compensation mechanism in which the burden of the higher energy tax is almost compensated by lower contributions to the social security system has been changed by using more actual figures for calculating the relief from lower social security rates. As a result, E.ON expects no material impact from the higher energy tax. The legislature also increased the reduced tax rates from 20 percent to 60 percent of the normal rate. It increased the tax rates for natural gas for heating purpose by 58 percent to 5.5 per MWh. These changes, including other measures, are expected to result in an additional burden for the industry of approximately 1.6 billion in 2003. For additional information on the tax regime applicable to German corporations, see Item 10. Additional Information Taxation Taxation of German Corporations.

The power industry and the German government have now reached an agreement to phase out nuclear energy which has been passed into law and is expected to take effect shortly (see Business Overview E.ON Energie).

Europe

In 1992, the twelve original members of the former European Economic Community signed the Treaty on European Union (the Treaty), a significant step toward creating a single integrated market. The Treaty provided a working program for European integration, including the coordination of economic policies of the EU countries and preparations for the introduction of a single currency. On January 1, 1999, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland (the participating countries) adopted the euro as their single currency through the EMU, with fixed exchange rates for the participating currencies (the legacy currencies) against the euro. In the beginning of 2001, Greece also joined the EMU, becoming a participating country. On January 1, 2002, the euro became the official legal tender for cash transactions in all participating countries. The legacy currencies have been withdrawn from circulation. Not all

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EU member states participate in the EMU. The United Kingdom, Sweden and Denmark chose not to be initial participants in the euro.

Since the ratification of the Treaty, the EU has been enlarged from 12 to 15 member states, with the entry of Austria, Finland and Sweden in January 1995. It is now facing another possible enlargement to include several additional European countries, primarily East European countries. In 1997, the EU signed accession agreements with six applicant countries: Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia. The agreements provide for the entry into the EU of the relevant applicant, provided that the candidate-specific accession criteria are met. In early 2000, the EU started the accession process with another six countries – Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia. Turkey also reached the status of an accessing country. On December 15, 2002, the European Council in Copenhagen invited Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia to join the European Union as of May 1, 2004. Before these countries are able to join the EU, significant institutional reform within the current 15 EU member states will be necessary to enable the EU to integrate the new members. To date, the EU intergovernmental conference has not finalized a draft treaty on the necessary institutional reforms within the framework of an European Constitution. A draft is expected to be discussed within the EU during 2003.

U.K.

In the United Kingdom, the economy weathered the general global downturn relatively well in 2002. Due to strong household demand, low interest rates and growing public expenditures, the British economy performed well above the European average. Monetary and fiscal policy provided a stable macroeconomic environment, so that prospects for 2003 are quite good. The U.K. economy is expected to have grown at a rate of 1.6 percent in 2002 in real terms according to the Council of Economic Advisers. This is expected to accelerate to a growth rate of 2.4 percent in 2003. Inflation in 2002 was 1.6 percent.

U.S.

The economic recovery in the United States has been somewhat uneven. Although private investment was again weak in 2002, economic growth was fueled by strong government and private household demand. An expected turnaround in business capital investment has not yet materialized. However, interest rates remained low, supporting growth. The U.S. achieved a real growth rate of 2.4 percent in 2002, with a slight increase to 2.6 percent expected in 2003 according to the Council of Economic Advisers. Inflation remained under control, with an annual rate for 2002 of 1.6 percent.

RISK MANAGEMENT

While E.ON's divisions have varying degrees of international activities and varying exposures to fluctuations in exchange rates, on an overall basis E.ON has certain exposures to fluctuations between the euro and the other major world currencies that it seeks to manage through hedging activities. Foreign exchange rate risk management, along with liquidity management and interest rate risk management, is generally centralized on a Group-wide basis and is the responsibility of the Group treasury. With E.ON AG's approval, the currency and interest rate risks of Group companies are also hedged with external banks or with Group treasury in conformity with E.ON's financial guidelines. E.ON only uses interest rate and currency derivatives to hedge its risk positions deriving from underlying business transactions, and E.ON continually assesses its exposure to these risks resulting from the underlying exposures and the results of hedging transactions. Moreover, E.ON is exposed to risks from fluctuations in the prices of commodities and raw materials. The E.ON Energie and Powergen divisions also engage in the trading of energy-related commodity derivatives, subject to guidelines for risk management. For a more detailed discussion of the current exchange rate, interest rate and commodity price risk exposures and risk management policies of the Group, see Item 5. Operating and Financial Review and Prospects Results of Operations Exchange Rate Exposure and Currency Risk Management, Item 11. Quantitative and Qualitative Disclosures about Market Risk and Notes 29 and 30 of the Notes to Consolidated Financial Statements.

Table of Contents**ENVIRONMENTAL MATTERS**

E.ON is subject to numerous national and local environmental laws and regulations concerning its operations, products and other activities in the various jurisdictions in which it operates. Although E.ON believes that its domestic and international production facilities and operations are currently in material compliance with the laws and regulations with respect to environmental matters, such laws and regulations could require E.ON to take future action to remediate the effects on the environment of prior disposal or release of substances or waste. Such laws and regulations could apply to various sites, including power plants, chemicals plants, waste disposal sites and chemicals warehouses. Such laws and regulations could also require E.ON to install additional controls for certain of its emission sources or undertake changes in its operations in future years. For greater detail on the application of environmental laws and regulations to E.ON's operations, see "Environmental Matters" under "Business Overview" E.ON Energie, "Business Overview" Powergen and "Business Overview" Chemicals above. E.ON has established and continues to establish accruals for environmental liabilities where it is probable that a liability will be incurred and the amount of liability can be reasonably estimated. The provisions made are considered to be sufficient for known requirements. E.ON adjusts accruals as new remediation commitments are made and as information becomes available which changes estimates previously made.

The extent and cost of future environmental restoration and remediation programs are inherently difficult to estimate. They depend on the magnitude of any possible contamination, the timing and extent of corrective actions required and E.ON's share of liability relative to that of other responsible parties.

Any failure to comply with present or future environmental laws or regulations could result in the imposition of fines, suspension of operations or production or alteration of production processes. Such laws or regulations could also require acquisition of expensive remediation equipment or other expenditures to comply with environmental regulation.

ORGANIZATIONAL STRUCTURE

E.ON AG is the Group's Düsseldorf-based management holding company. E.ON AG provides strategic management for Group companies and coordinates Group activities. E.ON AG also provides centralized controlling, treasury, risk management (including hedging) and service functions to Group members, as well as communications, capital markets and investor relations functions. The Group's operating activities are organized into business divisions, each of which is responsible for managing its own day-to-day business. The following table sets forth certain information about each of the subsidiaries which served as a parent or co-parent company of an E.ON business division as of December 31, 2002:

Name of Subsidiary	Country of Incorporation	Percentage Ownership Interest held by E.ON	Percentage Voting Interest held by E.ON
E.ON Energie AG (energy)	Germany	100.0%	100.0%
Powergen Limited (energy)	U.K	100.0%	100.0%
Degussa AG (chemicals)	Germany	64.56% (1)	64.56% (1)
Viterra AG (real estate)	Germany	100.0%	100.0%

- (1) Ownership and voting interest reduced to 46.5 percent as a result of the transaction with RAG in February 2003. For more information, see "History and Development of the Company" Ruhrgas.

PROPERTY, PLANTS AND EQUIPMENT**GENERAL**

The Company owns most of its production facilities and other properties. Some of E.ON's facilities are subject to mortgages and other security interests granted to secure indebtedness to certain financial institutions. As of December 31, 2002, the total amount of indebtedness secured by these facilities was approximately \$5.9 billion, \$1.8 billion of which was secured by property owned by Viterra. E.ON believes that the Group's

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principal production facilities and other significant properties are in good condition and that they are adequate to meet the needs of the E.ON Group. In 2001, E.ON moved to its new headquarters located at E.ON-Platz 1, D-40479 Düsseldorf, Germany. E.ON owns its headquarters.

PRODUCTION FACILITIES***E.ON Energie***

E.ON Energie produces electricity at jointly and wholly owned power plants. Its power generation facilities have a total installed capacity of approximately 50,200 MW, E.ON Energie's attributable share of which is approximately 34,100 MW (not including mothballed, shut down and reduced power plants). Electricity is transmitted to purchasers by means of high-voltage transmission lines and underground cables owned by E.ON Energie. For further details, see [Business Overview E.ON Energie](#). E.ON Energie believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. E.ON Energie's base load nuclear power plants operated at approximately 87.3 percent of available capacity in 2002. E.ON Energie believes that average utilization data calculated on the basis of all of its international and German power stations would not reflect differences between base load and peak load requirements or differential costs of generation and would therefore dilute the significance of such a measure.

Powergen

Powergen produces electricity at jointly and wholly owned power plants. Its power generation facilities have a total installed capacity of approximately 24,300 MW, Powergen's attributable share of which is approximately 20,200 MW (not including mothballed and shutdown power plants). Electricity is transmitted to purchasers by means of the National Grid transmission network in the U.K. and LG&E Energy's transmission network (operated by MISO) in the U.S. For further details, see [Business Overview Powergen](#). Powergen believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. Powergen's power plants operated at approximately 50 percent of theoretical capacity in the U.K. and 58 percent of theoretical capacity in the U.S. in 2002. This average utilization is calculated for all U.K. and U.S. power stations and does not reflect differences between base load and peak load power stations.

Chemicals

On a global basis, Degussa operates 62 major production plants, the locations of which are as follows:

Germany	Marl, Krefeld, Darmstadt, Trostberg, Essen, Lülldorf, Worms, Kalscheuren, Augsburg, Oldenburg, Pullach, Rheinfelden, Hanau-Wolfgang and Wesseling
Europe	Malmö, Sweden; Weissenstein, Austria; Schaffhausen, Switzerland; Antwerp, Belgium; Botlek, the Netherlands; Rotterdam, the Netherlands; Ambès, France; Ham, France; Baupte, France; Ravenna, Italy; Treviso, Italy; Rubi, Spain; Sines, Portugal; Knottingly, U.K.; Seal Sands, U.K.; Jaslo, Poland; Perm, Russia; Slovenska Lupca, Slovakia; Chrudim, Czech Republic and Istanbul, Turkey
Brazil	Barra do Riacho; Sao Paulo
United States and Canada	Mobile, Alabama; Hopewell, Virginia; Greensboro, North Carolina; Cincinnati, Ohio; Elyria, Ohio; Amherst, New York; Philadelphia, Pennsylvania; Chester, Pennsylvania; Mapleton, Illinois; Shakopee, Minnesota; Janesville, Wisconsin; Jayhawk, Kansas; Piscataway, New Jersey and Edmonton, Canada
Africa	Port Elizabeth, South Africa; Fez, Morocco
Asia	Yokkaichi, Japan; Nanning, China; Qingdao, China; Shanghai, China; Yosu, South-Korea; Ta Yuan, Taiwan; Maptaphut, Thailand; Gajraula, India; Bekasi, Indonesia
Oceania	Dandenong, Australia; Morrinsville, New Zealand

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Degussa believes that its production facilities are in good operating condition and that its machinery and equipment have been well maintained.

Real Estate

Viterra owns approximately 165,000 housing units and approximately 90 commercial properties. See [Business Overview](#) [Real Estate](#) for further information. No single property is material to the E.ON Group.

INTERNAL CONTROLS

E.ON's own financial controls indicate that E.ON is organized, and will continue to be operated, in a financially sound manner. E.ON's internal controls and procedures are integrated with its firm-wide risk management system. E.ON's integrated risk management and internal controls system has the following key elements: the planning and controlling process, the reporting structure, E.ON Group-wide guidelines, internal control and monitoring by E.ON's Management Board and Supervisory Board, the internal auditing process and the risk reporting system.

E.ON's control systems and procedures are used to monitor the Company's investments, obligations, commitments and operations. The internal control system is not restricted to identifying and monitoring balance sheet items, but also identifies and monitors off-balance sheet transactions. The formation of corporate or other business entities to hold, control or own any investment, asset or liability would also be controlled by the process to manage the risks associated therewith.

E.ON believes that appropriate internal controls are in place to provide material information to E.ON's management with regard to E.ON's operations, financial practices and corporate structure. In addition, E.ON believes that its internal controls work effectively to assure that material information is recorded, accounted for and disclosed appropriately and in accordance with applicable law.

As a result of the listing of its ADRs on the NYSE, E.ON is also subject to the listing requirements of the NYSE and the U.S. federal securities laws, including the U.S. Sarbanes-Oxley Act of 2002 ([Sarbanes-Oxley](#)) and the rules and regulations thereunder. For more information on E.ON's compliance with these requirements, see [Item 10. Additional Information](#) [Memorandum and Articles of Association](#) [Corporate Governance](#) and [Item 15. Controls and Procedures](#).

Item 5. Operating and Financial Review and Prospects.

OVERVIEW

On June 16, 2000, the Company completed the merger between VEBA and VIAG. VIAG was one of Germany's largest corporate groups, operating in five core businesses, classified in two main categories: energy and telecommunications (services) and chemicals, packaging and aluminum (innovative industries). VIAG's divisions were Bayernwerk for the energy business, SKW Trostberg for the chemicals business, VIAG Telecom for the telecommunications business, VAW for the aluminum business and Schmalbach-Lubeca AG and Gerresheimer Glas AG ([Gerresheimer Glas](#)) for the packaging business.

The VEBA-VIAG merger was accounted for under the purchase method of accounting. The merger was completed on a step by step basis. The first step was the acquisition from the Free State of Bavaria on October 7, 1999 of a total of 10 percent of VIAG's shares at 23.00 per share, for an aggregate purchase price of 1,592 million. The second step was the acquisition of the remaining 90 percent of VIAG's shares using the share exchange ratio of one VEBA share for 2.5 VIAG shares, resulting in the issuance of 249,113,480 new Ordinary Shares for an aggregate purchase price of 9,271 million. The total purchase price amounted to 10,920 million, including acquisition costs of 57 million. The difference of 340 million between the purchase price of the acquired net assets and their fair values as of June 30, 2000 was capitalized as goodwill. The operations of VIAG are therefore included in E.ON's financial data beginning as of July 1, 2000. For more information on the VEBA-

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VIAG merger, see Item 4. Information on the Company History and Development of the Company VEBA-VIAG Merger and Note 4 of the Notes to Consolidated Financial Statements.

Following the VEBA-VIAG merger, E.ON subsidiaries PreussenElektra and Bayernwerk merged to form the new E.ON Energie on July 14, 2000. E.ON acquired the remaining 2.46 percent of E.ON Energie held by former shareholders of Bayernwerk AG in September 2000 through the issuance of 11,387,615 Ordinary Shares, for a purchase price of 686 million. This acquisition was accounted for under the purchase method. The amount of 548 million was recorded as goodwill. On February 9, 2001, E.ON subsidiaries Degussa-Hüls and SKW Trostberg merged to form the new Degussa. More information about these mergers can be found in Item 4. Information on the Company Business Overview E.ON Energie Overview and Business Overview Chemicals Overview.

In July 2002, E.ON acquired 100 percent of the issued share capital of Powergen, an integrated international utility business based in London and Coventry/ England, for total cash consideration of 7.6 billion (net of 0.2 billion of cash acquired) and the assumption of 7.4 billion of debt. The acquisition was accounted for under the purchase method and goodwill in the amount of 8.9 billion resulted from the purchase price allocation. A subsequent impairment charge reduced this amount to 6.5 billion. For more information on this charge, see Results of Operations Powergen. The operations of Powergen are reflected in the Powergen business segment from July 1, 2002. Additional information on the Powergen acquisition can be found in Item 4. Information on the Company History and Development of the Company Powergen Acquisition and Business Overview Powergen.

E.ON participates in a number of different businesses. E.ON operates in the continental European energy business through E.ON Energie, in the U.K. and U.S. energy businesses through Powergen, in the chemicals business through Degussa and in the real estate business through Vitera. The E.ON Group also has minority participations in numerous companies, particularly in the E.ON Energie division, which are classified as associated companies. Income from these participations is reflected in the income statement as income from equity interests and is generally included in internal operating profit. Management views these associated companies as an integral part of the operations of E.ON. Beginning as of January 1, 2002, E.ON is reporting the results of its two remaining equity interests in telecommunications companies under Holding/other. For more information, see Item 4. Business Overview Introduction. In line with its objective to focus on energy as its core business, E.ON has sold or classified as discontinued the operations of its former silicon wafer, aluminum, oil and distribution/logistics business segments, as well as certain components of its chemicals and real estate business segments. For additional information, see Item 4. Information on the Company Business Overview Discontinued Operations and Acquisitions and Dispositions.

ACQUISITIONS AND DISPOSITIONS

The following discussion summarizes each of the principal acquisitions and dispositions made by E.ON since January 1, 2000, and is organized by business segment. For information on the accounting treatment of these transactions, see Note 4 of the Notes to Consolidated Financial Statements. For information on E.ON AG's acquisition of Powergen in 2002 and Ruhrgas in 2003, as well as its expected disposition of Degussa, see Item 4. Information on the Company History and Development of the Company Powergen Acquisition and History and Development of the Company Ruhrgas.

E.ON Energie. On January 10, 2000, E.ON Energie acquired 87.4 percent of the shares of EZH, the Dutch energy utility. E.ON Energie purchased the remaining 12.6 percent of EZH on January 27, 2000. The total purchase price for these purchases was 1,082 million. The acquisition was accounted for using the purchase method of accounting and the purchase price allocation resulted in goodwill of 590 million. EZH's results for the entire 2000 financial year and all subsequent periods have been included in the Consolidated Financial Statements. Following completion of the acquisition, EZH was renamed E.ON Benelux Generation.

As of October 31, 2000, E.ON Energie sold its 18.5 percent shareholding in VEW to RWE. In return, E.ON Energie's majority-owned subsidiary Thüga acquired RWE's 11.95 percent shareholding in Gasag and E.ON

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Energie acquired a 28.1 percent shareholding in Gelsenwasser, thereby increasing the Group's holdings in Gasag to 24.9 percent and those in Gelsenwasser to 80.5 percent.

During the first part of 2001, E.ON Energie acquired a controlling interest in Sydkraft, a Swedish energy group, in a series of transactions. As a result of these transactions, for which E.ON Energie paid an aggregate of 1.7 billion, E.ON Energie owned 60.8 percent of Sydkraft, and fully consolidated Sydkraft in the Consolidated Financial Statements effective as of May 1, 2001. The purchase price allocation resulted in no goodwill being recorded. In October 2001, the Company concluded a put option agreement which allows a minority shareholder of Sydkraft to sell any or all of its shares to E.ON Energie at any time through December 15, 2005. The consideration payable by E.ON Energie upon the exercise of this option in full is approximately 2 billion.

In June 2001, E.ON Energie acquired an additional 61.85 percent interest in Hein Gas for 514 million, raising its total ownership interest to 89.9 percent. E.ON therefore fully consolidated Hein Gas effective June 1, 2001. The purchase price allocation resulted in goodwill of 74 million.

During 2001, E.ON, in compliance with conditions imposed in connection with the antitrust approval for the VEBA-VIAG merger, sold investments in LAUBAG, VEAG, BEWAG and HEW which were owned by VEBA and/or VIAG prior to the merger. LAUBAG and VEAG were sold on May 16, 2001 for an aggregate of 837 million, resulting in a 1 million loss. BEWAG was sold on May 16, 2001 for 1,394 million, resulting in a gain of 63 million. HEW was sold on May 17, 2001 for 419 million, resulting in a gain of 63 million.

In 2002, E.ON Energie acquired new interests or increased its existing shareholdings in a number of entities. The aggregate consideration paid for the following 2002 acquisitions totaled 3,449 million, and the related purchase price allocations resulted in aggregate goodwill of 1,425 million, of which 1,003 million is based on preliminary allocations as of December 31, 2002.

In January and April, E.ON Energie acquired a majority interest in the Finnish energy utility company Espoon Sähkö. Espoon Sähkö was fully consolidated as of April 1, 2002. As of December 31, 2002, E.ON Energie held an interest of 65.6 percent in Espoon Sähkö.

In May, E.ON Energie increased its 46 percent interest in EAM, a regional utility based in Kassel, Germany, to a majority interest. E.ON Energie fully consolidated EAM as of June 1, 2002. As of December 31, 2002, E.ON Energie held 73.3 percent of EAM.

In June, E.ON Energie purchased a 100 percent interest in EWB from the Finnish utility Fortum. EWB is a holding company with a 100 percent ownership interest in EWW, a regional utility in Hameln, Germany. Both companies were fully consolidated as of July 1, 2002.

In July, E.ON Energie acquired an additional 30.1 percent interest in EMR, a regional utility in Herford, Germany, from municipal shareholders, giving E.ON Energie a total interest in EMR of 55.2 percent. EMR was fully consolidated as of August 1, 2002.

In August, E.ON Energie acquired an additional 25.1 percent interest in Thüga from Bayerische Landesbank, thus raising its interest in Thüga, which was already fully consolidated, to 87.1 percent.

In September, E.ON Energie acquired a 49 percent interest in ZSE, the largest regional utility company in Slovakia. ZSE is accounted for under the equity method.

In November, E.ON Energie acquired an additional 62.9 percent interest in ÉDÁSZ, a regional Hungarian utility, thereby increasing its stake in ÉDÁSZ to 90.6 percent. ÉDÁSZ was fully consolidated effective December 1, 2002.

In 2002, E.ON Energie divested the following shareholdings, receiving total consideration of 940 million and realizing an aggregate net gain on these sales of 341 million.

In January, E.ON and E.ON Energie sold their indirect shareholdings of 6.5 percent each in STEAG, a German independent power producer to RAG.

In March 2002, E.ON Energie reduced its shareholding in Sydkraft by transferring 5.8 percent of its interest to Statkraft.

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In July, E.ON Energie disposed of its entire 24.5 percent interest in Watt AG, a Swiss utility, to Nordostschweizerische Kraftwerke AG.

At December 31, 2002, E.ON Energie had outstanding obligations arising under put options held by third parties that would require it to pay a total of approximately 3.2 billion if all such options were exercised. Approximately 2 billion of the total relates to the put option for Sydkraft.

Powergen. On October 21, 2002, Powergen acquired the U.K. based retail business of the TXU Group along with three coal-fired generation plants and certain gas supply contracts, for total cash consideration of 2.1 billion, net of 0.1 billion of cash acquired. Powergen also funded working capital associated with these businesses of 0.4 billion. Goodwill of 2.3 billion resulted from the purchase price allocation.

In October 2002, Powergen acquired the remaining 50.0 percent interest in its former joint venture Powergen Renewables Holdings Limited (Powergen Renewables) for 92 million and subsequently holds 100 percent of Powergen Renewables. In addition, Powergen assumed 57 million of debt. Total goodwill of 64 million was recorded in the purchase price allocation.

On November 8, 2002, in accordance with Powergen's strategy to focus on the core U.K. and U.S. markets, Powergen reached agreements to sell its 20 percent share in certain joint venture companies holding interests in independent power projects in India, Australia and Thailand. The sale of the interest in Thailand closed in January 2003 for proceeds of 5 million. The sales of the remaining joint ventures are expected to close later in 2003.

Chemicals. In the second half of 2000, E.ON proposed to merge Degussa-Hüls (in which it held 64.74 percent) and SKW Trostberg (in which it had acquired a 63.92 percent interest in the VEBA-VIAG merger) into a new entity called Degussa AG. The merger, in which Degussa-Hüls acted as the acquirer for accounting purposes, was approved by the shareholders of Degussa-Hüls and SKW Trostberg in October 2000, cleared by the EU antitrust authorities in early 2001 and became effective upon its entry into the commercial register on February 9, 2001. The transaction was effected through an exchange of shares using the following exchange ratios: one new Degussa AG share for one Degussa-Hüls AG share and five new Degussa AG shares for 22 SKW Trostberg shares. This share exchange resulted in E.ON holding a 64.55 percent ownership interest in Degussa AG. E.ON accounted for the merger as a transaction between entities under common control, and therefore no fair value adjustments to E.ON's interest in SKW Trostberg were made; however the interest of the public shareholders of SKW Trostberg was recorded at its fair value. As a result of this merger, E.ON recognized a Staff Accounting Bulletin 51 gain of 184 million which represents the difference between E.ON's net investment basis in the newly formed Degussa AG and its old basis in Degussa-Hüls and SKW Trostberg prior to the merger.

In December 2000, Degussa purchased 19.6 percent of Laporte, a specialty chemicals company, for 434 million. During the first half of 2001, Degussa acquired the remaining 80.4 percent of Laporte through a public tender offer for consideration of 1.8 billion. Laporte was fully consolidated as of March 31, 2001. The Laporte acquisition was accounted for using the purchase method. The purchase price accounting was finalized in March 2002 and resulted in goodwill of 1.1 billion.

In 2001 and 2002, Degussa disposed of a number of non-core businesses. In April 2001, Degussa sold Phenolchemie GmbH & Co. KG to the British Ineos group for 322 million, net of debt assumed of 66 million. In August 2001, Degussa sold the activities of dmde Degussa Metals Catalysts Cerdec AG (dmde) to OM Group, Inc. of the U.S. for 1.2 billion. In October 2001, Degussa sold ASTA Medica's oncology business to Baxter Healthcare S.A., a Swiss subsidiary of the U.S.-based company Baxter International, for 525 million. In October 2001, Degussa sold the Degussa Dental Group to the U.S. company Dentsply International Inc. for 576 million, including the assumption of 27 million in debt. These transactions resulted in a net gain of 530 million, which was recorded as income from continuing operations in the Consolidated Statement of Income for 2001. Degussa's dispositions of certain non-core businesses in 2002 qualified for discontinued operations accounting under SFAS 144, which E.ON adopted on January 1, 2002. For further information, see Discontinued Operations .

Real Estate. On January 1, 2002 Viterra acquired a 86.3 percent interest in FSG for a total purchase price of 312 million, including cash acquired of 39 million. FSG was fully consolidated effective January 1, 2002.

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After selling a 0.2 percent shareholding to a third party investor in December 2002, Viterra acquired an additional 13.7 percent interest in FSG for a purchase price of approximately 49 million in January 2003. No goodwill resulted from the purchase price allocation for either transaction.

Others. E.ON Telecom's 51.25 percent subsidiary VR Telecommunications GmbH & Co. sold its 60.25 percent stake in E-Plus Mobilfunk GmbH (E-Plus) to BellSouth on February 10, 2000. The total sale price was 7.4 billion plus the repayment of shareholder loans in the amount of 1 billion. E.ON's share of both of these amounts was 51.25 percent. On March 28, 2000, the former VEBA Telecom (later renamed E.ON Telecom) sold its 32 percent share in Cablecom Holding AG to NTL Inc. for 851 million.

On July 3, 2000, E.ON sold its 71.9 percent stake in Gerresheimer Glas, a glass business that was formerly part of the VIAG Group, to Investcorp and Chase Capital Partners. No gain or loss was recognized on the sale, as Gerresheimer Glas AG was accounted for as a business held for sale in the VEBA-VIAG merger.

Schmalbach-Lubeca is a packaging business that was formerly 59.8 percent owned by the VIAG Group. In August 2000, AV Packaging, at that time a 100 percent subsidiary of E.ON, made a tender offer to Schmalbach-Lubeca's minority shareholders which resulted in the tender of an aggregate 37.4 percent stake in Schmalbach-Lubeca. On August 30, 2000, AV Packaging increased its capital via the transfer of E.ON's 59.8 percent share in Schmalbach-Lubeca, and on September 30, 2000, AV Packaging further increased its capital via a cash contribution by Allianz Capital Partners GmbH, following which the tender was completed. After completion of a statutory squeeze-out of the remaining minority shareholders in 2002, AV Packaging, a 49-51 joint venture of E.ON and Allianz Capital Partners, holds a 100 percent stake in Schmalbach-Lubeca. Schmalbach-Lubeca's revenues are included in the Company's consolidated results of operations from July 1 to September 30, 2000, after which Schmalbach-Lubeca was accounted for under the equity method indirectly through AV Packaging until its disposition in December 2002.

As of October 1, 2000, E.ON sold the operating entities of VEBA Electronics to a consortium of buyers consisting of Arrow Electronics, Melville, Avnet, Phoenix and Schroder Ventures. The purchase price, including the transfer of shareholder loans, amounted to 2.6 billion. A gain of 44 million was recorded upon the sale. VEBA Electronics is included in the Consolidated Financial Statements through September 30, 2000.

On November 10, 2000, VIAG Telecom sold its 42.5 percent share in Orange Communications SA (Orange Communications) to France Telecom for aggregate consideration of approximately 1.8 billion, including the repayment of approximately 460 million in shareholder loans previously extended by E.ON to Orange Communications. The total amount of the shareholder loans and one fourth of the remaining consideration was payable in cash. The remaining three fourths of the selling price were paid for via the issuance of 102,675,638 shares in Orange S.A., the mobile business unit of France Telecom. The first official trading day of Orange S.A. stock was February 13, 2001. In connection with its receipt of these shares, E.ON entered into a lock-up agreement with France Telecom which excluded any sale of the Orange S.A. shares prior to February 26, 2002. In addition, France Telecom granted E.ON a put option allowing E.ON to sell the Orange S.A. shares to France Telecom on January 29, 2002 at a strike price of 9.00 per share and E.ON granted France Telecom a call option at a strike price of 11.00 per share that was exercisable on February 26, 2002. The sale of the stake in Orange Communications did not result in a significant gain, as it was accounted for at its fair value as part of the VEBA-VIAG merger.

In December 2000, Stinnes acquired 99.41 percent of the shares of the publicly traded Dutch chemicals distributor HCI through a cash tender offer to HCI's shareholders, with the total purchase price amounting to 293 million. The acquisition has been accounted for under the purchase method and resulted in goodwill of 185 million. HCI was fully consolidated effective December 1, 2000.

In January 2001, E.ON sold its 45 percent share in VIAG Interkom to British Telecommunications plc (BT) in accordance with the terms of an existing option agreement between the two parties. The cash consideration paid by BT totalled 7.25 billion, with BT also repaying 4.2 billion in shareholder loans. A gain of 110 million was recognized on the sale, as the book value of VIAG Interkom had been increased to its fair value at the time of the VEBA-VIAG merger.

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In October 2001, Klöckner's multi-metal distribution business was sold to Balli Group plc (94.5 percent) and to Westdeutsche Landesbank Girozentrale (5.5 percent) for 1.1 billion. The purchase price included the assumption of debt and pension provisions of approximately 800 million, with the remainder being paid in cash. A gain of approximately 140 million was recognized on the sale.

In January 2002, E.ON and France Telecom amended their agreement regarding the Orange S.A. shares. The strike price of the put option which France Telecom granted to E.ON was changed to 9.25 per share and the strike price of the call option E.ON granted to France Telecom was changed to 11.25 per share. The exercise dates for the respective options were also extended. E.ON exercised its amended put option on June 5, 2002, selling all 102,675,638 Orange S.A. shares to France Telecom for 9.25 per share, thereby receiving total consideration of approximately 950 million. E.ON realized a loss of 103 million on the transaction.

In July 2002, Schmalbach-Lubeca sold its PET and White Cap business units to Amcor, an Australian packaging manufacturer, for approximately 1.8 billion. In December 2002, AV Packaging sold Schmalbach-Lubeca to Ball Corporation, a U.S. based packaging manufacturer, for 1.2 billion. In 2002, E.ON recorded income from its equity investment in AV Packaging of approximately 558 million, resulting from gains on these transactions.

In January 2003, E.ON entered into an agreement to sell its 15.9 percent shareholding in Bouygues Telecom to the Bouygues Group for a total of approximately 1.1 billion. The disposition will occur in two tranches. In the first step, the Bouygues Group agreed to acquire a 5.8 percent stake in Bouygues Telecom (including approximately 60 million in shareholder loans) from E.ON for approximately 400 million. The second step involves parallel put and call options for the 10.1 percent interest, plus approximately 80 million in shareholder loans that E.ON will retain after the closing of the first step. Bouygues has a call option to buy the interest from E.ON between April 2003 and October 2005 and E.ON has a put option to sell this interest to Bouygues between October 2005 and February 2007. The exercise price of both the put and call options is approximately 670 million plus accrued interest over the period from the date of the completion of the first step through the exercise of the option. E.ON realized a gain of approximately 300 million on the divestment of the first tranche of Bouygues Telecom shares, which occurred on March 5, 2003.

Discontinued Operations. Consistent with its plans to focus on its energy business, E.ON disposed of a number of its non-core divisions and businesses during 2001 and 2002. As a result of the 2001 divestitures, the Company's former silicon wafer and aluminum business segments were accounted for as discontinued operations in accordance with Accounting Principles Bulletin No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, (APB 30). On January 1, 2002, the Company adopted SFAS No. 144, Accounting for the Impairment or Disposal of Long-lived Assets (SFAS 144), which requires it to account for disposals of a component of a segment as discontinued operations, thereby reducing the threshold needed for a particular divestiture to result in discontinued operations treatment. In 2002, E.ON discontinued the operations of its former oil and distribution/logistics business segments, following its disposal of VEBA Oel and Stinnes. In addition, certain operations in the chemical and real estate business segments have either been disposed of or have been classified as held for sale and, as such, these components are also accounted for as discontinued operations. These transactions are summarized below.

On September 30, 2001, E.ON entered into an agreement for the sale of MEMC, its former silicon wafer division to TPG Partners III. In November 2001, E.ON sold both its 71.8 percent interest in the silicon wafer division and its shareholder loans for a symbolic purchase price of \$6. The disposal of the silicon wafer division resulted in a loss from discontinued operations net of income taxes and minority interests of 810 million in 2001 and income from discontinued operations net of income taxes and minority interests of 6 million in 2000. The loss in 2001 includes a 990 million loss on disposition. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Silicon Wafers.

On January 6, 2002, E.ON entered into an agreement to sell its 100 percent stake in its former aluminum division VAW to Norsk Hydro ASA for 3.1 billion. The results of the ongoing operations of VAW up to the date of disposal and the 893 million gain realized by E.ON on its disposal are reported in Income (loss) from discontinued operations, net in the Consolidated Statements of Income. The income from discontinued

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operations net of income taxes related to VAW totalled 927 million, 274 million and 114 million in 2002, 2001 and 2000, respectively. The net gain on disposal of 893 million does not include the reversal of VAW's negative goodwill of 191 million, as this amount was required to be recognized as income from a change in accounting principles upon the adoption of SFAS 142 on January 1, 2002. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Aluminum.

In July 2001, E.ON and BP entered into an agreement pursuant to which BP agreed to acquire a 51 percent stake in VEBA Oel by way of a capital increase. The agreement also provided E.ON with a put option that allowed it to sell its remaining 49 percent interest in VEBA Oel to BP at any time from April 1, 2002 for an exercise price of 2.8 billion, subject to certain purchase price adjustments. The capital increase took place in February 2002, giving BP majority control of VEBA Oel as of February 1, 2002. E.ON exercised its put option effective June 30, 2002. E.ON received proceeds of 2.8 billion for its VEBA Oel shares. In addition, 1.9 billion in shareholder loans made previously by the E.ON Group to VEBA Oel were repaid. During 2003, E.ON expects the contractual purchase price adjustments to be finalized. The disposal of VEBA Oel resulted in income from discontinued operations net of income taxes of 1,784 million, 295 million and 266 million in 2002, 2001 and 2000, respectively. In 2002, E.ON recognized a gain on disposal of 1,367 million. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Oil.

In July 2002, E.ON agreed to sell its 65.4 percent interest in Stinnes to DB in a cash tender offer DB made on August 7, 2002 to all Stinnes shareholders at a price of 32.75 per share. E.ON received cash proceeds of 1.6 billion upon completion of the tender, and Stinnes was deconsolidated as of September 30, 2002. The disposal of Stinnes resulted in income from discontinued operations net of income taxes and minority interests of 603 million, 95 million and 127 million in 2002, 2001 and 2000 respectively. In 2002, E.ON recognized a gain on disposal of 588 million. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Distribution/Logistics.

During 2002, Degussa divested several non-core businesses. In January, Degussa transferred its gelatin business to Sobel N.V. Degussa sold its persulfate operations to Unionchimica Industriale S.p.A. in February. The textile additives business was divested in February 2002 to the Bozzetto Group. In April, Degussa divested the fertilizer manufacturer SKW Piesteritz to A&A Stickstoff Holding AG. In June, Degussa sold Degussa Bank to Allgemeine Deutsche Direktbank AG. Viatris, a former part of the Degussa Health Products business ASTA Medica, was sold to Advent International in August 2002. Finally, in December, Degussa sold the biopharmaceutical company Zentaris to Aeterna Laboratories Inc. These chemicals division disposition transactions resulted in aggregate proceeds of approximately 866 million, an aggregate loss from discontinued operations of 84 million in 2002 (net of income taxes and minority interests), income from discontinued operations of 6 million (net of income taxes and minority interests) in 2001 and a loss from discontinued operations of 11 million (net of income taxes and minority interests) in 2000. In 2002, E.ON recognized a loss of 93 million from Degussa's disposal of these non-core businesses. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other.

In accordance with its strategy of focusing on its core business of residential real estate, Viterra has decided to divest its 100 percent interest in Viterra Energy Services, which provides heat and water submetering services for administrators and owners of residential and commercial property. Viterra currently expects to sell Viterra Energy Services in the course of 2003, and has accordingly classified Viterra Energy Services as an asset held for sale in the Consolidated Financial Statements. The results of the ongoing operations of Viterra Energy Services are reported in Income (loss) from discontinued operations, net in the Consolidated Statements of Income. The portion of income from discontinued operations, net of income taxes related to Viterra Energy Services totalled 52 million, 59 million and 101 million in 2002, 2001 and 2000, respectively. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other.

The Consolidated Financial Statements and related notes thereto for the year ended December 31, 2002, and the Consolidated Statements of Income for 2001 and 2000, as well as the related notes thereto, have been reclassified to reflect the discontinued operations treatment outlined above. The presentation of discontinued operations reported in the Consolidated Financial Statements in 2001 under APB 30 have been reclassified to conform with the presentation requirements of SFAS 144. Operating results for discontinued operations from the

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disposal date, as well as the gains or losses from ultimate sale, are reported in Income (loss) from discontinued operations, net in the Consolidated Statements of Income. The assets and liabilities of the business units which are classified as held for sale as of December 31, 2002 and 2001, but which were not yet sold, are reported as Assets of disposal groups and Liabilities of disposal groups, respectively, in the respective Consolidated Balance Sheet. Cash flows from discontinued operations have been eliminated from the Consolidated Statements of Cash Flows for all periods presented.

For more information on the discontinued operations, including certain selected financial information, see Note 4 of the Notes to Consolidated Financial Statements.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of E.ON's financial condition and results of operations are based on its Consolidated Financial Statements, which are prepared in accordance with U.S. GAAP and included in Item 18. The reported financial condition and results of operations of E.ON are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. The Company's critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered in reviewing E.ON's Consolidated Financial Statements and the discussions below in Results of Operations.

Goodwill and Intangible Assets

E.ON's group strategy is to become one of the world's leading energy service providers while aiming to become best in class in the production, distribution and sale of electricity and gas. One element of that strategy is the growth of the business through playing an active role in the ongoing consolidation of Europe's energy sector and acquisitions in the U.S. energy market.

Business Combinations. This strategy has resulted in E.ON completing a significant number of acquisitions in recent years, and E.ON can be expected to continue to make acquisitions in the future. E.ON's acquisitions have been, and will continue to be, accounted for under the purchase method of accounting (the purchase method). Under the purchase method, an acquired company is recorded on E.ON's balance sheet using the fair values of the acquired assets (tangible and intangible) and liabilities as of the acquisition date.

The application of the purchase method requires a company to make certain estimates and judgments. One of the most significant estimates relates to the determination of the fair value of assets and liabilities acquired. For tangible assets acquired, E.ON determines the fair value based on the nature of the asset. For example, marketable securities are valued at the market rate on the date of acquisition, while an independent appraisal is often obtained for land, buildings and equipment. The Company also assesses whether any significant intangible assets arise from contractual or other legal rights of the acquired entity or are separable from the acquired entity (*i.e.* capable of being sold). If any intangible assets are identified, the Company must determine the value of these intangibles. Depending on the type of intangible and the complexity of determining its fair value, the Company either consults with an independent external valuation expert or develops the fair value internally, using an appropriate valuation technique. The determination of the useful life of intangible assets is based upon the nature of the intangible, as well as the characteristics of the acquired business and the industry in which it operates. Any residual amount remaining after allocation of the purchase price to the fair value of all assets and liabilities acquired is goodwill.

Goodwill. On January 1, 2002, E.ON adopted SFAS 142, which significantly changed the accounting requirements for goodwill. Upon adoption, E.ON ceased amortizing pre-existing goodwill with a net book value of 6,083 million at December 31, 2001, recognized 191 million in unamortized negative goodwill as income, identified reporting units as defined by SFAS 142, allocated all assets (including goodwill) and liabilities to those reporting units, established procedures for impairment testing of the goodwill balances and performed transitional impairment testing on the goodwill as of January 1, 2002. Goodwill was, and will be for future acquisitions, allocated to the reporting units whose assets and liabilities were acquired in the business combination that resulted in the goodwill and to reporting units that will benefit from the acquisition.

The first step of the SFAS 142 impairment test requires E.ON to identify potential impairment situations by comparing the fair value of a reporting unit with its carrying value including goodwill. When determining the fair

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value of the reporting units, E.ON utilizes appropriate valuation techniques. The input data for the valuation is in principle based on the Company's mid-term plan.

If the carrying value exceeds the fair value of a reporting unit, thus indicating a possible impairment, E.ON performs the second step of the SFAS 142 impairment test, which requires E.ON to allocate the fair value to the assets and liabilities of the reporting unit using a methodology consistent with the application of the purchase method. Any excess of fair value over the fair value of net assets is compared to the allocated goodwill. If the allocated goodwill exceeds the residual fair value, an impairment charge equal to the difference is recognized.

E.ON has designated the fourth quarter of its fiscal year for its annual impairment test in order to coincide with its mid-term planning process. E.ON believes that this schedule ensures that the most current information available is used and provides consistency in methodology. Acquisitions in 2002 resulted in goodwill totaling 12,904 million, before impairment. Total goodwill as of December 31, 2002 was

14,512 million. For the transitional goodwill impairment test performed as of January 1, 2002 in connection with the adoption of SFAS 142, there was no impairment. During the third quarter, E.ON recorded a charge of 2.4 billion reflecting the impairment of goodwill at its Powergen U.K. and Powergen U.S. reporting units. For further details regarding the impairment charge, see Results of Operations Year Ended December 31, 2002 Compared with Year Ended December 31, 2001 Powergen and Notes 4 and 12 of the Notes to Consolidated Financial Statements.

Fair Value of Derivatives

As quoted market prices for certain financial derivatives used by E.ON are not readily available, the fair values of these derivatives have been calculated using common market valuation methods and value-influencing market data at the relevant balance sheet date as follows:

Short term currency, electricity, gas, coal and oil forwards, as well as electricity, gas, coal and oil related commodity swaps are fair valued at future rates or market prices as of the relevant balance sheet date. The fair values of forward contracts are based on spot prices that are calculated taking into account forward premiums or discounts quoted in the relevant markets.

Long-term commodity forward contracts are fair valued using weighted-average probability models reflecting the underlying conditions and variables associated with the relevant contractual agreements.

Currency, gas and electricity options and share options are fair valued using standard options pricing models. The fair value for caps, floors and collars embedded in these contracts is calculated separately, similar to stand-alone options.

Interest rate, interest rate cross currency and cross currency swaps are fair valued by using the expected cash flows over the remaining term of the individual contracts at the relevant balance sheet date, discounted at market interest rates. Certain interest rate options are fair valued using option pricing models.

The use of valuation models requires E.ON to make assumptions and estimates regarding the volatility of derivative contracts at the balance sheet date, and actual results could differ significantly due to fluctuations in value-influencing market data. The valuation models for the interest rate and currency derivatives are based on calculations and valuations using a group-wide financial reporting system, which provides consistent market data and valuation algorithms throughout the Company. The algorithms used to obtain valuations are those which are commonly used in the financial markets. In certain cases the calculated fair value of derivatives is compared with results which are produced by other market participants, including banks, as well as those available through other internally available systems. The valuations of commodity instruments are delivered by multiple use EDP-based systems, which also utilize common valuation techniques and models as described above.

The objective of E.ON's financial risk management is to minimize the risk of significant volatility in earnings and cash flows from derivative instruments. Through internal guidelines (i.e. group-wide financial guidelines), the Company ensures that derivatives used for risk management purposes, rather than proprietary trading, are only utilized to hedge booked, contracted or planned underlying transactions. E.ON's proprietary trading is limited to commodity derivatives and takes place in specified markets within defined limits designed to

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limit any significant impact of trading activities on earnings. The Company, in line with international banking standards, calculates and assesses market risks in accordance with the policies outlined in Item 11. Quantitative and Qualitative Disclosures about Market Risk. For additional details on the Group's use of derivative financial instruments, see Note 29 of the Notes to Consolidated Financial Statements.

Electricity Contracts

Certain electricity contracts that E.ON has entered into in the ordinary course of business meet all of the required criteria for a derivative as defined under SFAS 133 and are marked to market; however, due to the normal purchase normal sales exemption for electricity companies as interpreted by Derivatives Implementation Group Issue C-15, an insignificant part of these contracts are not accounted for as a derivative under SFAS 133 and therefore, are not being marked to market. As a result, any price volatility inherent in these contracts is not reflected in the operating results of E.ON. If this exemption is disallowed through future interpretations or actions of the Financial Accounting Standards Board (FASB), the impact on future operating results would not be significant.

Gas Contracts

The E.ON Energie and Powergen divisions enter into gas purchase and sale contracts in connection with their distribution and retail activities, as well as long-term gas purchase contracts for the operation of E.ON Energie's multi-fuel and both divisions' gas-fired generation plants. Contracts providing for physical delivery in Germany are currently accounted for as contracts with no derivative components, as no sufficient natural gas market mechanism or spot market exists in Germany which would allow the Company to classify gas as readily convertible to cash. Contracts providing for physical delivery in the U.K. are also accounted for as normal purchase and normal sales contracts apart from certain contracts which contain embedded derivatives and are therefore accounted for as derivatives under SFAS 133. In the future, it is possible that a sufficient market mechanism or spot market for natural gas could emerge resulting in a need to reassess the German contracts for derivatives under SFAS 133. If any such reassessment resulted in contracts being accounted for as derivatives under SFAS 133, the impact on future operating results could be significant.

Deferred Taxes

E.ON has significant deferred tax assets and liabilities which are expected to be realized through the statement of income over extended periods of time in the future. In calculating the deferred tax items, E.ON is required to make certain assumptions and estimates regarding the future tax consequences attributable to differences between the carrying amounts of assets and liabilities as recorded in the Consolidated Financial Statements and their tax basis. Significant assumptions made include the expectation that: (1) future operating performance for subsidiaries will be consistent with historical operating results; (2) recoverability periods for tax credits and net operating loss carryforwards will not change; (3) undistributed earnings of foreign investments have been permanently reinvested; (4) net operating losses for which E.ON has not provided a valuation allowance will more likely than not be recovered through future taxable income; and (5) existing tax laws and rates to which E.ON is subject to in various tax jurisdictions will remain unchanged into the foreseeable future. E.ON believes that it has used prudent assumptions and feasible tax planning strategies in developing its deferred tax balances; however, any changes to the facts and circumstances underlying its assumptions could cause significant changes in the deferred tax balances and resulting volatility in its operating results.

Nuclear Waste Management

German law requires nuclear power plant operators to establish sufficient financial provisions for financial obligations that arise from the use of nuclear power. The amounts provided by E.ON for its German nuclear power plants have been determined based on an industry-wide valuation prepared by German governmental authorities and qualified parties. In Sweden, nuclear power plant operators are obliged to contribute cash to a fund managed by the governmental authorities. The amount of the contributions, as determined annually by governmental authorities, is based on the volume of electricity produced using nuclear power. Despite these contributions to the fund, nuclear power plant operators in Sweden will still be obligated to make additional

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contributions if actual costs for nuclear waste management and decommissioning exceed the government's estimates.

E.ON believes that the valuations used for both the German and Swedish nuclear waste management programs provide the best estimate available in respect to its nuclear waste management and decommissioning liabilities. The costs associated with nuclear waste management and the decommissioning of nuclear power plants are substantial and are based on current legal requirements and the projection of costs over extended future periods. Any changes to the current legal requirements for nuclear waste management/decommissioning or the timing of payments to be made in relation to these requirements could have a significant impact on E.ON's future operating results.

E.ON will adopt SFAS No. 143, Accounting for Asset Retirement Obligations (SFAS 143), as of January 1, 2003, which requires that asset retirement obligations be recorded at their fair value on a company's balance sheet. The adoption of this standard is expected to increase the amounts recorded on the Consolidated Balance Sheet for E.ON's nuclear decommissioning liabilities. SFAS 143 changes the methodology for calculating the nuclear decommissioning accrual; however, the information used as a basis for establishing the total costs of decommissioning will remain consistent with that used in prior years.

NEW ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board issued the following accounting pronouncements in 2002 which are applicable to E.ON:

SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities;

SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123;

FASB Interpretation No. (FIN) 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of SFAS Nos. 5, 57, and 107 and Rescission of FIN 34; and

FIN 46, Consolidation of Variable Interest Entities.

For details of these pronouncements and their expected impact on the Company's future financial results, see Note 2 of the Notes to Consolidated Financial Statements.

RESULTS OF OPERATIONS

On June 16, 2000, E.ON completed the merger of VEBA and VIAG. For convenience reasons, June 30, 2000, has been chosen as the acquisition date. Operations of VIAG are included in E.ON's results of operations beginning as of July 1, 2000.

In 2002, E.ON's internal operating profit increased by 45.0 percent over 2001. The main factors behind this increase were the successful completion of acquisitions in the core energy businesses, the elimination of goodwill amortization due to the adoption of SFAS 142 and operational improvements resulting from the ongoing restructuring of the core energy businesses. This is in line with E.ON's strategic goal of growing its business through acquisitions and continuing to cut costs and implement restructuring activities. In 2001, E.ON's internal operating profit growth reflected the success of the Company's restructuring efforts and its strategic focus on one core business area. In line with its corporate focus and growth strategy, E.ON intends to expand its integrated energy business activities in both the European and U.S. energy markets. E.ON will continue to seek to maximize the value of its non-core businesses by divesting them at an appropriate time.

As E.ON focuses on its objective to internationalize its customer base, the percentage of E.ON's sales to customers outside of Germany, especially in its core business divisions, should increase. However, in 2002, 55.6 percent of the Group's total sales were to customers in Germany and 44.4 percent were to customers in other parts of the world, compared with 48.7 percent and 51.3 percent in 2001, respectively. The increase in the

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percentage of sales represented by German customers reflects the divestment of Stinnes, which made approximately two-thirds of its sales to customers outside Germany, combined with the impact of the increase in shareholdings of German regional utilities by E.ON Energie in 2002, the effect of which is only partially offset by the addition of Powergen's U.K. and U.S. customer base. For the core energy businesses, the percentage of sales to customers outside Germany was 34 percent in 2002, as compared to 20 percent in 2001.

Due to its range of businesses, E.ON's sales and earnings are influenced by a number of differing economic and other external factors. The energy business, which represented 65 percent of the Group's sales in 2002, is quite steady, but is to some extent affected by seasonality in demand related to weather patterns. Typically, demand is higher for E.ON Energie and Powergen's U.K. business unit during the winter months and for Powergen's U.S. operations during the summer. The chemicals business, which represented 32 percent of the Group's sales in 2002, is subject to cyclical fluctuations in the prices for basic chemicals, as well as changes in the U.S. dollar exchange rate. For a discussion of trends and factors affecting E.ON's businesses, see the division descriptions in Item 4. Information on the Company Business Overview and Item 4. Information on the Company Operating Environment, as well as Item 3. Key Information Risk Factors.

BUSINESS SEGMENT INFORMATION

E.ON conducts its business through the activities of its subsidiaries in each of the business segments of the Group. Internal operating profit is the measure pursuant to which the Group evaluates the performance of its segments and allocates resources to them. Internal operating profit, which includes income from equity interests, is equivalent to income from continuing operations before income taxes, adjusted to exclude material, non-operating income and expenses that are non-recurring or infrequent in nature. For a reconciliation of internal operating profit to income from operations and additional information on business segments, see Note 31 of the Notes to the Consolidated Financial Statements.

The following table sets forth sales and internal operating profit (loss) for each of the business segments of E.ON for 2002, 2001 and 2000 (in each case excluding the results of discontinued operations):

E.ON BUSINESS SEGMENT SALES AND INTERNAL OPERATING PROFIT (LOSS)

	2002		2001		2000(1)	
	Sales	Internal Operating Profit (Loss)	Sales	Internal Operating Profit (Loss)	Sales	Internal Operating Profit (Loss)
(in millions)						
E.ON Energie(2)	19,518	2,855	16,227	1,971	11,027	1,099
Powergen(3)	4,476	329				
Chemicals(4)	11,765	655	16,337	507	17,435	580
Real Estate(4)	1,226	203	875	154	947	132
Holding/ others(5)	74	(152)	3,834	50	9,688	(207)
Total(6)	37,059	3,890	37,273	2,682	39,097	1,604

(1) Includes results of the former VIAG Group in the E.ON Energie and chemicals divisions, as well as in others, beginning as of July 1, 2000.

(2) Sales include electricity taxes of 933 million in 2002, 694 million in 2001 and 349 million in 2000. Sales and cost of sales from trading activities in 2001 have been presented as a net amount in sales, to conform with the required presentation of trading activities in 2002.

(3) Includes the results of Powergen from the date of acquisition on July 1, 2002.

(4) Excludes the sales and internal operating profit of certain activities now accounted for as discontinued operations. For more details, see Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.

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(5) Includes the parent company and effects from consolidation, the results from the former telecommunications division, as explained under Item 4. Business Overview Introduction, and the sales of Klöckner (through October 2001), as well as three months consolidated results of Schmalbach-Lubeca and VEBA Electronics in 2000, as explained under Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions.

(6) Excludes intercompany sales.

YEAR ENDED DECEMBER 31, 2002 COMPARED WITH YEAR ENDED DECEMBER 31, 2001

E.ON Group

E.ON's sales in 2002 decreased 1.2 percent to 36,126 million from 36,579 million in 2001 (in each case net of electricity taxes). Sales of the E.ON Energie division increased 20.3 percent in 2002 to 19,518 million (including 933 million of electricity taxes) from 16,227 million (including 694 million of electricity taxes) in 2001, primarily as a result of the first-time inclusion of a full year's results of companies acquired in 2001, particularly Sydkraft and Hein Gas, and the regional utilities in Germany consolidated during the year, as well as the gradual rise of electricity prices in Germany. Sales of the Powergen division amounted to 4,476 million for the six-month period following its acquisition on July 1, 2002. Sales of the chemicals division decreased 28.0 percent to 11,765 million in 2002 from 16,337 million in 2001, primarily reflecting the disposition of several non-core business components accounted for as discontinued operations. Sales of the real estate division increased 40.1 percent to 1,226 million in 2002 from 875 million in 2001, largely as a result of revenues generated by companies fully consolidated for the first time in 2002.

Cost of goods sold and services provided in 2002 decreased 8.8 percent to 26,769 million compared with 29,351 million in 2001, reflecting the effect of disposals of businesses in 2001 (primarily Klöckner and Degussa non-core disposals), and the change in classification of certain expenses described in selling expenses below, which was partially offset by the inclusion of Powergen's costs for the six-month period subsequent to its acquisition. Cost of goods sold and services as a percentage of revenues declined to 74.1 percent in 2002 compared with 80.2 percent in 2001. Gross profit increased 29.5 percent to 9,357 million in 2002 from 7,228 million in 2001.

Selling expenses increased 23.3 percent to 4,925 million in 2002, compared with 3,993 million in 2001. Excluding the effect of significant acquisitions, selling expenses increased by approximately 14 percent, primarily due to increased selling costs at the E.ON Energie division, as in 2002, certain of its entities became purely sales oriented. Accordingly, the costs associated with these entities are included in selling expenses in 2002, whereas they had been recorded in cost of goods sold and services provided in 2001, when they totaled 454 million.

General and administrative expenses decreased by approximately 161 million or 8.8 percent on a year on year basis, amounting to 1,666 million in 2002 compared with 1,827 million in 2001.

Other operating income (expenses), net decreased 61.4 percent to 208 million in 2002 from 539 million in 2001.

Internal operating profit in 2002, as compared with 2001, was as shown above in the table E.ON Business Segment Sales and Internal Operating Profit (Loss). The increase of 45.0 percent was primarily attributable to sharply higher earnings at E.ON Energie, effects from the first-time consolidation and the elimination of goodwill amortization on January 1, 2002 upon the adoption of SFAS 142.

In the third quarter of 2002, E.ON recorded an impairment charge of 2.4 billion on goodwill from the Powergen acquisition. For further details, see Year Ended December 31, 2002 Compared with Year Ended December 31, 2001 Powergen and Notes 4 and 12 of the Notes to Consolidated Financial Statements.

In 2002, E.ON recorded an impairment charge against its 6.7 percent investment in Bayerische Hypo- und Vereinsbank AG due to stock market trends which indicated an other than temporary decline in the market value of the stock. The impairment charge resulted in a loss of 1.9 billion, which was recorded as a component of financial earnings. For additional details, see Note 7 of the Notes to Consolidated Financial Statements.

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The Group's net income in 2002 was 2,777 million, a 35.6 percent increase from 2,048 million in 2001. The results of discontinued operations contributed 3,282 million (net of income taxes and minority interests) directly to net income. The significant impact of the discontinued operations on net income reflects the Company's ability to realize significant value from these businesses through their timely divestment. Excluding the results of discontinued operations, E.ON would have recorded a net loss of 505 million in 2002, primarily due to the negative impact of the impairment charges discussed above.

E.ON Energie

Total sales of the E.ON Energie division increased by 20.3 percent to 19,518 million (including 933 million of electricity taxes and 37 million in intercompany sales) in 2002, compared with 16,227 million (including 694 million of electricity taxes and 49 million in intercompany sales) in 2001. The increase was primarily attributable to the contribution of recently acquired entities, as well as a gradual increase in electricity prices in Germany. E.ON Energie's 2002 results reflect the first-time inclusion of a full year of sales at the Swedish utility Sydkraft, which was consolidated in May 2001, and at the German gas company Hein Gas, which was consolidated in June 2001, as well as the sales of the German regional energy companies EAM, EWW and EMR following their consolidation in June, July and August, respectively. The following table sets forth the sales of the E.ON Energie division for the last two years for each business unit:

SALES OF E.ON ENERGIE DIVISION

	2002	2001	Percent Change
	(in millions)		
In Germany(1)(2)	14,965	12,752	+17.4
Electricity(2)	11,597	9,846	+17.8
Gas	3,101	2,661	+16.5
Water	267	245	+8.9
Outside Germany(1)(2)	3,586	2,670	+34.3
Other/Consolidation(2)	34	111	-69.4
Total(2)	18,585	15,533	+19.6

(1) Sales and cost of sales from trading activities in 2001 have been presented as a net amount in sales, to conform with the required presentation of trading activities in 2002.

(2) Excludes electricity taxes.

Sales of the German electricity business unit increased by 17.4 percent, primarily due to the first-time consolidation of several regional utilities, including EAM, EWW and EMR, as well as the positive impact of a gradual increase in electricity prices. Sales of the German gas business unit increased by 16.5 percent, primarily reflecting the first-time inclusion of a full year of sales of Hein Gas, which had been consolidated in June 2001. German water sales in 2002 increased by 8.9 percent, largely as a result of the contribution of relatively minor businesses acquired during the year.

E.ON Energie's sales outside Germany increased by 34.3 percent, primarily as a result of the inclusion of full year of results of Sydkraft (which was consolidated in May 2001), as well as nine months of results of Espoon Sähkö following its acquisition in April 2002.

Total power supplied or procured by the E.ON Energie division (excluding physically-settled trading activities) rose 11.0 percent to 250.6 billion kWh in 2002, compared with 225.7 billion kWh in 2001, primarily as a result of the inclusion of a full year's results from Sydkraft and the acquisition of EWW and the other German regional utilities. E.ON Energie's own production of power rose to 155.7 billion kWh in 2002, compared with 141.8 billion kWh in 2001, largely as a result of inclusion of a full year's production of Sydkraft. E.ON Energie produced 59.5 percent of its power requirements in 2002, compared with 60.3 percent in 2001. Compared with 2001, electricity purchased from jointly operated power stations decreased from 17.5 billion kWh to 14.7 billion kWh, reflecting the increase in the attributable capacity from the Grohnde power plant associated with the EWW/EMR acquisition. Purchases of electricity from third parties, excluding physically-settled trading activities,

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increased 20.6 percent, from 75.9 billion kWh in 2001 to 91.5 billion kWh in 2002, mainly due to increased sales volumes.

In 2002, the E.ON Energie division contributed internal operating profit of 2,855 million, a 44.9 percent increase from 1,971 million in 2001. This increase was primarily attributable to the change in accounting method for the adoption of SFAS 142 effective January 1, 2002, which resulted in the discontinuance of goodwill amortization, as well as the effect from the harmonization of policies for estimates to reflect the internationalization of the division, which together accounted for 580 million of the increase, operational improvements realized in the German operations (450 million), and the first full year contribution by Sydkraft and Hein Gas, as well as those of the division's other acquisitions (240 million). These positive effects were partially offset by nonrecurring items in the generation operations (310 million).

Powergen

Following the acquisition of Powergen by E.ON, the Powergen division was established. Powergen's results were included in the Consolidated Financial Statements from July 1, 2002. The following table sets forth the sales of the Powergen division for the six-month period from July 1 to December 31, 2002 for each major business unit:

SALES OF POWERGEN DIVISION

	July 1 to December 31, 2002
	(in millions)
U.K. Operations	3,162
U.S. Operations	1,314
Total	4,476

Powergen's sales for the six months from July 1, 2002 to December 31, 2002 were 4,476 million, of which 71 percent were from the U.K. business and 29 percent from the U.S. business.

Sales for the U.K. business totalled 3,162 million. Of this amount, 2,410 million, or 76 percent, was attributable to retail, including the results of the former TXU Group retail business following its acquisition in October. Generation and trading contributed 617 million of the total, with distribution accounting for a total of 231 million. Over 40 percent of distribution's sales are to Powergen's own retail business and therefore the related amounts (96 million) are eliminated in arriving at the total figure for the U.K. business.

The U.S. business recorded sales of 1,314 million, of which 73 percent, or 965 million, were from the two regulated utilities, Louisville Gas and Electric Company and Kentucky Utilities Company, and 27 percent or 349 million, from non-utility operations. These non-utility operations included generating plant based in western Kentucky (WKE), a pipeline services business headquartered in Texas (CRC-Evans) and interests in gas distribution assets in Argentina.

The Powergen division contributed internal operating profit of 329 million for the six month period from July 1, 2002 to December 31, 2002. Internal operating profit from its U.K. operations totalled 155 million, with distribution contributing the largest portion of the total. Margins in generation and trading were adversely affected by low wholesale prices in the U.K., while those in retail benefited from the contribution from the former TXU Group retail business following its acquisition in October. Powergen's U.S. operations recorded internal operating profit of 194 million for the six-month period, as the utility operations benefited from high energy demand during the third quarter due to unseasonably warm weather. In contrast, margins at the non-utility operations were adversely affected by declines in wholesale prices and higher fuel costs, as well as by the negative political and economic situation in Argentina, which adversely affected the gas distribution operations in which Powergen has interests. In addition, Powergen also recorded 20 million of net corporate and consolidation costs, which reduced internal operating profit.

In the third quarter of 2002, the original goodwill of 8.9 billion associated with the Powergen acquisition was reduced by an impairment charge of 2.4 billion. E.ON originally made its acquisition offer for Powergen in April 2001, and between that date and the completion of the acquisition on July 1, 2002, the market environment in which both Powergen's U.K. and U.S. businesses operate changed significantly. Electricity prices in the U.K.

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generation sector declined some 25 percent in the twelve months following the introduction of NETA in March 2001. Earnings at the U.S. non-utilities were also down year-on-year owing to lower power sales prices, as well as higher fuel costs. The U.S. business is also active in natural gas distribution in Argentina. The ongoing political and economic crisis in that country has led to a substantial devaluation of the peso and negative economic growth. In view of these factors it was necessary to test the goodwill for impairment, which resulted in an impairment charge being recorded against income during the third quarter. For further information on the goodwill impairment, see Notes 4 and 12 of the Notes to Consolidated Financial Statements.

Chemicals

Total sales of the chemicals division decreased 27.9 percent in 2002 to 11,765 million, including intercompany sales of 20 million, compared with 16,337 million in 2001, with the decrease primarily reflecting the fact that the 2001 results include those of the non-core businesses divested during the year through the date of their disposition, whereas the businesses divested in 2002 qualify for discontinued operations treatment under SFAS 144 and have therefore been eliminated from both years. The following table sets forth the sales of the chemicals division for the last two years for each segment (in each case excluding the sales of discontinued operations):

SALES OF CHEMICALS DIVISION

	2002	2001	Percent Change
	(in millions)		
Core Business	10,958	10,835	+1.1
Health & Nutrition	1,179	1,186	-0.7
Construction Chemicals	1,819	1,741	+4.5
Fine & Industrial Chemicals	2,347	2,116	+10.9
Performance Chemicals	1,358	1,407	-3.5
Coatings & Advanced Fillers	2,126	2,277	-6.6
Specialty Polymers	1,308	1,264	+3.5
Others	821	844	-2.7
Non-Core Business	807	3,365	-76.0
Total Chemicals Division(1)	11,765	14,200	-17.1

(1) Excludes revenues from precious metals trading in 2001.

Sales in Degussa's core businesses remained largely consistent with the prior year, as the positive effects of overall higher sales volumes were generally offset by lower average prices. Sales of the Health & Nutrition division decreased slightly compared to the prior year, mainly as a result of weakened demand in the Flavors & Fruit Systems business unit, the limited output of a new methionine production facility in the Feed Additives business unit and negative foreign currency exchange effects due to the stronger euro. Sales of the Construction Chemicals division increased, reflecting strong demand in southern Europe at the Admixture Systems Europe business unit, the positive effects of which were partially offset by a cyclical drop in sales volumes experienced in the Admixture Systems Asia/ Pacific business unit. In the Fine & Industrial Chemicals division, sales increased primarily as a result of the first-time inclusion of a full year's sales from Laporte, which was consolidated on April 1, 2001. In the Performance Chemicals division, sales decreased, reflecting the closure of a superabsorbents production line at the Greensboro plant in the U.S. Sales in the Coatings & Advanced Fillers division also decreased, primarily as a result of the transfer of the carbon black activities in North America to the Degussa Engineered Carbons joint venture and negative foreign currency exchange effects. In the Specialty Polymers division, sales increased, reflecting higher demand in the Methacrylates business unit for molding compounds and in the Specialty Acrylics business unit for oil additives. The positive impact of these increases was partially offset by lower sales in the High Performance Polymers business unit due to weak demand from the telecommunications industry. The decrease in sales in the non-core businesses was primarily attributable to the fact that the 2001 results include those of the divested operations through the date of their disposition.

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The chemicals division contributed internal operating profit of 655 million in 2002 compared with 507 million in 2001. This 29.2 percent increase was primarily attributable to the cessation of regular goodwill depreciation (which had totalled 225 million in 2001) due to the adoption of SFAS 142, as well as positive contributions by the Performance Chemicals division's Superabsorbents business unit due to significant costs savings from restructuring operations and a drop in raw material prices and from the Coatings & Advanced Fillers division's Advanced Fillers & Pigments business unit stemming from cost containment measures. These positive factors were partially offset by declines in internal operating profit experienced by the Fine & Industrial Chemicals and Health & Nutrition divisions due to a combination of cyclical downturns and competitive price pressures.

Real Estate

Sales of the real estate division increased 40 percent in 2002 to 1,226 million, including intercompany sales of 10 million, from 875 million in 2001, primarily reflecting the contribution of a full year's results from WohnBau Rhein-Main (fully consolidated on October 1, 2001) and FSG and Deutschbau (fully consolidated on January 1, 2002).

The real estate division contributed internal operating profit of 203 million in 2002, compared with 154 million in 2001. This 31.8 percent increase was primarily attributable to an increase in the number of housing units sold in the residential real estate business unit, which increased by 3,200 units in 2002 to a total of approximately 9,900 units.

YEAR ENDED DECEMBER 31, 2001 COMPARED WITH YEAR ENDED DECEMBER 31, 2000*E.ON Group*

E.ON's sales in 2001 decreased 5.6 percent to 36,579 million from 38,748 million in 2000 (in each case net of electricity tax). Sales of the E.ON Energie division increased 47.2 percent in 2001 to 16,227 million (including 694 million of electricity tax) from 11,027 million (including 349 million of electricity tax) in 2000, primarily as a result of increased electricity sales, reflecting the first-time inclusion of full year results for Bayernwerk and eight months of Sydkraft, increased electricity trading activities and the recovery of electricity prices. Sales of the chemicals division (including precious metals trading) decreased 6.3 percent to 16,337 million in 2001 from 17,435 million in 2000, primarily due to the divestiture of certain non-core businesses, particularly the activities of dmc² and Phenolchemie. Sales of the real estate division decreased 7.6 percent to 875 million in 2001 from 947 million in 2000 primarily as a result of declines in the residential development and commercial real estate business, as well as the disposal of the Sicherheit + Services business of the residential services unit.

Cost of goods sold and services provided in 2001 decreased 9.5 percent to 29,351 million compared with 32,436 million in 2000, mainly as a result of the divestiture of businesses in the chemicals division. Cost of goods sold and services as a percentage of revenues declined to 80 percent in 2001 compared with 84 percent in 2000. Gross profit increased 14.5 percent to 7,228 million in 2001 from 6,312 million in 2000.

Selling expenses increased 14.4 percent to 3,993 million in 2001, compared with 3,489 million in 2000 primarily due to the first-time inclusion of Sydkraft and Hein Gas at E.ON Energie.

General and administrative expenses remained basically unchanged, amounting to 1,827 million in 2001 compared with 1,806 million in 2000.

Other operating income/expenses decreased significantly to 539 million in 2001 from 4,203 million in 2000. This 87.2 percent decrease was primarily attributable to the unusually high level of gains recorded from the disposal of fixed assets in 2000, mainly in the Holding/ Others division.

Internal operating profit in 2001, as compared with 2000, was as shown above in the table E.ON Business Segment Sales and Internal Operating Profit (Loss). The increase in internal operating profit of 67.2 percent in 2001 was predominantly due to improved results in the E.ON Energie division, as discussed in more detail below.

The Group's net income in 2001 was 2,048 million, a 42.6 percent decrease from 3,570 million in 2000.

Table of Contents***E.ON Energie***

Sales of the E.ON Energie division increased by 47.2 percent to 16,227 million (including 694 million of electricity tax and 49 million in intercompany sales) in 2001, compared with 11,027 million (including 349 million of electricity tax and 50 million in intercompany sales) in 2000. This increase was primarily a result of significantly increased electricity sales, primarily reflecting the first-time full year inclusion of Bayernwerk and eight months of Sydkraft, higher electricity trading, as well as the recovery of electricity prices.

Total power supplied or procured by the E.ON Energie division (including physically-settled trading activities and the power used in its own production) rose 85.9 percent to 327.6 billion kWh in 2001, compared with 176.2 billion kWh in 2000, primarily reflecting the first-time full year consolidation of Bayernwerk and increased electricity trading activities, which are partly the result of the first-time inclusion of Sydkraft's trading activities. E.ON Energie's own production of power rose to 141.8 billion kWh in 2001 compared with 101.7 billion kWh in 2000, largely as a result of the first-time inclusion of Sydkraft. E.ON Energie produced 43.3 percent of its power requirements in 2001 compared with 57.7 percent in 2000. This decrease reflects the increased trading volumes. Compared with 2000, electricity purchased from jointly operated power stations increased from 16.9 billion kWh to 17.5 billion kWh, reflecting the inclusion of new companies. Purchases of electricity from third parties almost tripled, from 57.6 billion kWh in 2000 to 168.3 billion kWh in 2001, mainly due to the increased trading volumes.

Sales of gas increased 79.9 percent to 2,687 million in 2001 compared with 1,494 million in 2000, primarily reflecting an increase in sales volumes of 46.0 percent from 65.6 billion kWh to 95.8 billion kWh that was mainly attributable to the first-time inclusion of Hein Gas and Sydkraft's gas operations. Water sales in 2001 increased 8.3 percent to 235 million from 217 million in 2000, notwithstanding a 11.6 percent decrease in sales volumes at Gelsenwasser.

In 2001, the E.ON Energie division contributed internal operating profit of 1,971 million, a 79.3 percent increase from 1,099 million in 2000. This increase was largely attributable to the first-time inclusion of full year results of the former Bayernwerk, which was only consolidated for six months in 2000. Excluding this effect, internal operating profit rose 14.3 percent, primarily due to lower expenses resulting from cost cutting measures and the realization of merger synergies from the merger of PreussenElektra and Bayernwerk. Additional positive factors were the first-time inclusion of Sydkraft and the recovery of electricity prices. These positive factors were partly offset by higher fuel costs and costs related to Germany's Renewable Energy and Co-Generation Protection Laws.

Chemicals

Total sales of the chemicals division decreased 6.3 percent in 2001 to 16,337 million, including intercompany sales of 68 million, compared with 17,435 million in 2000, with the decrease primarily reflecting the disposal of a number of non-core businesses, especially the activities of dmc² and Phenolchemie. Excluding precious metals trading, the division's sales increased by 0.8 percent to 14,200 million, primarily due to the first-time inclusion of a full year of SKW Trostberg's results (which had been consolidated for only six months in 2000), the first-time inclusion of Laporte and slightly higher prices. These positive effects were offset by the

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decrease in 2001 sales stemming from the disposal of certain non-core activities. The following table sets forth the sales of the chemicals division for the last two years for each segment:

SALES OF CHEMICALS DIVISION

	2001	2000(1)	Percent Change
	(in millions)		
Core Business	10,835	8,870	+22.2
Health & Nutrition	1,186	781	+51.9
Construction Chemicals	1,741	873	+99.4
Fine & Industrial Chemicals	2,116	1,788	+18.3
Performance Chemicals	1,407	1,015	+38.6
Coatings & Advanced Fillers	2,277	2,393	-4.8
Specialty Polymers	1,264	1,297	-2.5
Others	844	723	+16.7
Non-Core Business	3,365	5,213	-35.4
 Total Chemicals Division(2)	 14,200	 14,083	 +0.8

(1) Includes sales of the former SKW Trostberg businesses as of July 1, 2000.

(2) Excludes revenues from precious metals trading.

Sales in the core business area increased 22.2 percent, primarily as a result of the first-time inclusion of SKW Trostberg's results for a full year. Excluding this effect, sales increased only slightly. In order to more clearly illustrate underlying trends, the following analysis of sales and internal operating profit in each segment includes the impact of inclusion of SKW Trostberg's results for a full year in 2000. In the Fine & Industrial Chemicals division sales increased primarily as a result of the first-time inclusion of Laporte and an increase in volume in the C⁴ Chemistry business unit that reflected higher demand in the n-Butene-1 and isononanol businesses, which was only partly offset by lower demand in the Bleaching & Water Chemicals business unit. Sales of the Health & Nutrition division increased, mainly as a result of an increase in sales volumes in the Feed Additives business unit that reflected higher demand in the methionine and threonine businesses. Sales of the Construction Chemicals division increased slightly, as increased demand, primarily in Europe and the Asia/ Pacific region, was partly offset by the negative impact of the weakened construction economy, especially in Germany. In the Performance Chemicals division, sales increased, reflecting greater demand for the personal and fabric care products of the Care Specialties business unit and the significantly higher demand, primarily in Asia and Europe, in the Oligomers & Silicones business unit. Sales in the Coatings & Advanced Fillers division decreased, primarily as negative economic conditions were reflected in lower demand in the Advanced Fillers & Pigments and in the Aerosil & Silanes business unit. In the Specialty Polymers division, sales remained relatively unchanged. The decrease in sales in the non-core business area reflected the divestiture of several significant businesses during the course of the year.

The chemicals division contributed internal operating profit of \$507 million in 2001 compared with \$580 million in 2000. This 12.6 percent decrease was primarily attributable to the disposal of non-core business activities and higher goodwill depreciation and interest expenses resulting from the acquisition of Laporte, which was partly offset by the first-time inclusion of SKW Trostberg's results for a full year. Excluding the effect of the first-time inclusion of SKW Trostberg's results, internal operating profit in the core business area remained relatively stable. An increase in internal operating profit in the Performance Chemicals division was largely attributable to cost savings in the superabsorbent unit, which more than offset higher raw material costs that could not be fully passed on to the customers. In the Construction Chemicals division, internal operating profit rose slightly as a result of higher sales volumes, which were partly offset by higher energy and transportation costs which could not fully be passed on to the customers, as well as increasing price pressure reflecting the weaker economy. The overall effect of these increases was partly offset by a decrease in internal operating profit in the Coatings & Advanced Fillers division that was primarily attributable to lower sales and significantly higher raw material costs, especially in the Coatings & Colorants business unit. Internal operating profit in the non-core business area decreased significantly.

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Real Estate

Sales of the real estate division decreased 7.6 percent in 2001 to 875 million (including intercompany sales of 23 million) from 947 million in 2000, primarily reflecting a decrease in sales in the residential development business due to reduced demand for single-family housing units, and lower sales of the commercial real estate business. The prior year's results included the sale of a large office property in Berlin, as well as the revenues of the Sicherheit + Services business of the residential services unit.

The real estate division contributed internal operating profit of 154 million in 2001, compared with 132 million in 2000. This 16.7 percent increase was primarily attributable to both higher sales volumes of housing units and an improved cost position in the residential investment division's rental business and the disposal of the loss-making Sicherheit + Services business. These positive factors more than offset a decrease in operating profit in the residential development business due to lower demand.

INFLATION

The rates of inflation in Germany during 2002, 2001 and 2000 were 1.3 percent, 2.5 percent and 1.9 percent, respectively (basis 1995 equals 100). The effects of inflation on E.ON's operations have not been significant in recent years.

EXCHANGE RATE EXPOSURE AND CURRENCY RISK MANAGEMENT

Certain business activities within the E.ON Group are internationally oriented and, accordingly, result in certain foreign exchange rate exposures. Of the Group's consolidated revenues in 2002, 2001 and 2000, 36 percent, 35 percent and 43 percent, respectively, were attributable to customers located outside of member states participating in the EMU.

To manage the Group's exposure to exchange rate fluctuations, E.ON continually monitors its exposures to currency risks and pursues a systematic and Group-wide foreign exchange risk management policy. At the end of 2002, the Group's consolidated foreign exchange rate exposure, which is calculated as its netted transaction risk exposure deriving from booked and forecasted transactions excluding any foreign exchange translation exposure from net investments in entities with a functional currency other than the euro, was approximately 0.3 billion, compared with approximately 1.7 billion at year-end 2001. The decrease in the Group's foreign exchange rate exposure was primarily due to the deconsolidation of VAW and the completion of the acquisition of Powergen in 2002. The Group's foreign exchange rate exposure is principally attributable to the energy divisions E.ON Energie and Powergen (which have short positions in U.S. dollars) and the chemicals division (which has a long position in U.S. dollars, Japanese yen and British pounds). Due to the acquisition of Powergen, the E.ON Group has also a net investment in assets denominated in British pounds and U.S. dollars which is continually monitored and partly hedged with foreign exchange instruments in accordance with the financial guidelines of the E.ON Group.

The principal derivative financial instruments used by E.ON to cover foreign currency exposures are foreign exchange forward contracts, cross currency swaps, interest rate cross currency swaps and currency options. As of December 31, 2002, the E.ON Group had entered into foreign exchange forward contracts with a nominal value of 13.1 billion, cross currency swaps with a nominal value of 8.9 billion, interest rate cross currency swaps with a nominal value of 0.3 billion and currency options with a nominal value of 0.3 billion. The currencies in which the Group's derivative financial instruments are denominated reflect the currencies in which it is subject to transaction and translation risks. For further information, see Item 11. Quantitative and Qualitative Disclosures about Market Risk and Note 29 of the Notes to Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

The principal sources of liquidity for E.ON in 2002 were cash from operations and cash from divestments, as well as proceeds from its first bond issue in the international capital markets. Cash from operations amounted to 3,690 million in 2002, 2,652 million in 2001 and 2,024 million in 2000. The 39.1 percent increase in cash from operations in 2002 was principally a result of improvements in operating costs at the E.ON Energie division

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and a gradual increase of electricity prices in Germany, as well as the addition of cash flows from entities acquired. Profits from divestments, which are included in net income, are recorded separately within cash flow from operating activities and are stated as gains from dispositions. Proceeds from dispositions are shown in cash used for investing activities. The proceeds from E.ON's bond issue under its Medium Term Note Program amounted to approximately 7.5 billion and are included in cash flows from financing activities. As of December 31, 2002, the Group had lower liquid funds (consisting of cash and cash equivalents and short-term securities) of 8,385 million, a decrease of 3,759 million compared with liquid funds of 12,144 million at year-end 2001 (8,501 million at year-end 2000). This decrease was mainly attributable to acquisitions made in 2002 in line with E.ON's strategy to expand its core energy business. For additional details regarding the Group's sources of liquidity, see Note 25 of the Notes to Consolidated Financial Statements.

E.ON's principal liquidity requirement in recent years has been for purchases of financial assets (including equity investments) and other fixed assets. Capital expenditures in 2002, 2001 and 2000 amounted to 24,182 million, 6,909 million and 10,550 million, respectively. E.ON's investment levels increased significantly in 2002 compared to 2001, primarily reflecting the acquisition of Powergen, the acquisition of the TXU Group retail business, the acquisition of shares in Ruhrgas and a high level of acquisition activity in the E.ON Energie division. Capital expenditures in 2001 primarily involved the acquisition of financial assets, including interests in Sydkraft, Hein Gas and Laporte. Capital expenditures in 2000 included the expenses for the financing of VIAG Interkom's UMTS license and the acquisition of the remaining interest in Aral, part of the former oil division. The following table shows the cash provided by operating activities and used for capital expenditures for each of the Group's divisions in 2002, 2001 and 2000 (in each case excluding the cash flows of discontinued operations).

E.ON BUSINESS SEGMENT CASH FLOW AND CAPITAL EXPENDITURES(1)

(in millions)

	2002		2001		2000	
	Cash from Operations	Capital Expenditures	Cash from Operations	Capital Expenditures	Cash from Operations	Capital Expenditures
E.ON Energie	3,313	6,140	2,792(2)	4,027	1,423(2)	3,356
Powergen(3)	376	3,094				
Chemicals	841	1,114	908	2,042	536	1,612
Real Estate	56	386	(20)	127	(38)	427
Holding/Other	(896)	13,448(4)	(1,028)	713	103	5,155
Total	3,690	24,182	2,652	6,909	2,024	10,550

- (1) For a detailed description of capital expenditures by purchases of financial assets and purchases of other fixed assets, see Note 31 of the Notes to Consolidated Financial Statements.
- (2) E.ON Energie had shareholdings in E-Plus, Cablecom, Orange Communications and VIAG Interkom. The resulting tax burden from the disposal of these telecommunication activities was charged to E.ON Energie and reduced its cash flow from operations. The Company has reclassified the cash flow impact of these tax effects from the E.ON Energie segment to the holding/other segment in order to show cash flow from operations of each of these segments more clearly. Prior year figures have been adjusted accordingly.
- (3) Includes the cash flows of Powergen from the date of acquisition on July 1, 2002.
- (4) Includes the acquisition of Powergen and shares of Ruhrgas.

The E.ON Energie division continued to account for the largest portion of the Group's capital expenditures over the most recent three-year period, primarily as a result of acquisitions of financial assets and additions to property, plant and equipment. E.ON Energie's investments in 2002 increased to 6,140 million. This 52.5 percent increase from the prior year reflected a high level of acquisition activity, including the acquisition of an additional 25.1 percent of Thüga; the purchase of an additional 62.9 percent shareholding in ÉDÁSZ; the acquisition of 65.6 percent of Espoon Sähkö; the purchase of 49 percent of ZSE and increases in shareholdings in a number of German regional utilities. E.ON Energie's investments in 2001 amounted to 4,027 million. This 20.0 percent increase compared to 2000 largely resulted from the acquisition of additional shares in Sydkraft for

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an aggregate of 1.4 billion net of liquid funds acquired. Investments in property, plant and equipment focused primarily on the improvement of the electricity and heat distribution network. In 2000, the E.ON Energie division's investments amounted to 3,356 million, primarily as a result of the acquisition of E.ON Benelux Generation and the inclusion of the former Bayernwerk's activities. Expenditures in 2000 also included amounts for long-term securities and investments in the improvement of the electricity distribution network.

The Powergen division's capital expenditures for the six months beginning on July 1, 2002 amounted to almost 3.1 billion. Of this figure, 2.5 billion, net of 0.1 billion cash acquired and including 0.4 billion for working capital funding, was for the acquisition of the TXU Group retail business and associated assets. The remainder primarily comprised additions to property, plant and equipment totalling 0.4 billion in the U.S. and 0.2 billion in the U.K.

Investments in the chemicals division in 2002 declined by 45.4 percent to 1,114 million compared to the prior year. This reduction in capital expenditures is primarily the result of a lower level of acquisition activity compared to prior years and a reduction in expenditures for fixed assets. The chemicals division's capital expenditures in 2001 increased by 26.7 percent compared to 2000, to 2,042 million. Investments in financial assets primarily included the acquisition of approximately 80 percent of Laporte. Investments in fixed assets remained relatively unchanged compared with 2000 and were focused primarily on the improvement and construction of new production facilities in divisions including Coatings & Advanced Fillers and Fine & Industrial Chemicals. Investments by the chemicals division in 2000 amounted to 1,612 million, largely attributable to the first-time inclusion of SKW Trostberg. Principal investments were the acquisition of a 19.6 percent stake in Laporte, the construction of new production facilities in business units including Fine Chemicals, Sivento and Advanced Fillers and Pigments, as well as the expansion of production capacity in certain business units of Degussa-Hüls and SKW Trostberg.

The real estate division's capital expenditures in 2002 more than tripled to 386 million, primarily as a result of the acquisition of a majority interest in FSG in January 2002 for 273 million, net of 39 million cash acquired. The real estate division's capital expenditures in 2001 decreased by 70.3 percent compared to 2000, to 127 million. The largest investments related to building improvements and the purchase of an additional 44.99 percent of Wohnbau Rhein-Main. Investments by the real estate division in 2000 amounted to 427 million, mainly due to the purchase of eight logistics sites from Deutsche Post AG.

The financial liabilities of E.ON increased to 24,850 million at year-end 2002 from 16,089 million at year-end 2001. This 54.4 percent increase was primarily the result of debt acquired in the Powergen acquisition (7.4 billion). Bank loans decreased from 9,167 million at year-end 2001 to 6,552 million at year-end 2002, reflecting the deconsolidation of entities holding debt of 1,739 million. 1,925 million (29 percent) of the amounts payable under bank loans at year-end 2002 are due after 2007, with 2,080 million (32 percent) due in 2003, 999 million (15 percent) due in 2004, 547 million (8 percent) due in 2005, 438 million (7 percent) due in 2006 and 563 million (9 percent) due in 2007. Mortgage loans incurred by Vitera account for 1,801 million of the total. For more detailed information on interest rates, maturities and other details of the Group's financial liabilities, including the credit facilities and Commercial Paper and Medium Term Note programs of E.ON AG and certain of its subsidiaries, see Note 25 of the Notes to Consolidated Financial Statements.

E.ON follows a centralized financing policy. Most of the financing transactions of E.ON's divisions have been centralized and netted at the Group level to reduce the Group's overall debt and interest expense. As a general rule, external financings will be undertaken at the E.ON AG level (or via finance subsidiaries under its guarantee) and on-lent as needed within the Group. In certain limited circumstances, future financings may also take place at subsidiary level *e.g.* for reasons of tax efficiency or regulatory compliance. E.ON's aim is to maximize its financing efficiency and minimize structural subordination issues that would arise if significant external debt was held at the operating subsidiary level. Over time it is E.ON's intention to refinance external subsidiary debt as it falls due with intercompany loans.

In 2002, E.ON's implementation of its centralized financing policy was reflected in the increase of the authorized amount of its Commercial Paper program to 5 billion in February 2002 and that of its Medium-Term Note program to 20 billion in August 2002. In addition, E.ON established a revolving credit facility in December 2002 that permits borrowings in various currencies in an aggregate amount of up to 15 billion. This facility replaced existing credit facilities of E.ON and Powergen and also provides a general liquidity backstop.

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For additional information on these programs, including amounts outstanding and available as of year-end 2002, see Note 25 of the Notes to Consolidated Financial Statements.

At year-end 2002, Standard & Poor's Ratings Group (S&P) and Moody's Investors Service (Moody's) rated E.ON's Commercial Paper program A-1+ and Prime-1 respectively, and E.ON's Medium Term Note program Aa2 and AA-, respectively. On January 10, 2003, Moody's reduced its rating to A1. Following the settlement of litigation that had blocked E.ON's Ruhrgas acquisition, S&P confirmed its E.ON rating on January 31, 2003.

In an effort to further optimize the planning process, E.ON has reduced the length of its investment planning period from five years to three. The basis for this decision was E.ON's belief that the product life cycles are continuously shortening and that conditions in markets and competitive relationships are changing more quickly.

E.ON has budgeted 18 billion for capital investments for the three-year period between 2003 and 2005. This budgeted figure does not include the capital investments at Ruhrgas of 6-8 billion announced during the ministerial approval process, which primarily relate to gas exploration and infrastructure development.

Total investments at the E.ON Energie division are expected to amount to 8.0 billion during the next three years. Of this amount, 5.7 billion is earmarked for fixed assets, primarily power transmission and distribution networks. Powergen's investment is expected to total 2.5 billion, which is planned to be divided about equally between fixed asset investments in the U.K. and the U.S. Expenditures at Ruhrgas are projected to be 2.7 billion. Of the remaining 4.8 billion of the Group total, approximately 4 billion relates to the cost to acquire the remaining shares of Ruhrgas. The remaining amount is dedicated to other operations, primarily at the real estate division. The Group plans to spend about 95 percent of the total investment (17.1 billion) in its core energy business. Approximately 60 percent of the total capital expenditures are targeted inside Germany. Nearly two thirds of E.ON's budgeted capital expenditures are aimed at enlarging existing positions and tapping new markets.

The Group expects to be able to finance the total volume of budgeted capital investments through divestment proceeds anticipated during the three-year planning period. E.ON plans to be able to markedly improve its financial position through increases in its operating cash flow. This would give the Group considerable financial flexibility to fund major strategic acquisitions.

Material transactions that are expected to have a significant impact on E.ON's cash flows in 2003 include the following. On March 5, 2003, E.ON sold shares equal to 5.8 percent of Bouygues Telecom's outstanding shares to the Bouygues Group. Cash inflows from this transaction are expected to total 400 million. In February 2003, E.ON received 1.4 billion from the sale of 37.2 million shares of Degussa to RAG. Finally, E.ON's capital expenditures for the completion of the acquisition of Ruhrgas will total approximately 4 billion.

E.ON expects that cash flow from operations and cash received from disposals of non-core assets will continue to be the primary source of funds for its capital expenditures and working capital requirements in 2003. E.ON believes that its cash flow and available liquid funds and credit lines will be sufficient to meet its anticipated cash needs. In addition, various means of raising share capital are available to E.ON as discussed in Item 10. Additional Information Memorandum and Articles of Association Changes in Capital and Note 17 of the Notes to Consolidated Financial Statements.

For a discussion of related party transactions, see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions.

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The following represent the contractual obligations and commercial commitments of E.ON as of December 31, 2002:

Contractual Obligations	Total
	(in millions)
Long-Term Debt	24,850
Purchase and Other Contractual Obligations	4,586
Operating Leases	1,560
Other Long-Term Contractual Obligations	735
Total Contractual Obligations	31,731
Other Commercial Commitments	Total Amounts Committed*
	(in millions)
Financial Guarantees (excluding nuclear obligations)	816
Indemnification Agreements	5,376
Indirect Guarantees of Indebtedness of Others	753
Other Guarantees	36
Total Commercial Commitments	6,981

* Maximal potential undiscounted future payments, excluding provisions.

E.ON has contingent contractual obligations of approximately 3.6 billion related to put options which would require it to acquire certain shareholdings. These put options relate primarily to the E.ON Energie division. For more information, see Note 26 of the Notes to Consolidated Financial Statements.

For more information with regards to E.ON's contractual obligations and commercial commitments, see Notes 25 and 26 of the Notes to Consolidated Financial Statements.

E.ON has established risk management policies that allow the use of foreign currency, interest rate and commodity derivative instruments and other instruments and agreements to manage its exposure to market, currency, interest rate, commodity price and counterparty risk. E.ON uses derivatives for both trading and non-trading purposes. Proprietary trading is conducted with the goal of improving operating results within defined limits in specified markets. For additional information about E.ON's trading activities and risk management policies, see Item 4. Information on the Company Business Overview E.ON Energie German Operations Trading , Powergen Energy Trading and Item 11. Quantitative and Qualitative Disclosures about Market Risk.

E.ON applies mark-to-market accounting for all of its energy trading activities, under the guidance of SFAS 133 and EITF Issue No. 98-10, Accounting for Contracts Involving Energy Trading and Risk Management Activities (EITF 98-10), respectively. EITF 98-10 requires that energy trading contracts are reflected at fair value, inclusive of future servicing costs and valuation adjustments, with resulting unrealized gains and losses recorded as assets and liabilities on the Consolidated Balance Sheet. Current period changes in the assets and liabilities from risk management activities are recognized as net gains or losses on the Consolidated Statement of Income. Changes in assets and liabilities from energy trading activities primarily result from changes in valuation of the portfolio of contracts, maturity and settlement of contracts and newly originated contracts. In October 2002, the Emerging Issues Task Force reached the conclusion to rescind EITF 98-10. The rescindment is effective for fiscal periods beginning after December 15, 2002. For details of this rescindment and the expected impact on the Company's future financial results, see Note 2 of the Notes to Consolidated Financial Statements.

and Development.

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TREND INFORMATION

For information on the principal trends and uncertainties affecting the Company's results of operations and financial condition, see Item 3. Key Information – Risk Factors, Item 4. Information on the Company – Operating Environment – Business Overview – E.ON Energie Regulatory Environment and Powergen Regulatory Environment and Item 5. Operating and Financial Review and Prospects – Results of Operations – and Liquidity and Capital Resources.

Item 6. Directors, Senior Management and Employees.

DIRECTORS AND SENIOR MANAGEMENT

GENERAL

In accordance with the Stock Corporation Act, E.ON has a Supervisory Board and a Board of Management. The two Boards are separate and no individual may simultaneously be a member of both Boards.

The Board of Management is responsible for managing the day-to-day business of E.ON in accordance with the Stock Corporation Act and E.ON's Articles of Association. The Board of Management is authorized to represent E.ON and to enter into binding agreements with third parties on behalf of it.

The principal function of the Supervisory Board is to supervise the Board of Management. It is also responsible for appointing and removing the members of the Board of Management. The Supervisory Board may not make management decisions, but may determine that certain types of transactions require its prior consent.

In carrying out their duties, the individual Board members must exercise the standard of care of a diligent and prudent businessperson. In complying with such standard of care, the Boards must take into account a broad range of considerations including the interests of E.ON and its shareholders, employees and creditors. In addition, the members of the Board of Management are personally liable for certain violations of the Stock Corporation Act by the Company.

SUPERVISORY BOARD (AUFSICHTSRAT)

The present Supervisory Board of E.ON consists of twenty members, ten of whom were elected by the shareholders by a simple majority of the votes cast at a shareholder meeting in accordance with the provisions of the Stock Corporation Act, and ten of whom were elected by the employees in accordance with the German Co-determination Act (*Mitbestimmungsgesetz*).

A member of the Supervisory Board elected by the shareholders may be removed by the shareholders by a majority of the votes cast at a meeting of shareholders. A member of the Supervisory Board elected by the employees may be removed by three-quarters of the votes cast by the relevant class of employees. The Supervisory Board appoints a Chairman and a Deputy Chairman of the Supervisory Board from amongst its members. At least half the total required number of members of the Supervisory Board must be present or participate in the decision making to constitute a quorum. Unless otherwise provided for by law, resolutions are passed by a simple majority of the votes cast. In the event of a tie, another vote is held and the Chairman (who is, in practice, a representative of the shareholders because the representatives of the shareholders have the right to elect the Chairman if two-thirds of the total required number of members of the Supervisory Board fail to agree on a candidate) then casts the tie-breaking vote.

The members of the Supervisory Board are each elected for the same fixed term of approximately five years. The term expires at the end of the annual general shareholders' meeting after the fourth fiscal year following the year in which the Supervisory Board was elected. Reelection is possible. The remuneration of the members of the Supervisory Board is determined by E.ON's Articles of Association.

Because all members of the Supervisory Board are elected at the same time, their terms expire simultaneously. The term of a substitute member of the Supervisory Board elected or appointed by a court to fill a vacancy ends at the time when the term of the original member would have ended. The incumbent members of

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E.ON's Supervisory Board, their respective ages and their principal occupation and experience, each as of December 31, 2002, as well as the year in which they were first elected to the Supervisory Board are as follows:

Name and Position Held	Age	Principal Occupation	Year First Elected
Dr. Klaus Liesen(1) Chairman of the Supervisory Board	71	Chairman of the Supervisory Board of Ruhrgas AG	1991
Hubertus Schmoltdt(3) Deputy Chairman of the Supervisory Board	57	Supervisory Board Memberships/ Directorships: Allianz AG (Chairman), TUI AG, Volkswagen AG Chairman of the Board of Management of Industriegewerkschaft Bergbau, Chemie, Energie Supervisory Board Memberships/ Directorships: Bayer AG, Buna Sow Leuna Olefinverbund GmbH, Deutsche BP AG, RAG Coal International AG	1996
Günter Adam(3) Member of the Supervisory Board	51	Foreman, Degussa AG	2002
Dr. Karl-Hermann Baumann(1) Member of the Supervisory Board	67	Supervisory Board Memberships/ Directorships: Degussa AG Chairman of the Supervisory Board of Siemens AG; formerly member of the Board of Management of Siemens AG Supervisory Board Memberships/ Directorships: Deutsche Bank AG, Linde AG, mg technologies AG, Schering AG, ThyssenKrupp AG, Wilhelm von Finck AG	2000
Ralf Blauth(1)(3) Member of the Supervisory Board	51	Industrial clerk, Degussa AG	1996
Dr. Rolf-E. Breuer Member of the Supervisory Board	65	Supervisory Board Memberships/ Directorships: Degussa AG Chairman of the Supervisory Board of Deutsche Bank AG, formerly Spokesman of the Board of Management of Deutsche Bank AG Supervisory Board Memberships/ Directorships: Bertelsmann AG, Deutsche Börse AG (Chairman), Deutsche Lufthansa AG, Siemens AG, Compagnie de Saint-Gobain S.A.(2), Landwirtschaftliche Rentenbank(2), Kreditanstalt für Wiederaufbau(2)	1997
Dr. Gerhard Cromme Member of the Supervisory Board	59	Chairman of the Supervisory Board of ThyssenKrupp AG Supervisory Board Memberships/ Directorships: Allianz AG, Axel Springer Verlag AG, Deutsche Lufthansa AG, Ruhrgas AG, Volkswagen AG, Suez S.A.(2)	1993
Wolf-Rüdiger Hinrichsen(3) Member of the Supervisory Board	47	Head of the Economic Affairs Department of E.ON AG	1998
Ulrich Hocker Member of the Supervisory Board	52	General Manager of the German Investor Protection Association Supervisory Board Memberships/ Directorships: CBB Holding AG (Chairman), Feri Finance AG, Karstadt Quelle AG, ThyssenKrupp Steel AG, Gartmore Capital Strategy Fonds(2), Phoenix Mecano AG(2)	1998
Dr. Jochen Holzer, Honorary Senator(4) Member of the Supervisory Board	68	Former Chairman of the Supervisory Board of VIAG AG 1993-1998	2000

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Name and Position Held	Age	Principal Occupation	Year First Elected
Jan Kahmann(3) Member of the Supervisory Board	55	Member of the Board of the Unified Service Sector Union (ver.di) Supervisory Board Memberships/ Directorships: Eurogate Beteiligungs GmbH, TUI AG	2001
Eva Kirchhof(3) Member of the Supervisory Board	45	Diploma-Physicist, Degussa AG Supervisory Board Memberships/ Directorships: Degussa AG, Infracor GmbH	2002
Dr. h.c. Andre Leysen Member of the Supervisory Board	75	Honorary Chairman of the Administrative Board of Gevaert N.V., formerly Chairman of the Administrative Board of Gevaert N.V. Supervisory Board Memberships/ Directorships: Deutsche Telekom AG, Schenker AG	1993
Margret Mönig-Raane(3) Member of the Supervisory Board	54	Vice-Chairwoman of the Board of the Unified Service Sector Union (ver.di) Supervisory Board Memberships/ Directorships: Deutsche Bank AG	1998
Ulrich Otte(3) Member of the Supervisory Board	53	Systems engineer, E.ON Energie AG Supervisory Board Memberships/ Directorships: E.ON Energie AG, E.ON Kraftwerke GmbH	2001
Klaus-Dieter Raschke(1)(3) Member of the Supervisory Board	49	Tax Assistant, E.ON Kernkraft GmbH Supervisory Board Memberships/ Directorships: E.ON Energie AG, E.ON Kernkraft GmbH	2002
Armin Schreiber(3) Member of the Supervisory Board	49	Electrical Engineer, E.ON Kernkraft GmbH, Formerly member of the Supervisory Board of VIAG AG 1997-2000	2000
Dr. Henning Schulte-Noelle Member of the Supervisory Board	60	Chairman of the Board of Management, Allianz AG Supervisory Board Memberships/ Directorships: Allianz Dresdner Asset Management GmbH (Chairman), Allianz Lebensversicherungs-AG (Chairman), Allianz Versicherungs-AG (Chairman), BASF AG, Dresdner Bank AG (Chairman), Linde AG, Siemens AG, ThyssenKrupp AG, AGF S.A.(2), RAS S.p.A.(2)	1993
Kurt F. Viermetz Member of the Supervisory Board	63	Retired Vice Chairman and Director of the Board of J.P. Morgan & Co. Incorporated, formerly Chairman of the Supervisory Board of Bayerische Hypo- und Vereinsbank AG Supervisory Board Memberships/ Directorships: Bayerische Hypo- und Vereinsbank AG, Grosvenor Estate Holdings(2)	1996
Dr. Bernd W. Voss Member of the Supervisory Board	63	Member of the Supervisory Board of Dresdner Bank AG, formerly Member of the Board of Management of Dresdner Bank AG Supervisory Board Memberships/ Directorships: Allianz AG, Continental AG, Karstadt Quelle AG, Quelle AG, TUI AG, Wacker Chemie GmbH, Bankhaus Reuschel & Co(2) (Chairman), ABB Ltd.(2)	1993

(1)

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Member of E.ON AG's Audit Committee. For more information, see Item 10. Additional Information - Memorandum and Articles of Association - Corporate Governance.

(2) Membership in comparable domestic or foreign supervisory body of a commercial enterprise.

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- (3) Elected by the employees.
- (4) Pursuant to the merger agreement between VEBA AG und VIAG AG, as long as the State of Bavaria holds more than a four percent interest in E.ON AG, it has the right to propose for election one member of the Supervisory Board. Accordingly, the State of Bavaria proposed Mr. Holzer for Supervisory Board membership. This right of proposal, however, is not binding on the Supervisory Board, which submits a proposal for election of Supervisory Board members to the applicable shareholders meeting according to its due discretion. The current members of the Supervisory Board are subject to reelection in 2003.

BOARD OF MANAGEMENT (VORSTAND)

As of December 31, 2002, the Board of Management of E.ON consisted of five members (the total number is determined by the Supervisory Board) who are appointed by the Supervisory Board in accordance with the Stock Corporation Act.

Pursuant to E.ON's Articles of Association, any two members of the Board of Management, or one member of the Board of Management and the holder of a special power of attorney (*Prokura*), may bind E.ON. According to E.ON's Articles of Association, Prokura is granted by the Board of Management.

The Board of Management must report regularly to the Supervisory Board, in particular on proposed business policy and strategy, profitability, on the current business of E.ON and on business transactions that may affect the profitability or liquidity of E.ON, as well as on any exceptional matters which may arise from time to time. The Supervisory Board is also entitled to request special reports at any time.

The members of the Board of Management are appointed by the Supervisory Board for a maximum term of five years. They may be re-appointed or have their term extended for additional five-year terms, subject to certain limitations depending upon the age of the member. Under certain circumstances, such as a serious breach of duty or a bona fide vote of no confidence by the shareholders at a shareholders meeting, a member of the Board of Management may be removed by the Supervisory Board prior to the expiration of such term.

The current members of the Board of Management, their respective ages and their positions and experience, each as of December 31, 2002, as well as the year in which they were first appointed to the Board and the years in which their terms expire, respectively, are as follows:

<u>Name and Title</u>	<u>Age</u>	<u>Business Activities and Experience</u>	<u>Year First Appointed</u>	<u>Year Current Term Expires</u>
Ulrich Hartmann Chairman of the Board of Management	64	Co-Chief Executive Officer; Corporate Communications, Corporate and Public Affairs, Investor Relations, Supervisory Board Relations; formerly Chairman of the Board of Management of VEBA AG Supervisory Board Memberships/ Directorships: E.ON Energie AG(2) (Chairman), Deutsche Lufthansa AG, Hochtief AG, IKB Deutsche Industriebank AG (Chairman), Münchener Rückversicherungs-Gesellschaft AG (Chairman), RAG Aktiengesellschaft (Chairman), Arcelor(3), Henkel KGaA(3), Powergen plc(3)(5) (Chairman)	1989(1)	2003
Prof. Dr. Wilhelm Simson Chairman of the Board of Management	64	Co-Chief Executive Officer; Group Strategy, Executive Development, Audit; formerly Chairman of the Board of Management and Chief Executive Officer of VIAG AG Supervisory Board Memberships/ Directorships: Degussa AG(2) (Chairman), VIAG Telecom AG(2) (Chairman), Bayerische Hypo- und Vereinsbank AG	2000(4)	2003

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Name and Title	Age	Business Activities and Experience	Year First Appointed	Year Current Term Expires
Dr. Hans Michael Gaul Member of the Board of Management	60	Controlling/ Corporate Planning, M&A, Legal Affairs; formerly Member of the Board of Management of VEBA AG Supervisory Board Memberships/ Directorships: Degussa AG(2), E.ON Energie AG(2), Viterrra AG(2) (Chairman), Allianz Versicherungs-AG, DKV AG, RAG Aktiengesellschaft, STEAG AG, Volkswagen AG, E.ON North America, Inc.(3)(5), LG&E Energy Corp.(3)(5), Powergen plc(3)(5)	1990	2004
Dr. Manfred Krüper Member of the Board of Management	61	Labor Relations, Personnel, Infrastructure and Services, Procurement, Organization; formerly Member of the Board of Management of VEBA AG Supervisory Board Memberships/ Directorships: Viterrra AG(2), equitrust Aktiengesellschaft (Chairman), RAG Aktiengesellschaft, RAG Immobilien AG, Victoria Versicherung AG, Victoria Lebensversicherung AG, E.ON North America, Inc.(3)(5) (Chairman)	1996	2005
Dr. Erhard Schipporeit Member of the Board of Management	53	Chief Financial Officer; Finance, Accounting, Taxes, IT; formerly Member of the Board of Management of VIAG AG (appointed in 1997) Supervisory Board Memberships/ Directorships: Degussa AG(2), E.ON Energie AG(2), VIAG Telecom AG(2), Commerzbank AG, HDI Privat Versicherung AG, Connect Austria GmbH(3)(5), E.ON Risk Consulting GmbH(3)(5) (Chairman), HDI Va.G.(3)	2000	2005

- (1) Appointed Chairman of the Board of Management of VEBA AG in 1993.
- (2) Group mandate.
- (3) Membership in comparable domestic or foreign supervisory body of a commercial enterprise.
- (4) Appointed Chairman of the Board of Management of VIAG AG in 1993, and became Co-Chairman of E.ON's Board of Management following the VEBA-VIAG merger.
- (5) Other Group mandate (membership in comparable domestic or foreign supervisory body of a commercial enterprise).

In its meeting on March 5, 2003, the Supervisory Board appointed Dr. Burckhard Bergmann as member of the Board of Management with immediate effect. He is in charge of the gas business.

In its meeting on September 3, 2002, the Supervisory Board appointed Dr. Wulf Bernotat as Chairman of the Board of Management and Chief Executive Officer with effect as of May 1, 2003.

The members of the Supervisory Board and Board of Management hold, in aggregate, less than one percent of E.ON's outstanding Ordinary Shares.

COMPENSATION

Provided that E.ON shareholders approve the proposed dividend at the Annual Shareholders Meeting on April 30, 2003, total remuneration to members of the Supervisory Board will be 2.6 million. Of this total, 0.7 million consists of fixed compensation (including compensation for duties performed at subsidiaries and attendance fees) and 1.9 million of variable compensation.

Pursuant to E.ON AG's Articles of Association, members of the Supervisory Board receive an annual fixed fee of 10,000 and are reimbursed each fiscal year for their meeting-related expenses, including reimbursement for the value added tax on their remuneration. Members of the Supervisory Board also receive an attendance fee

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of 1,000 per meeting. In addition, members of the Supervisory Board receive an annual variable fee of 1,250 for each percentage point by which the dividend paid to shareholders exceeds 4 percent of the Company's capital stock. The Chairman of the Supervisory Board receives three times the above-mentioned fees, the Deputy Chairman receives double the above-mentioned fees, and each member of a committee receives one-and-a-half times the above-mentioned fees.

Members of the Supervisory Board who serve less than the entire financial year owing to a change in the Board's composition receive the above-mentioned fees on a proportionate basis. There were no loans to members of the Supervisory Board in the 2002 financial year.

Total remuneration to members of the Board of Management was 10.5 million. Of this total, 4.6 million consisted of fixed compensation, including compensation for duties performed at subsidiaries, as well as monetary benefits and other compensation. Variable compensation of 5.2 million reflects the performance-related bonus members of the Board of Management would receive if the dividend of 1.75 per Ordinary Share is approved. Total remuneration also includes gains totaling 0.7 million from the exercise of 124,750 stock appreciation rights (SARs) from the first and second tranche of the SAR plan described in Note 10 of the Notes to Consolidated Financial Statements.

In early 2002, members of the Board of Management received 260,000 SARs. These SARs were part of the fourth tranche of the SAR plan. On the balance sheet date, the SARs of all tranches had a hypothetical exercise value of zero, because the E.ON share price ended the year markedly below the strike prices of the respective tranches.

Total payments to retired members of the Board of Management and their beneficiaries were 4.9 million. Provisions of 53.9 million have been provided for the pension obligations to retired members of the Board of Management and their beneficiaries. There were no loans to members of the Board of Management in the 2002 financial year.

E.ON has service agreements with the members of its Board of Management. The service agreements of the members of the Board of Management do not contain provisions for payments should a member's employment be terminated prior to expiration of the agreement or not be extended by the Supervisory Board. In the case where an agreement has not been extended, members of the Board of Management shall receive retirement payments after their service agreements have ended which are based on the length of their membership on the Board of Management. Should a member's service agreement be terminated prior to expiration or not be extended at the request of such member or for important reason no retirement payments shall be due, except for statutory claims, such as mandatory pension benefits. In the special case of a change in control of E.ON AG, members of the Board of Management shall receive a payment equal to a maximum of five years' annual compensation.

EMPLOYEES

As of December 31, 2002, E.ON employed a workforce of 107,856 people, which represented an increase of 16.2 percent from year-end 2001. This increase is mainly due to the first-time inclusion of Powergen. Excluding Powergen, the number of employees in the Group increased slightly in 2002. Of the total number of employees, 61 percent were based in Germany. Of the 107,856 employees at year-end 2002, 4,729 were apprentices. The following table sets forth information about the number of employees of E.ON as of December 31, 2002, 2001 and 2000:

	Employees at December 31, 2002			Employees at December 31, 2001			Employees at December 31, 2000		
	Total	Germany	Foreign	Total	Germany	Foreign	Total	Germany	Foreign
E.ON Energie	45,394	34,268	11,126	39,560	30,829	8,731	34,406	30,396	4,010
Powergen	11,591		11,591						
Chemicals Division	47,623	28,351	19,272	48,927	29,532	19,395	56,816	34,212	22,604
Real Estate Division	2,683	2,660	23	2,049	2,020	29	2,660	2,569	91
Holding/ Other	565	377	188	2,218	379	1,839	13,470	2,918	10,552
Total	107,856	65,656	42,200	92,754	62,760	29,994	107,352	70,095	37,257

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Expenditures for salaries and wages totaled 6.5 billion in 2002, up 0.6 percent from 2001, primarily due to the first-time inclusion of Powergen from July 1, 2002.

Many of the Group's employees are members of labor unions. Almost all of the union members in Germany belong to the national chemicals/mining/energy and the public services/transportation/traffic unions. None of E.ON's facilities in Germany is operated on a closed shop basis. In Germany, employment agreements for blue collar workers and for white collar employees below management level are generally collectively negotiated between the regional association of the companies within a particular industry and the respective unions. In addition, under German law, works councils comprised of both blue collar and white collar employees participate in determining company policy with regard to certain compensation matters, work hours and hiring policy.

Powergen U.K.'s organizational structure comprises a number of businesses which are supported by central functional teams that provide finance, legal and human resources services. Powergen U.K. has in place a company level framework for collective bargaining that has been jointly agreed with the five recognized trade unions. This framework provides for arrangements for negotiation and consultation at the company level and the business unit level. At the company level, a range of common standards is negotiated with the trade unions for company-wide application. At the business unit level, detailed negotiation of pay and other business-specific terms and conditions is negotiated by business level employee forums. These forums consist of representatives from management, trade unions and employees and fulfill a consultative as well as a negotiating role. Since privatization, Powergen U.K. believes it has maintained constructive relationships with its recognized unions.

The employees of LG&E Energy who are members of labor unions belong to local units of the International Brotherhood of Electrical Workers (IBEW) and The United Steelworkers of America (USWA). Most of these union employees are involved in operational and maintenance work in power generation and distribution operations. The majority of LG&E Energy's employees are not union members. In the United States, Collective Bargaining Agreements (CBA) are negotiated between the local management (*i.e.*, LG&E, KU and WKE) and local union representatives. Each CBA generally has a term of three to four years and has no strike or lock out clauses during the term of the agreement. While LG&E Energy had an adversarial relationship in the past with the IBEW, its primary union, management believes relations have significantly improved and may now be characterized as cooperative.

Pursuant to EU requirements, E.ON also established a European works council in 1996 that is responsible for cross-border issues. The Company believes that it has satisfactory relations with its works councils and unions and therefore anticipates reaching new agreements with its labor unions on satisfactory terms as the existing agreements expire. There can be no assurance, however, that new agreements will be reached without a work stoppage or strike or on terms satisfactory to the Company. A prolonged work stoppage or strike at any of its major manufacturing facilities could have a material adverse effect on the Company's results of operations. The Group has not experienced any material strikes during the last ten years.

Since 1984, E.ON has had an employee share purchase program under which employees may purchase shares at a discount to the extent provided under German tax laws (according to Section 19a of the German Income Tax Law, in 2002 employees were eligible for a discount of up to 154 per employee). In 2002, employees purchased 218,305 Ordinary Shares under this program.

STOCK INCENTIVE PLANS

Since 1999, E.ON AG has run a SAR plan for key executives of the Group. The purpose of this plan is to focus key executives on long-term corporate growth. The SAR plan is based on the performance of E.ON AG's ordinary shares. E.ON AG granted approximately 1.6 million SARs to 186 top-level executives worldwide in 2002, including members of the Board of Management, as part of their compensation.

In 2001, Degussa also introduced a SAR plan for executives. This plan is based on the performance of Degussa's ordinary shares. In 2002, Degussa granted approximately 1.5 million SARs to 227 executives worldwide, including the members of Degussa's Board of Management, as part of their compensation.

For more information about these plans, see Note 10 of the Notes to Consolidated Financial Statements.

Table of Contents**Item 7. Major Shareholders and Related Party Transactions.****MAJOR SHAREHOLDERS**

As of December 31, 2002, E.ON had an aggregate number of 652,341,876 Ordinary Shares with no par value outstanding. Under the Articles of Association, each Ordinary Share represents one vote.

Based on information available to E.ON, including filings with the SEC, the following table summarizes the holdings of those shareholders who beneficially owned more than 5 percent of the Ordinary Shares as of the dates indicated. None of these Ordinary Shares possess any special voting rights.

	As of December 31,					
	2002		2001		2000	
	No. of Shares	% of Class	No. of Shares	% of Class	No. of Shares	% of Class
Allianz AG	44,850,517	6.5	61,807,102	8.9	83,386,334	10.9

Holders of voting securities of listed German corporations (including E.ON) whose shareholding reaches, passes or falls below certain thresholds are subject to certain notification requirements under German law. These thresholds are 5, 10, 25, 50 and 75 percent of a company's voting rights. For more information, see Item 10. Additional Information Memorandum and Articles of Association and Note 17 of the Notes to Consolidated Financial Statements.

In addition as of December 31, 2002 E.ON directly and indirectly held a total of 39,658,124 of its own Ordinary Shares in treasury stock, representing 5.73 percent of its voting rights. E.ON cannot vote these shares. For more information, see Notes 17 and 21 of the Notes to Consolidated Financial Statements.

Although E.ON is unable to determine the exact number of its Ordinary Shares held in the United States, it believes that as of December 31, 2002, approximately 12 percent of its outstanding share capital was held in the United States. For more information, see Item 9. The Offer and Listing General.

RELATED PARTY TRANSACTIONS

In the ordinary course of its business, E.ON enters into transactions with numerous businesses, including firms in which the Group holds ownership interests and those with which some of E.ON's Supervisory Board members hold positions of significant responsibility.

Allianz AG is a major shareholder of E.ON. Allianz AG provides the Group with insurance coverage in the ordinary course of business for which it was paid reasonable and customary fees. E.ON has ongoing banking relations with Deutsche Bank AG, previously a major shareholder, in the ordinary course of business.

E.ON directly and indirectly holds a 39.2 percent interest in RAG. In January 2002, E.ON and its wholly owned subsidiary E.ON Energie sold their respective 6.5 percent interests in STEAG, a German independent power producer, to RAG. Proceeds received for this 13 percent shareholding totaled approximately 288 million and E.ON realized a gain of 173 million after elimination of intercompany profit. Finally, in February 2003, E.ON sold 37.2 million of its shares in Degussa (approximately 18 percent of Degussa's outstanding shares) to RAG for 1.4 billion and has an agreement to sell additional shares to RAG in the future. Subsequent to this transaction, both E.ON and RAG hold a 46.5 percent interest in Degussa. E.ON has also agreed to purchase the underlying shares from the lenders who provided RAG's third-party debt financing of the acquisition under certain cases of default by RAG. For more information on these transactions, see Item 4. Information on the Company History and Development of the Company Ruhrgas and Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions.

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From time to time E.ON may make loans to companies in which the Group holds ownership interests. At year-end 2002, E.ON had aggregate outstanding loans to companies in which the Group holds ownership interests amounting to 2,091 million.

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Item 8. Financial Information.

CONSOLIDATED FINANCIAL STATEMENTS

See Item 18. Financial Statements and pages F-1 to F-73.

LEGAL PROCEEDINGS

Various legal actions, including lawsuits for product liability or for alleged price fixing agreements, governmental investigations, proceedings and claims are pending or may be instituted or asserted in the future against the Company. Since litigations or claims are subject to numerous uncertainties, their outcome cannot be ascertained; however, in the opinion of management, the outcome of these matters will not have a material adverse effect upon the financial condition, results of operations or cash flows of the Company.

In the wake of the various corporate restructurings of the past several years, shareholders have filed a number of claims (*Spruchstellenverfahren*). The claims contest the adequacy of share exchange ratios or cash settlements. The claims impact the Company's E.ON Energie, chemicals and the former distribution/ logistics divisions, as well as the VEBA-VIAG merger. In connection with the VEBA-VIAG merger, certain shareholders of the former VIAG have filed claims with the district court in Munich, contesting the adequacy of the share exchange ratio used in the merger. The claims challenge in particular the valuation used for VIAG's telecommunications shareholdings, which were valued at the earnings value of the businesses. The plaintiffs claim that a divestiture of these shareholdings was anticipated, and therefore the holdings should have been valued at fair market value as if sold as of the merger date. Because the share exchange ratios and settlements were determined by outside experts and reviewed by independent auditors, E.ON believes that the exchange ratios and settlements are correct.

On July 2, 2002, the EU Commission imposed a fine on Degussa in the amount of 118 million for violations of EU competition rules arising out of alleged price fixing with respect to the feed additive methionin. Degussa has initiated court proceedings with the aim of challenging the fine. Although Degussa's management believes that its challenge is supported by the facts, the outcome of the proceedings is uncertain, and no assurance can be given that the fine will be overturned or reduced.

For a discussion of litigation in connection with E.ON's acquisition of Ruhrgas, see Item 4. Information on the Company History and Development of the Company Ruhrgas.

For information about proceedings instituted by the German Federal Cartel Office affecting E.ON Energie's subsidiaries, see Item 3. Key Information Risk Factors External.

E.ON maintains general liability insurance covering claims on a worldwide basis with coverage limits and retention amounts which management believes to be adequate and appropriate in light of E.ON's businesses and the risks to which they are subject. For a discussion of E.ON Energie's nuclear accident protection, see Item 4. Information on the Company Business Overview E.ON Energie.

DIVIDEND POLICY

The Supervisory Board and the Board of Management jointly propose the dividends based on the E.ON AG's unconsolidated financial statements. The dividends are officially declared at the annual general meeting of shareholders which is usually convened during the second quarter of each year. The shareholders approve the dividends. Holders of E.ON's Ordinary Shares on the date of the annual general meeting of shareholders are entitled to receive the dividend, less any amounts required to be withheld on account of taxes or other governmental charges. See also Item 10. Additional Information Taxation. Cash dividends payable to holders of Ordinary Shares will be distributed by Dresdner Bank AG, Frankfurt, as paying agent. In Germany, the payment will be made to the holder's custodian bank or other institution holding the shares for the shareholder which will credit the payment to the shareholder's account. For purposes of distribution in the United States, the dividend will be paid to J.P. Morgan Chase & Co. as U.S. transfer agent. For ADS holders in the United States,

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the payment will be converted from euros to U.S. dollars unless the ADS holder instructs otherwise. The U.S. dollar amounts of dividends may be affected by fluctuations in exchange rates. See Item 3. Key Information Exchange Rates.

E.ON AG expects to continue to pay dividends, although there can be no assurance as to the particular amounts that may be paid from year to year. The payment of future dividends will depend upon E.ON's earnings, financial condition (including its cash needs), future earnings prospects and other factors.

See also Item 3. Key Information Dividends.

SIGNIFICANT CHANGES

For information about significant changes following December 31, 2002, see Item 4. Information on the Company History and Development of the Company.

Item 9. The Offer and Listing.**GENERAL**

The principal trading market for the Ordinary Shares is the Frankfurt Stock Exchange. The Ordinary Shares are also traded on the other German stock exchanges in Berlin, Bremen, Düsseldorf, Hamburg, Hanover, Munich and Stuttgart, as well as on XETRA (see below), and on the Swiss Stock Exchange. Options on Ordinary Shares are traded on the German derivatives exchange (*Eurex Deutschland*). E.ON believes that as of December 2002, it had close to 478,000 stockholders.

ADSs, each representing one Ordinary Share with a pro rata amount of the registered capital of E.ON AG attributable to each share of 2.60, are listed on the NYSE and trade under the symbol EON. The depository for the ADSs is J.P. Morgan Chase & Co. of New York.

TRADING ON THE NEW YORK STOCK EXCHANGE

The table below sets forth, for the periods indicated, the high and low closing sales prices for the ADSs on the NYSE, as reported on the NYSE Composite Tape.

	Price per ADS (\$)	
	High	Low
1998	72 5/8	48
1999	66 1/4	42 1/8
2000	60 3/8	40 5/8
2001 (1)	60.50	42.03
First Quarter(1)	60.50	42.03
Second Quarter	52.40	46.00
Third Quarter	56.75	47.30
Fourth Quarter	56.90	46.67
2002	58.02	39.80
First Quarter	52.25	47.75
Second Quarter	58.02	50.80
Third Quarter	57.90	42.80
Fourth Quarter	50.31	39.80
September	50.30	42.80
October	50.31	43.40
November	48.51	41.51
December	45.90	39.80
2003		
January	45.36	39.85
February	44.92	38.91

- (1) On January 29, 2001, the NYSE started trading all listed issues in decimals instead of fractions.
On March 10, 2003, the closing sale price per ADS on the NYSE as reported on the NYSE Composite Tape was \$41.06.

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TRADING ON THE FRANKFURT STOCK EXCHANGE

The Frankfurt Stock Exchange is by far the most significant of the eight German stock exchanges. By the end of December 2002, it accounted for approximately 90 percent of the total securities orderbook turnover in Germany. As of the end of 2002, the equity securities of 5,768 corporations, including 4,901 foreign corporations, were traded on the Frankfurt Stock Exchange.

The Exchange Council of the Frankfurt Stock Exchange (*Frankfurter Wertpapierbörse*) approved a new segmentation of the Exchange's equity markets on November 19, 2002, with the goal of increasing transparency, liquidity, legal certainty and integrity. The new structure, which took effect on January 1, 2003, consists of the Prime Standard Segment and the General Standard Segment.

The Prime Standard segment is designed for companies that wish to target international investors. Accordingly, Prime Standard companies are required to meet transparency criteria over and above those required for General Standard companies. These criteria, which are based on international practice, include:

Quarterly reporting;

Application of international accounting standards (either IAS or U.S. GAAP);

Publication of a financial calendar listing the most important corporate events;

At least one analysts' conference per year; and

Provision of English language versions of all current reports and ad-hoc disclosures required under the German Securities Trading Act (*Wertpapierhandelsgesetz*, or Securities Trading Act).

Issuers are admitted to the Prime Standard segment upon application, subject to approval by the Admission Board of the Frankfurt Stock Exchange. E.ON's Ordinary Shares have been admitted to the Prime Standard segment.

Companies that had been listed in the former first or second segments of the Frankfurt Stock Exchange that did not apply for admission to the Prime Standard segment were automatically included in the General Standard segment as of January 1, 2003. The General Standard segment is aimed at smaller and mid-sized companies that predominantly attract domestic investors, and are interested in a relatively inexpensive way of being and remaining listed. This segment requires companies to comply with the statutory minimum requirements of the Official Market (*Amtlicher Markt*) or the Regulated Market (*Geregelter Markt*), including:

Annual financial statements;

Semi-annual reporting; and

Publication of ad-hoc disclosures required under the Securities Trading Act in German.

Prices are continuously quoted on the Frankfurt Stock Exchange floor and on XETRA each business day between 9:00 a.m. and 8:00 p.m. Central European Time (CET) for E.ON Ordinary Shares, as well as for other actively traded shares. The Frankfurt Stock Exchange publishes a daily official list (*Orderbuchstatistik*) which includes the volume of recorded transactions in the shares comprising the DAX 100 Index (a performance index comprising the shares of the 100 largest companies, including those 30 companies, of which E.ON is one, comprising the *Deutsche Aktienindex* or DAX 30 Index, the key benchmark of trading on the Frankfurt Stock Exchange), together with the prices of the highest and lowest recorded trades of the day. The list reflects price and volume information for trades completed by members on the floor during the day as well as for interdealer trades completed off the floor.

XETRA (*Exchange Electronic Trading System*) is a computerized trading platform that can be accessed by all market participants regardless of their geographical location. It is administered by the Deutsche Börse AG and integrated into the Frankfurt Stock Exchange and subject to the Exchange's rules and regulations. XETRA is open for trading from 9:00 a.m. to 8:00 p.m. CET. Unlike exchange floor-trading, electronic order processing makes it possible for orders to be entered in the system and matched up to the end of the trading day. All of the equity securities listed on the Frankfurt Stock Exchange, as well as approximately 2,200 warrants are traded on XETRA.

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The market supervisory committee of each German stock exchange is responsible for maintaining market transparency and regulating price determination and stock market pricing in general. The market supervisory committee is made up of the German Federal securities affairs supervisory body (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or BAFin), the local state stock market supervisory authority and the stock market internal trading supervision and monitoring body. This Frankfurt Stock Exchange's internal supervisory body is independently responsible for ensuring correct trading and order processing on the market, with the goal of enhancing the protection provided to the investor and improving the overall integrity of the market.

The Frankfurt Stock Exchange's market supervision committee also includes representatives of the Hessian State Ministry for Economic Affairs, Transport and State Development and the BAFin. The local state supervisory authority is responsible for ensuring that stock exchange regulations and directives governing stock exchange operations and the correct processing of stock exchange business are observed. The BAFin is responsible for the detection and enforcement of insider trading and ensuring transparency, and cooperates at the international level with other stock market supervisory authorities from outside of Germany.

The table below sets forth, for the periods indicated, the high and low closing sales prices (*Schlusskurse*) for the Ordinary Shares on XETRA, as reported by the Frankfurt Stock Exchange, together with the highs and lows of the DAX 30 Index.

See the discussion under Item 3. Key Information Exchange Rates with respect to rates of exchange between the dollar and the euro applicable during the periods set forth below.

	Price Per Ordinary Share		DAX 30 Index(1)	
	High	Low	High	Low
	()		(in thousands)	
1998	66.90	41.11	6,171.43	3,896.08
1999	62.60	41.60	6,958.14	4,678.72
2000	66.55	41.01	8,064.97	6,200.71
2001	64.50	46.91	6,795.14	3,787.23
First Quarter	63.50	46.91	6,795.14	5,388.02
Second Quarter	61.94	51.75	6,278.90	5,553.46
Third Quarter	64.50	51.75	6,109.50	3,787.23
Fourth Quarter	61.40	53.10	5,271.29	4,239.97
2002	59.97	38.16	5,462.55	2,597.88
First Quarter	59.61	55.60	5,462.55	4,745.58
Second Quarter	59.97	58.75	5,343.88	4,099.05
Third Quarter	59.80	43.53	4,483.03	2,769.03
Fourth Quarter	52.07	38.16	3,380.20	2,597.88
September	51.80	43.53	3,609.41	2,769.03
October	52.07	44.60	3,282.67	2,597.88
November	48.50	42.18	3,360.76	3,042.06
December	45.00	38.16	3,380.20	2,840.00
2003				
January	42.90	36.93	3,157.25	2,643.80
February	41.97	36.13	2,751.99	2,450.20

(1) The DAX 30 Index is a continuously updated, capital-weighted performance index of 30 German blue chip companies. E.ON represented approximately 9.38 percent of the DAX 30 Index as of March 10, 2003. In principle, the shares included in the DAX 30 Index were selected on the basis of their stock exchange turnover and their market capitalization. Adjustments of the DAX 30 Index are made for capital changes, subscription rights and dividends.

On March 10, 2003, the closing sale price per Ordinary Share on XETRA, as reported by the Frankfurt Stock Exchange was 37.11, equivalent to \$40.96 per Ordinary Share, translated at the euro Foreign Exchange Rate as published on Reuters page EUROFX/1 on such date.

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Item 10. Additional Information.

MEMORANDUM AND ARTICLES OF ASSOCIATION

Organization, Register and Entry Number

E.ON AG is a stock corporation organized under the laws of the Federal Republic of Germany under the Stock Corporation Law (*Aktiengesetz*). It is entered in the Commercial Register (*Handelsregister*) maintained by the local court of Düsseldorf, Germany, under the entry number HRB 22315.

Objects and Purposes

The purposes of the Company, described in Section 2 of E.ON AG's Articles of Association (*Satzung*), are as follows:

E.ON AG controls a group of companies active in the following business sectors in particular:

energy, with principal operations in electricity, gas and oil as well as water and waste disposal;

chemicals, principally consisting of specialty chemicals, construction chemicals and petrochemicals;
as well as activities in

telecommunications; and

real estate.

E.ON is also authorized to manage businesses in the fields of distribution and logistics, aluminum, silicon wafers and packaging.

Activities in these business sectors include electricity generation, distribution, transmission, supply and trading. Facilities of all kinds can be erected, acquired and operated, and services and business cooperations of all kinds can be undertaken.

Further, its Articles of Association authorize E.ON AG to conduct business itself in these sectors; in particular, it can conclude individual transactions. E.ON AG is entitled to take all actions and measures related to its purpose or suited to serve its purpose, directly or indirectly.

E.ON may also establish and purchase other companies, and may acquire shareholdings in other companies, particularly companies active, in whole or in part, in the business sectors set forth above. The Articles of Association further authorize E.ON to acquire interests in companies of all kinds with the primary objective of investing financial resources, regardless of whether the company operates within one of E.ON's stated business sectors.

Corporate Governance

German stock corporations are governed by three separate bodies: the annual general meeting of shareholders, the supervisory board and the board of management. Their roles are defined by German law and by the corporation's Articles of Association, and may be described generally as follows:

The Annual General Meeting of Shareholders ratifies the actions of the corporation's supervisory board and board of management. It decides, among other things, on the amount of the annual dividend, the appointment of an independent auditor and certain significant corporate transactions. In corporations with more than 2,000 employees, shareholders and employees elect or appoint an equal number of representatives to the supervisory board. The annual general meeting must be held within the first eight months of each fiscal year.

The Supervisory Board appoints and removes the members of the board of management and oversees the management of the corporation. Although prior approval of the supervisory board may be required in

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connection with certain significant matters, the law prohibits the supervisory board from making management decisions.

The Board of Management manages the corporation's business and represents it in dealings with third parties. The board of management submits regular reports to the supervisory board about the corporation's operations and business strategies, and prepares special reports upon request. A person may not serve on the board of management and the supervisory board of a corporation at the same time.

In February 2002, a Government Commission appointed by the German Minister of Justice presented the new German Corporate Governance Code (the Code). The new Code describes and summarizes the statutory corporate governance framework set forth in the Stock Corporation Act, and, to the extent applicable, the German Securities Trading Act and the German Takeover Act. It also includes recommendations and suggestions for standards on responsible corporate governance, with the recommendations being intended to reflect generally accepted best practices. A new Transparency and Publicity Act (*Transparenz- und Publizitätsgesetz*) came into effect in July 2002. A new Article 161 was also added to the Stock Corporation Act, stipulating that the board of management and supervisory board of German listed companies shall declare once a year that the recommendations of the Code have been and are being complied with, or identify which of the Code's recommendations have not been or are not being applied. E.ON submitted this declaration for the first time on December 19, 2002 and published the text on its corporate website at www.eon.com. Material appearing on the website is not incorporated by reference into this annual report.

E.ON complies with the Code's recommendations with only two exceptions. First, the liability insurance E.ON provides for members of the Board of Management and Supervisory Board (so-called D&O insurance) does not include a deductible. E.ON believes that imposing deductibles is not an appropriate means of improving the sense of responsibility with which the members of the Board of Management and Supervisory Board perform their assigned tasks and functions. Second, the Code recommends that chairpersons of Supervisory Board committees receive extra compensation for their service in this regard. Although E.ON does not currently pay such fees, it intends to follow the Code's recommendations in this regard and will propose a corresponding amendment to its Articles of Association at the next shareholders meeting.

E.ON has always welcomed the creation of uniform corporate governance standards. E.ON believes that the Code will make the German system of corporate governance more transparent and promote the trust of international and national investors and the general public in the management and supervision of German listed companies. Taking the Code as a basis, E.ON reviewed its internal rules and procedures relating to shareholders' meetings, the interaction between the Board of Management and the Supervisory Board and the transparency of its financial reporting, as well as the Company's procedures for accounting and auditing. E.ON concluded from this review that the Company had already been following a majority of the Code's recommendations for some time before the Code was published, reflecting E.ON's value-oriented corporate governance principles and capital markets-oriented accounting and reporting policies. In order to promote the transparency and efficiency of the Supervisory Board's activities, rules of procedure for the Supervisory Board were adopted on December 19, 2002 and it was decided to set up an audit committee, as well as a finance and investment committee, in addition to the already existing committees.

Cooperation between the Board of Management and the Supervisory Board. The E.ON Board of Management manages the business of the Company, with all its members bearing joint responsibility for its decisions, in accordance with German law. The Board of Management establishes the Company's objectives, sets its fundamental strategic direction, and is responsible for corporate policy and group organization. This includes, in particular, the management of the group and its financial resources, the development of its human resources strategy, the appointment of persons to management posts within the group and the development of its managerial staff, as well as the presentation of the group to the capital markets and to the public at large. In addition, the Board of Management is responsible for coordinating and supervising the group's business units in accordance with the group's established strategy.

The Board of Management regularly reports to the Supervisory Board on a timely and comprehensive basis on all issues of corporate planning, business development, risk assessment and risk management. It also submits

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the group's investment, finance and personnel plan for the coming fiscal year (as well as the medium-term plan) to the Supervisory Board for its approval at the last meeting of each fiscal year.

The Chairperson of the Board of Management informs the Chairperson of the Supervisory Board of important events that are of fundamental significance in assessing the condition, development and management of the Company and of any defects that have arisen in the Company's monitoring systems without undue delay. Transactions and measures requiring the approval of the Supervisory Board are also submitted to the Supervisory Board without delay.

Conflicts of Interest. In order to ensure that the Supervisory Board's advice and oversight functions are conducted on an independent basis, no more than two former members of the Board of Management may be members of the Supervisory Board. Supervisory Board members may also not hold a corporate office or perform any advisory services for key competitors of the Company. Supervisory Board members are required to disclose any information concerning conflicts of interest to the full Supervisory Board, particularly if the conflict arises from their advising or holding a corporate office with one of E.ON's customers, suppliers, creditors or other business partners. The Supervisory Board is required to report any conflicts of interest to the annual shareholders' meeting and to describe how the conflicts have been handled. Any material conflict of interest of a non-temporary nature will result in the termination of the member's appointment to the Supervisory Board. No conflicts of interest involving any members of the Supervisory Board were reported during 2002. In addition, any consulting or other service agreements between the Company and a member of the Supervisory Board require the prior consent of the full Supervisory Board. No such agreements existed during 2002.

Members of the Board of Management are also required to promptly report conflicts of interest to the Executive Committee of the Supervisory Board and to the full Board of Management. Members of the Board of Management may only assume other corporate positions, particularly appointments to the supervisory boards of non-Group companies, with the consent of the Executive Committee. Any material transactions between the Company and members of the Board of Management, their relatives or entities with which they have close personal ties require the consent of the Executive Committee, and all transactions must be conducted on an arm's length basis. No such transactions took place during 2002.

The Supervisory Board Committees. The Supervisory Board has 20 members and, in accordance with the German Codetermination Act (*Mitbestimmungsgesetz*), is composed of an equal number of shareholder and employee representatives. It supervises the management of the Company and advises the Board of Management. The Supervisory Board has formed the following committees from among its members.

The Executive Committee consists of four members. It prepares meetings of the Supervisory Board and advises the Board of Management on matters of general policy relating to the strategic development of the Company. In urgent cases, (*i.e.* if waiting for the prior approval of the Supervisory Board would materially prejudice the Company), the Executive Committee decides on business transactions requiring prior approval by the Supervisory Board.

In particular, the Executive Committee prepares the Supervisory Board's personnel decisions and deals with issues of corporate governance. It reports to the Supervisory Board at least once a year on the status, effectiveness and possible ways of improving the Company's corporate governance and on new requirements and developments in this field.

The Audit Committee consists of four members who have special knowledge in the field of accounting or business administration. The Company believes that at least one of the Audit Committee's members Dr. Karl-Hermann Baumann meets all of the requirements for being considered a financial expert within the meaning of Section 407 of Sarbanes-Oxley and the rules enacted thereunder, given his extensive experience in accounting and auditing matters, including the application of U.S. GAAP.

The Audit Committee deals in particular with issues relating to the Company's accounting policies and risk management, issues regarding the independence of the Company's external auditors, the establishment of auditing priorities and agreements on auditors' fees. The Audit Committee also prepares the Supervisory Board's decision on the approval of the annual financial statements of E.ON AG and the acceptance of the annual

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consolidated financial statements. It also inspects the company's annual report on Form 20-F and its quarterly reports and discusses the financial statements and the quarterly reports with the independent auditors.

The Audit Committee also prepares the proposal on the selection of the Company's external auditors for the annual general meeting of shareholders. In order to ensure the auditors' independence, the Audit Committee secures a statement from the auditors proposed detailing any facts that could lead to the firm being excluded for independence reasons or otherwise conflicted. As a condition of their appointment, the external auditors agree to promptly inform the chair of the Audit Committee should any such facts arise during the course of the audit. The auditors also agree to promptly inform the Supervisory Board of anything arising during the course of their audit that is of relevance to the Supervisory Board's duties, and to inform the chair of the Audit Committee of, or to note in their audit report, any facts determined during the audit that contradict the statements submitted by the Board of Management or Supervisory Board in connection with the Code.

The Finance and Investment Committee consists of four members. It advises the Board of Management on all issues of Group financing and investment planning. It decides on behalf of the Supervisory Board on the approval of the acquisition and disposition of companies, company participations and parts of companies, as well as on finance activities whose value exceeds one percent of the Group's equity, as listed in the latest consolidated balance sheet. If the value of any such transactions or activities exceeds 2.5 percent of this equity, the Finance and Investment Committee will prepare the Supervisory Board's decision on such matters.

Measures relating to the Sarbanes-Oxley Act. As a company whose ADSs are listed on the NYSE, E.ON is subject to the U.S. federal securities laws and the jurisdiction of the U.S. securities regulator, the SEC. In particular, E.ON is subject to the provisions of Sarbanes-Oxley, portions of which are still in the process of being implemented by the SEC through rulemaking. The aim of Sarbanes-Oxley is to increase the monitoring, quality and transparency of financial reporting in light of recent corporate and accounting scandals in the United States, and its provisions generally apply to both U.S. and non-U.S. issuers with securities listed in the United States. E.ON has complied with all of the Sarbanes-Oxley requirements currently applicable to the Company, as well as complying in advance with several provisions (including those relating to the financial expert discussed above) that are not yet applicable to E.ON. See Item 15. Controls and Procedures and the Certifications appearing at the end of this annual report. E.ON has also instituted the following additional measures to improve further the transparency of its corporate governance and financial reporting.

In addition to E.ON's general code of conduct for all employees, the Company has developed a special Code of Ethics for members of the Board of Management and senior financial officers and published the text on its corporate website at www.eon.com. Material appearing on the website is not incorporated by reference in this annual report. This code obliges these managers to make full, appropriate, accurate, timely and understandable disclosure of information both in the documents E.ON submits to the SEC and in its other corporate publications. E.ON believes that this code of ethics complies with the requirements of Section 406 of Sarbanes-Oxley and the rules enacted thereunder, notwithstanding the fact that such requirements are not yet applicable to E.ON.

In accordance with an SEC recommendation, E.ON has established a Disclosure Committee that is responsible for ensuring that effective procedures and control mechanisms for financial reporting are in place and for providing a correct and timely presentation of information to the financial markets. The committee is comprised of seven members from various sectors of E.ON AG who have a good overview of the Group and the processing of information relating to the quarterly reports and annual financial statements.

Under the Disclosure Committee's leadership, E.ON has carried out a review of the proceedings used in preparing the annual report on Form 20-F and inventoried the Company's existing control mechanisms. The effectiveness of these mechanisms has been assessed by E.ON AG's internal audit department; E.ON's independent auditors have performed a sample test on the effectiveness assessment conducted by E.ON AG's internal audit department.

Certain Provisions with Respect to Board Members

As a member of the Supervisory Board or Board of Management, a person is not permitted to vote on resolutions relating to transactions between himself and the Company. Further, contracts between members of the

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Supervisory Board and the Company require consent of the entire Supervisory Board, unless the contract establishes an employment relationship or relates to the member’s services on the Board. Members of both Boards are prohibited from voting on resolutions relating to the initiation or settlement of litigation between themselves and the Company. There are no age limit requirements for the retirement of Board members. Compensation of Board of Management members is determined by the Supervisory Board while compensation for the Supervisory Board is stipulated in E.ON AG’s Articles of Association. For more information about E.ON’s Board of Management and Supervisory Board, see Item 6. Directors, Senior Management and Employees.

Ordinary Shares

The share capital of E.ON AG consists of Ordinary Shares with no par value. Certain provisions with respect to the Ordinary Shares under German law and E.ON AG’s Articles of Association may be summarized as follows:

Dividends. Dividends in respect of Ordinary Shares are declared once a year at the annual general meeting of shareholders. For each fiscal year, the Board of Management approves E.ON AG’s unconsolidated financial statements and submits them together with a proposal regarding the distribution of profits to the Supervisory Board for its approval. After examining the financial statements and proposal for profit distribution, the Supervisory Board presents a report in writing at the annual general shareholders’ meeting. On the basis on the Supervisory Board’s report, the shareholders vote on the Management Board’s proposal regarding the disposition of all unappropriated profits, including the amount of net profits to be distributed as a dividend. E.ON’s shareholders participate in the distribution of dividends of the Company in proportion to their ownership of the outstanding share capital. Prior to dissolution of E.ON AG, the only amounts that may be distributed to shareholders under the Stock Corporation Act are the distributable profits (*Bilanzgewinn*).

Notice of the dividends to be paid will be published in the German Federal Official Gazette (*Bundesanzeiger*). For further information regarding E.ON dividends, see Item 3. Key Information Dividends and Item 8. Financial Information Dividend Policy.

Voting Rights. Each Ordinary Share entitles its holder to one vote. The members of the Supervisory Board are each elected for the same fixed term of approximately five years; they are not elected at staggered intervals. Cumulative voting is not permitted under German law. E.ON AG’s Articles of Association require that resolutions of shareholders’ meetings be adopted by a simple majority of votes and, in certain circumstances, by a simple majority of the share capital of the Company, unless a higher vote is required by German law. Under German law, certain corporate actions require approval by 75 percent of the shares represented at the shareholders’ meeting at which the matter is proposed. Such actions include, among others:

- amending the articles of association to alter the objects and purposes of the company;
- increasing or reducing the share capital;
- excluding preemptive rights of shareholders to subscribe for new shares;
- dissolving the corporation;
- merging the corporation into, or consolidating the corporation with, another stock corporation;
- transferring all or virtually all of the corporation’s assets; and
- changing corporate form.

Shareholder Rights in Liquidation. In accordance with German law, in the event of liquidation, the assets of E.ON remaining after discharge of its liabilities would be distributed to its shareholders in proportion to their shareholdings.

Redemption. Under German law, the share capital of E.ON AG may be reduced by a shareholder resolution amending the Articles of Association, passed by at least 75 percent of the share capital represented at the shareholders’ meeting. See Changes in Capital below.

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Preemptive Rights. Pursuant to E.ON AG's Articles of Association, the preemptive right of shareholders to subscribe for any issue of additional shares in proportion to their shareholdings in the existing capital (*Bezugsrecht*) may be excluded under certain circumstances.

Due to the restrictions on the offer and sale of securities in the United States under U.S. securities laws and regulations, there can be no assurance that any offer of new shares to existing shareholders on the basis of their preemptive rights will be open to U.S. holders of ADSs or Ordinary Shares.

Changes in Rights of Shareholders

Under German law, the rights of holders of E.ON shares may only be changed by a shareholder resolution amending the Articles of Association. The resolution must be passed by at least 75 percent of the share capital represented at the shareholders' meeting at which the issue was voted upon.

Shareholders' Meetings

The annual general meeting of shareholders is convened by E.ON's Board of Management or, when required by law, by its Supervisory Board, and must be held during the first eight months of the fiscal year. In addition, an extraordinary meeting of the shareholders may be called by the Board of Management, the Supervisory Board or shareholders owning in the aggregate at least five percent of the Company's issued share capital. There is no minimum quorum requirement for shareholder meetings. Each shareholder may be represented by a proxy by means of a written power of attorney. In Germany, non-institutional shareholders typically deposit their shares with a German bank (*Depotbank*). Such a bank may exercise the voting rights in relation to the deposited shares only if authorized to do so by a proxy of the shareholder. Such proxies are revocable at any time. If a shareholder giving a proxy does not give the bank instructions on how to exercise the voting rights, the bank will exercise the voting rights in accordance with its own proposals as previously communicated to the shareholder. Holders of ADRs may vote their shares by proxy by signing and returning the proxy card mailed to them by J.P. Morgan Chase & Co. (the Depository) in advance of the meeting. The Depository will, to the extent permitted by law, the Articles of Association and the provisions of the ADSs, vote or cause to be voted all ADSs for which it receives signed proxies by the applicable record date.

At the annual general meeting, shareholders are called upon to approve the distribution of Company profits, to ratify the actions of the Board of Management and the Supervisory Board taken during the prior year, and to appoint the Company's auditors. When necessary, other matters shall be resolved at shareholders' meetings in accordance with the relevant provisions of German law, including:

- election of members of the Supervisory Board (other than those elected by the employees);

- amendment of the Articles of Association;

- measures to increase or reduce share capital;

- mergers and similar transactions; and

- resolutions regarding the dissolution of the Company.

Notice of any shareholders' meeting, including an agenda describing items to be voted upon, shall be published in the German Federal Official Gazette (*Bundesanzeiger*) and in one other major daily German newspaper no later than one month before the deadline for depositing shares as described below. Holders of ADRs will be notified of any shareholders' meeting by the Depository.

E.ON AG's Articles of Association set forth certain requirements that shareholders must comply with in order to be eligible to participate in, and vote at, any E.ON shareholders' meeting. Specifically, shareholders are required to:

- deposit their shares or certificates of deposit for their shares with a notary, collective security-deposit bank, or other agency specified in the notice of the shareholders' meeting;

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make the deposit no later than the end of the day on the seventh day prior to the scheduled meeting date; and

leave the shares or certificates of deposit with the depository until the completion of the shareholders meeting.

If an E.ON shareholder deposits his shares with a notary, that shareholder must submit to the Company confirmation of the deposit no later than the day after the deadline for depositing shares. With the consent of one of the depositaries mentioned above, an E.ON shareholder may also be permitted to deposit his shares with another financial institution in the depository's name and have the shares frozen until the end of the shareholders meeting. Pursuant to a shareholder resolution approved at the former VEBA extraordinary shareholders meeting held on February 10, 2000, the Company excluded share certification in order to save the Company and its shareholders the high costs of printing and distributing share certificates. The shareholder's right to share certificates and profit-sharing coupons is thus excluded except as provided by the rules governing stock exchanges on which the shares are listed. E.ON has not issued and does not intend to issue share certificates.

Transparency and Corporate Reporting

The Board of Management and Supervisory Board of E.ON AG place a great deal of value on the transparency of corporate governance. E.ON's shareholders, capital markets participants, financial analysts, shareholder groups and the media are regularly and promptly informed of the condition of, and any material changes in, the Company's business. E.ON makes particular use of the Internet in communicating with its shareholders and the financial markets in general.

In particular, the Company produces the following financial reporting materials on a regular basis:

Quarterly reports;

Annual reports prepared in accordance with German law (in both German and English);

The Annual Report on Form 20-F;

A press conference at the time of release of the German annual report; and

Telephone conferences for analysts following the release of quarterly or annual results, as well as other investor relations presentations. The expected dates of issue for the Company's financial reports are summarized in the financial calendar, which is available on the Internet at www.eon.com. Material appearing on the website is not incorporated by reference in this annual report.

In addition to its regularly-scheduled financial reporting, announcements of material events are published by the Company through the German *ad hoc* disclosure system, released to the press and submitted to the SEC on Form 6-K.

Foreign Share Ownership

There are no limitations on the right to own Ordinary Shares, including the right of non-resident or foreign owners to hold or vote the Ordinary Shares, imposed by German law or the Articles of Association of E.ON AG.

Change of Control Provisions

There are no provisions in E.ON AG's Articles of Association that would have an effect of delaying, deferring or preventing a change in control of E.ON and that would only operate with respect to a merger, acquisition or corporate restructuring involving it or any of its subsidiaries. German law does not specifically regulate business combinations with interested shareholders. However, general principles of German law may restrict business combinations under certain circumstances.

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Disclosure of Shareholdings

E.ON AG's Articles of Association do not require shareholders to disclose their shareholdings. The Securities Trading Act which became effective on January 1, 1995 requires each investor whose investment in a German corporation (including E.ON AG) listed on the official market (*Amtlicher Handel*) of a German, European Union or European Economic Area stock exchange reaches, passes or falls below 5 percent, 10 percent, 25 percent, 50 percent or 75 percent of the voting rights of such corporation to notify such corporation and BAFin promptly in writing, but in any event within seven calendar days. Failure of a shareholder to notify the company will, for so long as such failure continues, disqualify such shareholder from exercising the voting rights attached to his shares. In connection with this requirement, the Securities Trading Act contains various rules designed to ensure the attribution of shares to the person who has effective control over the shares.

Members of the Board of Management and Supervisory Board are required to disclose any acquisition or sale of Ordinary Shares under Section 15a of the Securities Trading Act and Section 6.6 of the Code. No such reports were received by E.ON AG during 2002.

Changes in Capital

Under German law, share capital may be increased in consideration of contributions in cash or in kind, or by establishing authorized capital (*genehmigtes Kapital*) or conditional capital (*bedingtes Kapital*). Authorized capital provides a company's board of management with the flexibility to issue new shares for a period of up to five years. Conditional capital allows the board of management to issue new shares for specified purposes, including employee stock option plans, mergers and the issuance of shares upon conversion of option bonds and convertible bonds. Capital increases require an amendment of the articles of association approved by 75 percent of the issued shares present at the shareholders' meeting at which the increase is proposed. The board of management must also obtain the approval of the supervisory board before issuing new shares. Likewise, the share capital may be reduced by an amendment to the articles of association, passed by at least 75 percent of the share capital represented at the shareholders' meeting. E.ON AG's Articles of Association do not contain conditions regarding changes in the share capital that are more stringent than German law requires.

Authorized and Conditional Capital. Subject to the approval of the Supervisory Board, the Board of Management is authorized:

To increase the Company's capital stock by a maximum of 180,000,000 through the one-time or repeated issuance of new Ordinary Shares in return for cash contributions until May 25, 2005. E.ON shareholders have pre-emptive rights with respect to the issuance of these authorized shares though their rights may be excluded by the Board of Management under certain circumstances.

To increase the Company's capital stock by a maximum of 150,392,201 through the one-time or repeated issuance of new Ordinary Shares in return for contributions in kind until May 25, 2005. E.ON shareholders have no pre-emptive rights with respect to these authorized shares.

To increase the Company's capital stock by a maximum of 180,000,000 through the one-time or repeated issuance of new Ordinary Shares in return for cash contributions until May 25, 2005. E.ON shareholders generally have pre-emptive rights with respect to the issuance of these authorized shares, though their rights may be excluded by the Board of Management under certain circumstances.

Also pursuant to its Articles of Association, E.ON's capital stock has been conditionally increased by up to 75,000,000. This conditional increase may be implemented only to the extent that holders of conversion rights or option certificates issued under a program authorized by the E.ON shareholders on May 25, 2000, exercise their conversion or option rights.

For more information regarding the Company's capital stock, see Note 17 of the Notes to Consolidated Financial Statements.

Share Buyback. Pursuant to shareholder resolutions approved at the annual general meetings of shareholders held on May 25, 2000, and on May 18, 2001, the Board of Management was authorized to buy back up to 10 percent of E.ON AG's outstanding share capital through October 31, 2002, either through market purchases or

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via a public tender offer. On September 22, 2000, the Board of Management resolved to make use of this authorization over the following nine months, and to buy back up to 10 percent of E.ON's share capital through market purchases. As of October 31, 2001, the Company had bought back 76,329,887 Ordinary Shares at an average price of € 58.69 per share, representing approximately 10 percent of E.ON's total share capital. As of November 13, 2001, the Board of Management decided to cancel 71,298,875 Ordinary Shares. This decision was approved by the Supervisory Board on December 12, 2001, which authorized the Board of Management to cancel the repurchased shares without seeking further approval by the general meeting of shareholders. The remaining repurchased shares are used to compensate employees under various incentive plans. These amendments to the number of Ordinary Shares authorized were entered into the Commercial Register of the Düsseldorf District Court. E.ON AG's share capital now consists of 692,000,000 Ordinary Shares. During 2002, E.ON purchased an additional 241,523 Ordinary Shares in the market and sold 503,434 Ordinary Shares of treasury stock, either to its employees in connection with existing plans, or in the market following the exercise of SARs. Pursuant to shareholder resolutions approved at the annual general meeting of shareholders held on May 28, 2002, the Board of Management is authorized to buy back up to 10.0 percent of E.ON AG's outstanding share capital through October 31, 2003. For additional details on the share repurchases, see Note 21 of the Notes to Consolidated Financial Statements.

MATERIAL CONTRACTS

On July 1, 2002, E.ON completed its acquisition of Powergen, which is now wholly owned by E.ON, under a scheme of arrangement. The scheme of arrangement provided for the acquisition of all outstanding Powergen shares by virtue of an order of the English courts following approval of the transaction at a meeting of Powergen shareholders on April 19, 2002. The details of the acquisition are described in more detail in Item 4. Information on the Company History and Development of the Company Powergen Acquisition. A copy of the scheme of arrangement has been incorporated by reference as an exhibit to this annual report.

On July 15, 2001, E.ON and BP entered into a participation agreement which, among other things, provides for the acquisition by BP of a 51.0 percent stake in VEBA Oel by way of a capital increase and for a shareholders' agreement between the two parties following the capital increase. The agreement also gave E.ON a put option to sell the remaining 49.0 percent interest in VEBA Oel to BP at any time from April 1, 2002. E.ON exercised that put option in June 2002. The details of the transaction are described in more detail in Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions. A copy of the participation agreement has been incorporated by reference as an exhibit to this annual report.

In February 2003, E.ON acquired Ruhrgas. The details of the acquisition are described in more detail in Item 4. Information on the Company History and Development of the Company Ruhrgas. Copies of the contracts under which E.ON acquired majority control of Ruhrgas have been filed as exhibits to this annual report.

EXCHANGE CONTROLS

At the present time, Germany does not restrict the export or import of capital, except for investments in areas like Iraq and Myanmar or transactions with regard to certain groups of persons or institutions in Myanmar, Serbia, Afghanistan and Angola, in accordance with applicable resolutions adopted by the United Nations and the EU. However, for statistical purposes only, every individual or corporation residing in Germany (a Resident) must report to the German Central Bank (*Deutsche Bundesbank*), subject only to certain immaterial exceptions, any payment received from or made to or on account of an individual or a corporation resident outside of Germany (a Non-resident) if such payment exceeds € 12,500 (or the equivalent in a foreign currency). In addition, Residents must report any claims against or any liabilities payable to Non-residents if such claims or liabilities, in the aggregate, exceed € 1.5 million (or the equivalent in a foreign currency) at the end of any month.

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TAXATION

The following is a summary of material U.S. federal income tax and German tax considerations relating to the ownership of ADSs or Ordinary Shares. The discussion is based on tax laws of the United States and Germany as in effect on the date of this Annual Report, including the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital and to Certain Other Taxes (the Income Tax Treaty), and the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts (the Estate Tax Treaty). Such laws are subject to change. The discussion is also based in part upon the representations of the Depository and assumes that each obligation in the Deposit Agreement and any related agreement will be performed in accordance with its terms.

The discussion is limited to a general description of certain U.S. federal income and German tax consequences with respect to ownership and disposition of ADSs or Ordinary Shares by a U.S. Holder. In general, a U.S. Holder is any beneficial owner of ADSs or Ordinary Shares (1) who is a resident of the United States for the purposes of the Income Tax Treaty, (2) who is not also a resident of the Federal Republic of Germany for the purposes of the Income Tax Treaty, (3) who owns the ADSs or Ordinary Shares as capital assets, (4) who does not hold ADSs or Ordinary Shares as part of the business property of a permanent establishment located in Germany or as part of a fixed base of an individual located in Germany and used for the performance of independent personal services, and (5) who is entitled to benefits under the Income Tax Treaty with respect to income and gain derived in connection with the ADSs or Ordinary Shares. The discussion does not purport to be a comprehensive description of all the tax considerations that may be relevant to the ownership of ADSs or Ordinary Shares, and, in particular, it does not address U.S. federal taxes other than income tax and German taxes other than income tax, gift and inheritance taxes. Moreover, the discussion does not consider any specific facts or circumstances that may apply to a particular U.S. Holder, some of which (for example, tax-exempt entities, persons that own, directly or indirectly, 10 percent or more of any class of the Company's stock, holders subject to the alternative minimum tax, securities broker-dealers and certain other financial institutions, holders who hold the ADSs or Ordinary Shares in a hedging transaction or as part of a straddle or conversion transaction or holders whose functional currency is not the U.S. dollar) may be subject to special rules.

Owners of ADSs or Ordinary Shares are strongly urged to consult their tax advisers regarding the U.S. federal, state, local, German and other tax consequences of owning and disposing of ADSs or Ordinary Shares. In particular, owners of ADSs or Ordinary Shares are urged to consult their tax advisers to confirm their status as U.S. Holders and the consequence to them if they do not so qualify.

In general, for U.S. federal income tax purposes and for purposes of the Income Tax Treaty, holders of ADSs will be treated as the owners of the Ordinary Shares represented by those ADSs.

TAXATION OF GERMAN CORPORATIONS

Pursuant to the German Tax Reduction Act (*Steuersenkungsgesetz*) of October 23, 2000, profits earned by a German resident corporation in business years beginning on or after January 1, 2001 are subject to a uniform corporate income tax rate of 25 percent. The Flood Victims Solidarity Act (*Flutopfersolidaritätsgesetz*) of September 19, 2002 increased this rate from 25 percent to 26.5 percent for the year 2003 only. German resident corporations are also subject to a solidarity surcharge equal to 5.5 percent of their corporate income tax liability. The aggregate corporate income tax and solidarity surcharge amount to 27.96 percent for the year 2003 and to 26.375 percent for subsequent years. In addition to these taxes, profits of a German resident corporation are subject to a municipal income trade tax. This tax is levied at rates set by each municipality in which the corporation maintains a business establishment. The municipal trade income tax is an allowable deduction for corporate income and municipal trade income tax purposes.

Table of Contents**TAXATION OF DIVIDENDS**

The Company is generally required to withhold tax on dividends in an amount equal to 20 percent of the gross amount paid to resident and non-resident stockholders. A partial refund of the withholding tax can be obtained by U.S. Holders under the Income Tax Treaty.

There is a 5.5 percent solidarity surcharge on the German withholding tax on dividend distributions paid by the Company. The surcharge amounts to 1.1 percent (5.5 percent × 20 percent) of the gross dividend amount. This results in an aggregate withholding rate of 21.1 percent. Since the Income Tax Treaty reduces the German withholding tax, U.S. Holders are entitled to a full refund of this surcharge.

In the case of any U.S. Holder, other than a U.S. corporation owning ADSs or Ordinary Shares representing at least 10 percent of the voting stock of the Company, the German withholding tax is partially refunded under the Income Tax Treaty to reduce the withholding tax to 15 percent of the gross amount of the dividend.

The gross amount of dividends received by a U.S. Holder (including the additional dividend associated with the treaty refund and amounts withheld in respect of German withholding tax) generally will be subject to U.S. federal income taxation as foreign source dividend income, and will not be eligible for the dividends received deduction generally allowed to U.S. corporations. German withholding tax at the 15 percent rate provided under the Income Tax Treaty will be treated as a foreign income tax that, subject to generally applicable limitations under U.S. tax law, is eligible for credit against a U.S. Holder's U.S. federal income tax liability or, at the holder's election, may be deducted in computing taxable income. Thus, for a declared dividend of \$100, a U.S. Holder would be deemed to have paid German taxes of \$15. Foreign tax credits will not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities or in respect of arrangements in which a U.S. Holder's expected economic profit is insubstantial. U.S. Holders should consult their own advisers concerning the implications of these rules in light of their particular circumstances.

Dividends paid in euros to a U.S. Holder of ADSs or Ordinary Shares will be included in income in a dollar amount calculated by reference to the exchange rate in effect on the date the dividends are received by such holder (or, in the case of the ADSs, by the Depositary). If dividends paid in euros are converted into dollars on the date received, U.S. Holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income.

A U.S. Holder may be required to recognize domestic-source foreign currency gain or loss on the receipt of a refund in respect of German withholding tax to the extent the U.S. dollar value of the refund differs from the U.S. dollar equivalent of that amount on the date of receipt of the underlying dividend.

The U.S. Administration has proposed to implement a new regime for taxing dividends that would have the effect of reducing or eliminating taxes on certain dividends paid to United States persons by corporations that pay U.S. federal income taxes. The Administration's proposal is subject to the uncertainties inherent in the legislative process and it is impossible to predict whether and in what form the proposal will be enacted. If enacted in its current form, it is unlikely that the proposal would significantly affect the taxation of dividends paid by E.ON.

REFUND PROCEDURES

Individual claims for refund are made on a special German form, which must be filed with the German tax authorities: *Bundesamt für Finanzen*, Friedhofstraße 1, 53225 Bonn, Germany. Copies of the required form may be obtained from the German tax authorities at the same address, or from the Embassy of the Federal Republic of Germany, 4645 Reservoir Road N.W., Washington D.C. 20007-1998, or from the Office of the Assistant Commissioner (International), Internal Revenue Service, 950 L'Enfant Plaza South S.W., Washington D.C. 20024, Attention: Taxpayer Service Division.

As part of the individual refund claim, a U.S. Holder must submit to the German tax authorities the original bank voucher (or certified copy thereof) issued by the paying entity documenting the tax withheld, and an official certification on IRS Form 6166 of its last filed United States federal income tax return. IRS Form 6166 may be obtained by filing a request with the Internal Revenue Service Center in Philadelphia, Pennsylvania, Foreign Certificate Request, P.O. Box 16347, Philadelphia, PA 19114-0447. Requests for certification must include the

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holder's name, social security number or employer identification number, tax return form number, and tax period for which the certification is requested. Requests for certification can include a request to the Internal Revenue Service to send the certification directly to the German tax authorities. If no such request is made, the Internal Revenue Service will send a certificate on IRS Form 6166 to the U.S. Holder, which then must submit the certification with its claim for refund.

Claims must be filed within four years of the end of the calendar year in which the dividend was received.

A simplified refund procedure based on electronic data exchange (*Datenträgerverfahren*) has been introduced with effect from January 1, 2002. Under this new procedure, a broker which is registered as a participant in the electronic data exchange procedure with the *Bundesamt für Finanzen* may file a collective refund claim on behalf of all of the U.S. Holders for whom it holds ADSs or Ordinary Shares in custody by sending the relevant data either on CD-ROM or magnetic tape to the *Bundesamt für Finanzen*. The electronic application must include the name, address and U.S. tax identification number of each U.S. Holder, as well as the security identification number for the relevant security, the day of the distribution, the gross dividend amount, the amount of tax withheld and the amount of the refund. Unlike an individual refund claim, a collective refund claim transmitted by electronic data exchange need not include official certifications on IRS Form 6166 or original bank vouchers (or certified copies thereof) documenting the tax withheld. The transmitted data may be used by the German tax authorities for administrative exchange of information between Germany and the United States.

The refund is assessed against and paid to the broker, which will then pay the refund to the U.S. Holders for whom it is acting. The *Bundesamt für Finanzen* is entitled to review the U.S. Holders' eligibility for a refund of withholding tax under the Income Tax Treaty. In the event of a review, the broker must establish the entitlement of its clients to tax refunds by submitting to the *Bundesamt für Finanzen* within a reasonable time the official certifications on IRS Form 6166 of the last-filed U.S. federal income tax returns and the original bank vouchers (or certified copies thereof) issued by the paying entity documenting the tax withheld.

Another simplified refund procedure applies if ADSs of a U.S. Holder are registered with brokers participating in the Depository Trust Company (DTC). Pursuant to administrative procedures agreed between the German Federal Ministry of Finance and the DTC, claims for refunds payable under the Income Tax Treaty to such U.S. Holders may be submitted to the German tax authorities by the DTC (or a custodian as its designated agent) collectively on behalf of all such U.S. Holders.

The DTC will prepare the German claim for refund forms for such U.S. Holders of ADSs and file the combined claims with the *Bundesamt für Finanzen*. It is not necessary to submit any IRS Form 6166 or bank voucher at this stage of the procedure.

The *Bundesamt für Finanzen* will issue refunds to the DTC, which will issue corresponding refund checks to the participating brokers. The *Bundesamt für Finanzen* is entitled to conduct eligibility reviews, generally within a period of four years. In the event of a review, the DTC will receive a list of brokers who must establish the entitlement of their clients to tax refunds by submitting to the *Bundesamt für Finanzen* a list containing names and addresses of the relevant holders of ADSs, and the official certifications on IRS Form 6166 of the last-filed U.S. federal income tax returns of such holders. Details of the collective refund procedure will be available from the DTC.

A collective refund procedure will also be available to U.S. Holders whose ADSs are not registered with brokers participating in the DTC. Under this refund procedure, the U.S. transfer agent will prepare the German claim for refund forms on behalf of U.S. Holders and file them electronically with the German tax authorities. In order for the U.S. transfer agent to file the claim for refund forms, the U.S. transfer agent will prepare and mail to these U.S. Holders, and the U.S. Holders will be requested to sign and return to the U.S. transfer agent, (1) a statement authorizing the U.S. transfer agent to perform these procedures and agreeing that the German tax authorities may inform the IRS of any refunds of German taxes and (2) a written authorization to remit the refund of withholding to an account other than that of the U.S. Holder. The U.S. transfer agent will attach the signed statement and the documentation issued by the paying agency documenting the dividend paid and the tax withheld to the claim for refund form and file them with the German tax authorities. U.S. Holders should also request certification (IRS Form 6166) of their last filed United States federal income tax return from the IRS and

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have it ready for presentation to the U.S. transfer agent upon request. This certification (IRS Form 6166) may be requested from the U.S. Holder if the U.S. Holder is selected as part of a verifying sample; if in this case, the certification (IRS Form 6166) cannot be presented by the U.S. Holder within a reasonable time, the refund of the German withholding taxes will be denied.

Refunds under the Treaty are not available in respect of Ordinary Shares or ADSs held in connection with a permanent establishment or fixed base in Germany.

TAXATION OF CAPITAL GAINS

Under the Income Tax Treaty, a U.S. Holder will be protected against German tax on capital gains realized or accrued on the sale or other disposition of ADSs or Ordinary Shares provided the assets of the Company do not consist and have not consisted predominantly of immovable property situated in Germany.

Upon a sale or other disposition of ADSs or Ordinary Shares, a U.S. Holder will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized and the U.S. Holder's tax basis in the ADSs or Ordinary Shares. Such gain or loss will generally be capital gain or loss, and will be long-term capital gain or loss if the U.S. Holder's holding period for the ADSs or Ordinary Shares exceeds one year. In the case of an individual U.S. Holder of ADSs or Ordinary Shares, any such long-term capital gain will be subject to a maximum U.S. federal income tax rate of 20 percent. Deposits and withdrawals of Ordinary Shares in exchange for ADSs will not result in realization of gain or loss for U.S. federal income tax purposes.

GIFT AND INHERITANCE TAXES

The Estate Tax Treaty provides that an individual whose domicile is determined to be in the United States for purposes of such Treaty will not be subject to German inheritance and gift tax (the equivalent of the United States federal estate and gift tax) on the individual's death or making of a gift unless the ADSs or Ordinary Shares (1) are part of the business property of a permanent establishment located in Germany or (2) are part of the assets of a fixed base of an individual located in Germany and used for the performance of independent personal services. An individual's domicile in the United States, however, does not prevent imposition of German inheritance and gift tax with respect to an heir, donee, or other beneficiary who either is or is deemed to be resident in Germany at the time the individual died or the gift was made.

The Estate Tax Treaty also provides a credit against U.S. federal estate and gift tax liability for the amount of inheritance and gift tax paid to Germany, subject to certain limitations, in a case where the ADSs or Ordinary Shares are subject to German inheritance or gift tax and U.S. federal estate or gift tax.

OTHER GERMAN TAXES

There are no German transfer, stamp or other similar taxes that would apply to U.S. Holders who purchase or sell ADSs or Ordinary Shares.

INFORMATION REPORTING AND BACKUP WITHHOLDING

Dividends on Ordinary Shares or ADSs, and payments of the proceeds of a sale of Ordinary Shares or ADSs, paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding unless the holder (1) is a corporation or other exempt recipient or (2) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding. However, such a holder may be required to provide a certification to establish its non-U.S. status in connection with payments received within the United States or through certain U.S.-related financial intermediaries.

Table of Contents**DOCUMENTS ON DISPLAY**

E.ON AG is subject to the reporting requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, E.ON files reports and other information with the Securities and Exchange Commission. These materials, including this annual report and its exhibits, may be inspected and copied at the SEC's Public Reference Room at 450 Fifth Street N.W., Washington D.C. 20549 and at the SEC's regional offices at 500 West Madison Street, Suite 1400, Chicago, Illinois 60661, and 233 Broadway, New York, New York 10279. Copies of materials may be obtained from the Public Reference Room at prescribed rates. The public may obtain information on the operation of the SEC's Public Reference Room by calling the SEC in the United States at 1-800-SEC-0330. In addition, material filed by E.ON with the SEC may be inspected at the offices of the New York Stock Exchange at 20 Broad Street, New York, New York 10005.

Item 11. Quantitative and Qualitative Disclosures about Market Risk.

The following discussion should be read in conjunction with Summary of Significant Accounting Policies in the Notes to the Consolidated Financial Statements and in conjunction with Notes 29 and 30 of the Notes to Consolidated Financial Statements, which provides a summarized comparison of nominal values and fair values of financial instruments used by the Company for risk management purposes and other information relating to those instruments.

Risk Identification and Analysis

In the normal course of business, the Company is exposed to foreign currency risk, interest rate risk, commodity price risk, and counterparty (or repayment) risk. These risks create volatility in equity, earnings and cash flows from period to period. The Company makes use of derivative instruments in order to manage currency risk, interest rate risk and commodity price risk. Foreign exchange and interest rate derivatives held by the Company are used only for non-speculative purposes. The E.ON Energie and Powergen divisions also engage in the trading of energy-related commodity derivatives, subject to established guidelines for risk management. See Commodity Price Risk Management below and Item 4. Information on the Company Business Overview E.ON Energie Trading and Powergen Energy Trading. In its hedging and trading activities, the Company generally utilizes established and widely-used derivative instruments for which significant liquidity exists. The Company's comprehensive framework for risk management includes general risk management guidelines for the use and evaluation of derivative instruments which are in place on all group levels of the Company.

As part of its risk management system, the Company utilizes instruments such as interest rate swaps, interest rate/cross currency swaps, interest rate options, forward foreign exchange contracts, cross currency swaps, foreign exchange options, commodity forwards, commodity swaps and commodity futures and options contracts, seeking to reduce its risk exposure by entering into offsetting market positions.

The following discussion of the Company's risk management activities and the estimated amounts generated from value-at-risk and sensitivity analyses are forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those projected due to actual developments in the global financial markets. The methods used by the Company to analyze risks, as discussed below, should not be considered projections of future events or losses. The Company also faces risks that are either non-financial or non-quantifiable. Such risks principally include country risk, credit risk, and legal risk, which are not represented in the following analyses.

Foreign Exchange and Interest Rate Risk Management Principles

The Company's Corporate Treasury, which is primarily responsible for entering into derivative foreign exchange and interest rate contracts for the Group and its companies, acts as a service center for the Company and not as a profit center. With E.ON AG's approval, individual Group companies may also hedge their currency and interest rate risks directly with third parties.

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A computerized reporting and controlling system for treasury activities has been developed and implemented throughout the Company. It is designed to provide for the systematic and consistent identification and analysis of the Company's overall financial and market risks in the field of currencies and interest rates. The system is also used to determine, analyze, and monitor the Company's short- and long-term financing and investment requirements and market and counterparty risks arising from short- and long-term deposits and hedging transactions.

The range of action, responsibilities, and financial reporting procedures to be followed by each Group company are outlined in detail in the Company's internal financial guidelines. The individual subgroup headquarters have enacted their own guidelines for financial risk management within the limits established by the Group financial guidelines. To ensure efficient risk management at E.ON AG, the Treasury, Back Office, and Financial Controlling departments are organized as strictly separate units. Standard software is employed in processing relevant business transactions. The Financial Controlling department is charged with providing continuous and independent risk management. It prepares operational financial plans, calculates market price and counterparty risks, and evaluates financial transactions. The Financial Controlling Department reports at regular intervals on the Group's liquidity market price and counterparty risks. Those subsidiaries which make use of external hedging transactions have similar organizational and reporting arrangements.

Foreign Exchange Rate Risk Management

Due to the international nature of certain of its business activities, the Company is exposed to foreign exchange risk related to sales, assets, receivables liabilities denominated in currencies other than the euro, net investments in foreign operations, and anticipated foreign exchange payments. Of the Company's consolidated revenue in 2002, 2001, and 2000, approximately 36 percent, 35 percent and 43 percent, respectively, arose due to transactions with customers which were not located in member states of the EMU, and therefore exposed the Company to foreign exchange rate risk. The Company's exposure results principally from transactions in United States dollars, British pounds, Norwegian krona, Swedish krona and Japanese yen and from net investments in foreign operations whose functional currencies are U.S. dollars, British pounds and Swedish krona. As of December 31, 2002, the Company had in place hedging transactions with respect to each of these currencies.

In accordance with E.ON's hedging policy, macro-hedging transactions relating to currency risks are generally completed for periods of up to twelve months. Under certain circumstances the hedging horizon is wider. Macro-hedging transactions comprise a number of individual underlying transactions that have been grouped together and hedged as an individual unit.

The principal derivative financial instruments used by E.ON to cover foreign currency exposures are foreign exchange forward contracts, cross currency swaps, interest rate cross currency swaps and currency options. As of December 31, 2002, the E.ON Group had entered into foreign exchange forward contracts with a nominal value of 13.1 billion, cross currency swaps with a nominal value of 8.9 billion, interest rate cross currency swaps with a nominal volume of 0.3 billion and currency options with a nominal value of 0.3 billion.

Market risks for foreign exchange derivatives consist of the positive and negative changes in net asset value that result from fluctuations of the relevant currencies on relevant financial markets. The market values of derivative financial instruments are calculated by comparing all relevant price components of a transaction at the time of the deal with those prevailing on the valuation date. The relevant parameters used to calculate the potential change in market value are the contract amount and the contractual forward-exchange rate. In line with international banking standards, market risk has been calculated using the value-at-risk method on the basis of the RiskMetrics data and using risk management software of RiskMetrics Group. The value-at-risk is equal to the maximum potential loss from derivative positions that could be realized within the following business day, based on empirical standard deviations using a confidence interval of 99 percent. Correlations between individual instruments are considered within the calculations, the risk of a portfolio is generally lower than the sum of its individual risks.

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The market risk analysis of the Company's foreign exchange derivatives by transaction and maturity as of December 31, 2002 and December 31, 2001 is summarized in the following table.

Total Volume of Foreign Currency Derivatives as of December 31, 2002 and December 31, 2001

	December 31, 2002				December 31, 2001			
	Nominal Value	Fair Value(1)	Value-at-Risk	Stress Test	Nominal Value	Fair Value(1)	Value-at-Risk	Stress Test
(in millions)								
FX forward transactions								
Buy	4,486.9	(199.4)	17.7	53.1	2,095.4	35.3	18.2	54.6
Sell	8,605.8	317.5	37.4	112.2	2,935.9	(48.5)	20.7	62.1
FX currency options								
Buy	313.2	(20.8)	2.1	6.3	896.4	7.2	1.9	5.7
Sell					28.6	1.7	1.3	3.9
Subtotal	13,405.9	97.3	20.6	61.8	5,956.3	(4.3)	8.8	26.4
(Remaining maturities)								
Cross currency swaps								
up to 1 year	162.8	18.4	0.9	2.7	67.0	(11.9)	1.7	5.1
1 year to 5 years	2,885.2	75.8	18.8	56.4	1,892.0	73.9	17.4	52.2
more than 5 years	5,810.9	21.3	13.8	41.4	211.8	(3.4)	4.5	13.5
Interest rate/cross currency swaps								
up to 1 year	51.1	(0.7)	0.3	0.9	253.4	37.8	4.8	14.4
1 year to 5 years	278.4	21.4	2.3	6.9	629.7	20.0	11.6	34.8
more than 5 years								
Subtotal	9,188.4	136.2	33.3	99.9	3,053.9	116.4	30.3	90.9
Total	22,594.3	233.5	50.5	151.5	9,010.2	112.1	39.1	117.3

(1) Fair value deviation from nominal value.

The market risk table shows the outstanding nominal values and market values of foreign exchange derivatives as of the balance sheet date before any economic hedging correlations are assigned between hedging contracts on the one hand, and booked and pending transactions or net foreign investments on the other hand. In fact, all of the Group's foreign currency derivatives are assigned to a balance sheet item, a pending purchase or sales contract or an anticipated transaction.

As an additional means of monitoring market risks, including those arising from cases of extreme market price fluctuations, a stress test is performed on derivative positions at regular intervals. In doing so, the market risk, as calculated using the value-at-risk concept, is multiplied by a factor of three, in line with the recommendation for the capital adequacy of banks issued by the Bank for International Settlements (BIS). The results of this stress test are included in the above table.

The increase in nominal value and market risk compared with year-end 2001 is primarily due to the consolidation of Powergen and hedging activities with respect to the Powergen net investment denominated in British pounds and U.S. dollars.

The value-at-risk amounts presented here disregard the possibility that foreign exchange rates can move in the Company's favor. The assumption within the value-at-risk model is that all changes in foreign exchange rates are adverse. It is highly unlikely that the Company would

experience continuous daily losses such as these over an extended period of time.

Interest Rate Risk Management

Several line items on the Group's balance sheet and associated financial derivatives bear fixed interest rates, and are therefore subject to changes in fair value resulting from changes in market rates. The Company also faces a similar risk with regard to balance sheet items and associated financial derivatives bearing floating rates, as changes in interest rates will affect the Company's cash flows. The Company seeks to maintain a desired mix of floating-rate and fixed rate debt in its overall debt portfolio. The Company uses interest rate swaps, cross currency

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interest rate swaps and interest rate options to allow it to diversify its sources of funding and to reduce the impact of interest rate volatility on its financial condition.

Financial derivatives are also used to realize time congruent hedging of interest rate risks. E.ON's policy provides that macro-hedging transactions can be concluded for periods of up to five years to cover interest rate risks. For micro-hedging purposes, any adequate term is allowed for individual hedges of foreign exchange and interest rates. However, where possible and with adequate cost benefit ratio the Company applies interest rate derivatives for hedge accounting under SFAS 133.

The principal derivative financial instruments used by E.ON to cover interest rate risk exposures are interest rate cross currency swaps, interest rate swaps and interest rate options. As of December 31, 2002, the E.ON Group had entered into interest rate swaps with a nominal value of 7.2 billion and interest rate options with a nominal value of 0.4 billion.

Market risks for interest rate derivatives are calculated in the same manner as those for foreign exchange instruments, as discussed in detail under Foreign Exchange Rate Risk Management above.

The market risk analysis of the Company's interest rate derivatives by transaction and maturity as of December 31, 2002 and December 31, 2001, is summarized in the following table.

Total Volume of Interest Rate Derivatives as of December 31, 2002 and December 31, 2001

	December 31, 2002				December 31, 2001			
	Nominal Value	Fair Value(1)	Value-at-Risk	Stress Test	Nominal Value	Fair Value(1)	Value-at-Risk	Stress Test
(in millions)								
<i>(Remaining maturities)</i>								
Interest rate swaps								
fixed-rate payer								
up to 1 year	545.9	(12.6)	3.1	9.3	118.7	(1.1)	0.2	0.6
1 year to 5 years	2,378.6	(85.2)	10.7	32.1	2,129.8	(25.3)	17.6	52.8
more than 5 years	1,173.8	(46.4)	4.4	13.2	319.7	(13.2)	4.4	13.2
fixed-rate receiver								
up to 1 year	559.1	7.5	0.6	1.8	56.8	0.2	0.6	1.8
1 year to 5 years	1,184.6	56.1	5.2	15.6	391.1	15.2	5.2	15.6
more than 5 years	1,368.9	78.1	2.3	6.9	128.4	3.3	2.3	6.9
Subtotal	7,210.9	(2.5)	8.2	24.6	3,144.5	(20.9)	16.9	50.7
Interest rate options								
Buy up to 1 year								
1 year to 5 years	218.4	0.2	0.5	1.5	253.2	(0.5)	0.4	1.2
more than 5 years								
Sell up to 1 year								
1 year to 5 years	218.4	(3.0)	2.1	6.4	36.3	(0.1)	0.1	0.3
more than 5 years								
Subtotal	436.8	(2.8)	2.6	7.8	289.5	(0.6)	0.5	1.5
Total	7,647.7	(5.3)	10.8	32.4	3,434.0	(21.5)	17.4	52.2

(1) Fair value deviation from nominal value.

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The market risk table shows the outstanding nominal values and fair values of interest rate derivatives before any economic hedging correlations are assigned between hedging contracts and booked transactions. In fact, all of the Group's interest rate derivatives are assigned to a balance sheet item.

The increase in nominal value compared with year-end 2001 is primarily due to the consolidation of Powergen.

A sensitivity analysis was performed on the Group's interest bearing short- and long-term capital investments and borrowings, including interest rate derivatives. The aggregate hypothetical loss in fair value on all financial instruments and derivative instruments that would have resulted from a 100 basis-point shift in the interest rate structure curve would change the interest rate portfolio's market value by 1,058 million (2001: 135 million) as of the balance sheet date. The market risk according to the value-at-risk model amounted to 37 million as of December 31, 2002 (2001: 17 million).

Commodity Price Risk Management

E.ON is also exposed to risks resulting from fluctuations in the prices of commodities and raw materials. Hedging transactions with respect to commodity-related risks of notable scope are now only conducted by the energy divisions E.ON Energie and Powergen.

The principal derivative financial instruments used by E.ON to cover commodity price risk exposures are electricity, gas, coal and oil, swaps and forwards, electricity options and exchange-traded electricity future and option contracts.

Derivative financial instruments are used by the energy divisions E.ON Energie and Powergen to hedge the impact of electricity, gas and coal price fluctuations and to enable E.ON Energie to better make use of its own power generating capacities and distributed power. To a limited extent proprietary trading is conducted with the goal of improving operating results within defined limits in specified markets. The proprietary trading limits are established and monitored by a board independent from the trading operations. Limits used on hedging and proprietary trading activities mainly include value and profit at risk numbers, as well as volume and credit limits. Additional key elements of the risk management system are the clear division of duties between trading, settlement and control, as well as a risk reporting system independent from the trading operations.

As of December 31, 2002, the E.ON Group had entered into electricity, gas, coal and oil derivative instruments with a nominal value of 20.5 billion (2001: 11.4 billion). The increase in the volume of energy-related derivatives reflects the E.ON Energie division's expanding business activities and the consolidation of Powergen in 2002.

The fair value of commodity trading transactions for which E.ON has not established economic hedging conditions involving booked or contractually agreed upon or planned underlying transactions amounted to 45.5 million as of December 31, 2002 (2001: (8.1) million). A hypothetical 10 percent change in underlying raw material and commodity prices would cause the market value of these commodity trading transactions to change by (12) million (2001: 19 million).

Counterparty Risk From the Use of Derivative Financial Instruments

Counterparty risk consists of potential losses that may arise from the non-fulfillment of contractual obligations by individual counterparties. With respect to derivative transactions, counterparty risk is equivalent to the replacement cost incurred by covering the open position in the event of counterparty default. Only transactions with a positive market value for E.ON are exposed to this risk. The Company's counterparties for derivatives include financial institutions, commodity exchanges, energy distributors and broker-dealers, and other entities that satisfy E.ON's credit criteria. The divisions involved in electricity-, gas-, coal- and oil-related derivatives also perform thorough credit checks on counterparties and monitor their creditworthiness on a regular basis. In exceptional cases collaterals are demanded and provided. Derivative transactions are generally executed on the basis of standard agreements that allow all outstanding transactions with contracting partners to be offset. Exchange-traded electricity future contracts with a nominal value of 4,125 million as of December 31, 2002 (2001: 229.9 million) are liquid instruments and do not bear individual counterparty risk. The Company's

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counterparty risk with respect to derivatives amounts to 1,194.9 million as of December 31, 2002 (2001: 852.8 million). The increased credit risk reflects the fact that the volume of derivatives used by the E.ON Energie division has risen due to expanded business, as well as the consolidation of Powergen. Because of the fact that not all counterparties are rated by Standard & Poor's and/or Moody's, for these unrated counterparties thorough credit limit checks and credit risk evaluation systems are installed. E.ON's contractual ability to net transactions with positive and negative market values with any defaulting counterparty is not reflected in these figures, regardless of whether the counterparty is rated or unrated, causing the credit risk to appear greater than in actuality. In general, collateral is neither provided nor received for derivative transactions.

Item 12. Description of Securities other than Equity Securities.

Not applicable.

PART II

Item 13. Defaults, Arrearages and Delinquencies.

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds.

None.

Item 15. Controls and Procedures.

Within the 90 days prior to the date of this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Co-Chief Executive Officers and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon and as of the date of the Company's evaluation, the Co-Chief Executive Officers and the Chief Financial Officer concluded that the disclosure controls and procedures are effective in all material respects to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date of the evaluation. Therefore, no corrective actions have been taken.

For more information on E.ON's compliance with these requirements, see Item 10. Additional Information - Memorandum and Articles of Association - Corporate Governance.

Item 16. [Reserved]

Table of Contents**PART III****Item 17. Financial Statements.**

Not applicable.

Item 18. Financial Statements.

See pages F-1 to F-73, incorporated by reference.

Item 19. Exhibits.

Exhibit No.	Exhibit Title
1.1	English translation of the Articles of Association (<i>Satzung</i>) of E.ON AG as amended to date.*
4.1	Scheme of Arrangement between E.ON AG and Powergen plc, dated March 27, 2002.**
4.2	VEBA Oel Participation Agreement between E.ON AG and BP p.l.c., dated July 15, 2001.***
4.3	Gelsenberg Participation Agreement between E.ON AG and BP p.l.c., dated July 15, 2001.***
4.4	Amendment to Gelsenberg Participation Agreement between E.ON AG and BP p.l.c., dated July 15, 2001, between BP p.l.c. and Deutsche BP AG, and E.ON AG, E.ON Zehnte Verwaltungsgesellschaft mbH, dated June 28, 2002.****
4.5	Unofficial English translation of Framework Agreement between RAG AG, RAG Beteiligungs-GmbH, RAG Projektgesellschaft mbH and EBV Aktiengesellschaft, and E.ON AG, Chemie Verwaltungs AG, E.ON Vermögensanlage GmbH, dated May 20, 2002.****
4.6	Unofficial English translation of Ruhrgas Purchase Agreement between E.ON AG, and RAG AG, RAG Beteiligungs-GmbH and EBV Aktiengesellschaft, dated May 20, 2002.****
4.7	Unofficial English translation of Option Contract between E.ON AG, and Deutsche Bank Luxembourg S.A. and Morgan Stanley Senior Funding, Inc., dated May 22, 2002.****
4.8	Unofficial English translation of Guarantee Agreement between E.ON AG, and Deutsche Bank Luxembourg S.A. and Morgan Stanley Senior Funding, Inc., dated May 22, 2002.****
4.9	Unofficial English translation of Framework Agreement between Esso Deutschland GmbH and Deutsche Shell GmbH, and E.ON AG, dated July 1, 2002.****
4.10	Unofficial English translation of Share Purchase Agreement between Deutsche Shell GmbH and E.ON AG, dated July 1, 2002.****
4.11	Unofficial English translation of Share Purchase Agreement between Schubert Beteiligungs-Gesellschaft mbH and E.ON AG, dated July 1, 2002.****
4.12	Amended and Restated Fiscal Agency Agreement between E.ON AG, E.ON International Finance B.V., E.ON UK PLC, and Citibank, N.A. as Fiscal Agent, and Banque du Luxembourg S.A. and Citibank AG as Paying Agents, relating to the Euro 20,000,000,000 Medium Term Note Programme, dated August 21, 2002.****
8.1	Subsidiaries as of the end of the year covered by this annual report: see Item 4. Information on the Company Organizational Structure.

* Incorporated by reference to the Form 20-F filed by E.ON AG with the Securities and Exchange Commission on March 21, 2002, file number 1-14688.

** Incorporated by reference to Exhibit B-2 to the Application-Declaration on Form U-1, Amendment No. 2, filed by Powergen plc with the Securities and Exchange Commission on March 27, 2002, file number 070-10058.

*** Incorporated by reference to the Form 20-F filed by E.ON AG with the Securities and Exchange Commission on March 21, 2002, file number 1-14688. Confidential material appearing in this document has been omitted and filed separately with the Securities and Exchange Commission in accordance with the Securities Exchange Act of 1934, as amended, and Rule 24b-2 promulgated thereunder.

Omitted information has been marked through.

**** Filed herewith.

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E.ON AG AND SUBSIDIARIES

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Report of Independent Accountants

To the Board of Directors and Stockholders of

E.ON AG

We have audited the accompanying consolidated balance sheets of E.ON AG and its subsidiaries (E.ON or the Company) as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of E.ON's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of E.ON at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 a) to the consolidated financial statements, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

Düsseldorf	PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft	
February 19, 2003	/S/ BREBECK	/S/ WIEGAND
	<hr/>	<hr/>
	Brebeck Wirtschaftsprüfer (German Public Auditor)	Wiegand Wirtschaftsprüfer (German Public Auditor)

Table of Contents**E.ON AG AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**
(in millions, except for per share amounts)

	Note	Year Ended December 31,			
		2002*	2002	2001	2000
Sales	(31)	\$ 38,856	37,059	37,273	39,097
Electricity tax		(978)	(933)	(694)	(349)
Sales, net of electricity tax		37,878	36,126	36,579	38,748
Cost of goods sold and services provided	(5)	(28,067)	(26,769)	(29,351)	(32,436)
Gross profit on sales		9,811	9,357	7,228	6,312
Selling expenses		(5,164)	(4,925)	(3,993)	(3,489)
General and administrative expenses		(1,747)	(1,666)	(1,827)	(1,806)
Other operating income (expenses), net	(6)	218	208	539	4,203
Financial earnings	(7)	(1,349)	(1,287)	737	(43)
Goodwill impairment	(12a)	(2,507)	(2,391)		
Income/(loss) from continuing operations before income taxes and minority interests		(738)	(704)	2,684	5,177
Income taxes	(8)	676	645	(69)	(1,797)
Income/(loss) from continuing operations after income taxes		(62)	(59)	2,615	3,380
Minority interests	(9)	(668)	(637)	(460)	(413)
Income/(loss) from continuing operations		(730)	(696)	2,155	2,967
Income/(loss) from discontinued operations (less applicable income taxes of (238), (537) and (715), respectively)	(4)	3,441	3,282	(81)	603
Income before cumulative effect of change in accounting principles		2,711	2,586	2,074	3,570
Cumulative effect of change in accounting principles (less applicable income taxes of (0), (16) and (0), respectively)		201	191	(26)	
Net income		2,912	2,777	2,048	3,570
Basic earnings per share:	(11)				
Income/(loss) from continuing operations		(1.12)	(1.06)	3.19	4.78
Income/(loss) from discontinued operations, net		5.28	5.03	(0.12)	0.97
Cumulative effect of change in accounting principles, net		0.31	0.29	(0.04)	0.00
Net income		4.47	4.26	3.03	5.75
Diluted earnings per share:	(11)				

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Income/(loss) from continuing operations	(1.12)	(1.06)	3.19	4.78
Income/(loss) from discontinued operations, net	5.28	5.03	(0.12)	0.97
Cumulative effect of change in accounting principles, net	0.31	0.29	(0.04)	
	<u>4.47</u>	<u>4.26</u>	<u>3.03</u>	<u>5.75</u>
Net income	<u>4.47</u>	<u>4.26</u>	<u>3.03</u>	<u>5.75</u>

* Note 1

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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E.ON AG AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in millions)

	Note	At December 31		
		2002*	2002	2001
ASSETS				
Intangible assets	(12a)	\$ 19,964	19,040	10,458
Property, plant and equipment	(12b)	44,026	41,989	34,286
Financial assets	(12c)	17,795	16,971	15,297
Fixed assets		81,785	78,000	60,041
Inventories	(13)	4,026	3,840	4,997
Financial receivables and other financial assets	(14)	1,936	1,847	1,444
Operating receivables and other operating assets	(14)	17,833	17,009	17,325
Assets of disposal groups	(4)	533	508	3,091
Liquid funds	(15)	8,792	8,385	12,144
Non-fixed assets		33,120	31,589	39,001
Deferred taxes	(8)	3,190	3,042	2,244
Prepaid expenses	(16)	455	434	373
Total assets (thereof short-term 2002: 27,429; 2001: 36,996)		118,550	113,065	101,659
	Note	2002*	2002	2001
STOCKHOLDERS EQUITY AND LIABILITIES				
Capital stock	(17)	\$ 1,886	1,799	1,799
Additional paid-in capital	(18)	11,956	11,402	11,402
Retained earnings	(19)	14,126	13,472	11,795
Accumulated other comprehensive income	(20)	(797)	(761)	(260)
Treasury stock	(21)	(272)	(259)	(274)
Stockholders equity		26,899	25,653	24,462
Minority interests	(22)	6,827	6,511	6,362
Provisions for pensions	(23)	9,607	9,163	8,748
Other provisions	(24)	26,365	25,146	24,053
Accrued liabilities		35,972	34,309	32,801
Financial liabilities	(25)	26,055	24,850	16,089
Operating liabilities	(25)	14,874	14,186	14,024
Liabilities		40,929	39,036	30,113

Liabilities of disposal groups	(4)	356	339	2,613
Deferred taxes	(8)	6,461	6,162	4,492
Deferred income	(16)	1,106	1,055	816
<i>Total liabilities (thereof short-term 2002: 22,437; 2001: 26,207)</i>		<i>91,651</i>	<i>87,412</i>	<i>77,197</i>
Total stockholders equity and liabilities		118,550	113,065	101,659

* Note 1

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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E.ON AG AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

	Year Ended December 31			
	2002*	2002	2001	2000
Net income	\$ 2,912	2,777	2,048	3,570
Income applicable to minority interests	668	637	460	413
Adjustments to reconcile net income to net cash provided by operating activities:				
Income from discontinued operations	(3,441)	(3,282)	81	(603)
Depreciation, amortization, impairment	7,136	6,806	3,511	3,617
Changes in provisions	(1,328)	(1,267)	454	(51)
Changes in deferred taxes	(1,593)	(1,519)	(425)	262
Other non-cash income and expenses	291	278	(637)	1,490
(Gain)/loss on disposal of:				
Equity investments	15	14	(1,229)	(4,511)
Other financial assets	(694)	(662)	9	(18)
Intangible and fixed assets	(385)	(367)	(291)	(207)
Changes in non-fixed assets and other operating liabilities				
Inventories	267	255	121	(1,030)
Trade receivables	(721)	(688)	(94)	(1,724)
Other operating receivables	(893)	(852)	(340)	(884)
Trade payables	580	553	(119)	459
Other operating liabilities	1,055	1,007	(897)	1,241
Cash provided by operating activities	3,869	3,690	2,652	2,024
Payments from disposal of:				
Equity investments	8,763	8,358	14,103	5,585
Other financial assets	1,903	1,815	4,841	1,593
Intangible and fixed assets	817	779	925	711
Purchase of				
Equity investments	(21,301)	(20,316)	(3,298)	(2,761)
Other financial assets	(649)	(619)	(778)	(5,098)
Intangible and fixed assets	(3,404)	(3,247)	(2,833)	(2,691)
Charges in securities (other than trading) (> 3 months)	1,410	1,345	(631)	(887)
Changes in other liquid funds	1,437	1,371	(518)	1,225
Cash provided by (used for) investing activities	(11,024)	(10,514)	11,811	(2,323)
Payments received/made from changes in capital including minority interests	(27)	(26)	254	
Payments for treasury stock, net	16	15	(3,539)	(925)
Payments of cash dividends to				
Stockholders of E.ON AG	(1,153)	(1,100)	(954)	(629)
Minority stockholders	(444)	(423)	(253)	(62)
Payments for financial liabilities	13,035	12,432	7,145	8,916
Repayments of financial liabilities	(6,766)	(6,453)	(14,278)	(5,997)
Cash provided by (used for) financing activities	4,661	4,445	(11,625)	1,303
	(2,494)	(2,379)	2,838	1,004

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Net increase (decrease) in cash and cash equivalents maturing (< 3 months)				
Effect of foreign exchange rates on cash and cash equivalents (< 3 months)	(245)	(233)	66	30
Liquid funds at the beginning of the period (< 3 months)	4,445	4,239	1,617	531
Liquid funds from discontinued operations at the beginning of the period (< 3 months)	(299)	(285)	(567)	(515)
Liquid funds from continuing operations at end of the period (< 3 months)	1,407	1,342	3,954	1,050
Securities available for sale from continuing operations at the end of the period (> 3 months)	7,385	7,043	7,799	6,747
Securities available for sale from discontinued operations at the end of the period (> 3 months)			106	137
Liquid funds from discontinued operations at the end of the period (< 3 months)			285	567
Liquid funds as shown on the balance sheet	8,792	8,385	12,144	8,501

* Note 1

The accompanying Notes are an integral part of these Consolidated Financial Statements.

Table of Contents**E.ON AG AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

(in millions of)

	Accumulated Other Comprehensive Income							Treasury stock	Total
	Capital stock	Additional paid-in capital	Retained earnings	Currency translation adjustments	Available-for-sale securities	Minimum pension liability	Cash flow hedges		
January 1, 2000	1,307	2,197	11,763	196	397	(47)			15,813
Shares issued	678	9,205							9,883
Shares reacquired/sold								(925)	(925)
Dividends paid			(628)						(628)
Net income			3,570						3,570
Other comprehensive income				255	93	(28)			320
Total comprehensive income									3,890
December 31, 2000	1,985	11,402	14,705	451	490	(75)		(925)	28,033
Shares reacquired/sold								(3,539)	(3,539)
Redeemed shares	(186)		(4,004)					4,190	
Dividends paid			(954)						(954)
Net income			2,048						2,048
Other comprehensive income				(75)	(755)	(245)	(51)		(1,126)
Total comprehensive income									922
December 31, 2001	1,799	11,402	11,795	376	(265)	(320)	(51)	(274)	24,462
Shares reacquired/sold								15	15
Dividends paid			(1,100)						(1,100)
Net income			2,777						2,777
Other comprehensive income				(618)	262	(81)	(64)		(501)
Total comprehensive income									2,276
December 31, 2002	1,799	11,402	13,472	(242)	(3)	(401)	(115)	(259)	25,653

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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E.ON AG AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The Consolidated Financial Statements of E.ON AG (E.ON or the Company), Düsseldorf, have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP).

E.ON makes use of the relief outlined in § 292a of the German Commercial Code (HGB), which exempts companies from preparing consolidated financial statements in accordance with generally accepted accounting principles in Germany (German GAAP), if the consolidated financial statements are prepared in accordance with internationally accepted accounting principles and comply with the Fourth and Seventh Accounting Directive of the European Community. For the interpretation of these directives, the Company relied on German Accounting Standards (DRS) No. 1 and DRS No. 1a, Exempting Consolidated Financial Statements in accordance with § 292a of the German Commercial Code.

Solely for the convenience of the reader, the December 31, 2002 financial statements (except the changes in stockholders' equity) have also been translated into United States dollars (\$) at the rate of 1 = \$1.0485, the Noon Buying Rate of the Federal Reserve Bank of New York on December 31, 2002. Such translation is unaudited.

(2) Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements include the accounts of E.ON AG and its subsidiaries. The subsidiaries, associated companies and other related companies have been included in the Consolidated Financial Statements in accordance with the following criteria:

All material majority-owned subsidiaries in which E.ON directly or indirectly exercises control through a majority of the stockholders' voting rights (affiliated companies) are fully consolidated.

Majority-owned companies in which E.ON does not exercise management control due to restrictions in the control of assets and management (unconsolidated affiliates) are generally accounted for under the equity method.

Companies in which E.ON holds between 20 and 50 percent of the shares and has the ability to exercise significant influence in the investees' operations (associated companies) are also accounted for under the equity method.

Other share investments represent those in which E.ON holds less than 20 percent ownership and are accounted for under the cost method.

A list of all E.ON stockholdings and other interests will be filed with the Commercial Register of the District Court in Düsseldorf, HRB 22 315.

Intercompany results, expenses and income, as well as receivables and liabilities between the consolidated companies and equity investments, are eliminated.

Business Combinations

Effective July 1, 2001, E.ON adopted Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations (SFAS 141). In accordance with SFAS 141, all business combinations are accounted for under the purchase method of accounting, whereby all assets acquired and liabilities assumed are recorded at their fair value. After adjustments to the fair values of assets acquired and liabilities assumed are made, any resulting positive differences are capitalized in the balance sheet as goodwill. Situations in which the fair value of net assets acquired is greater than the purchase price paid result in an excess that is allocated as a pro

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rata reduction of the balance sheet amounts that would otherwise be assigned to certain of the acquired assets. Should any such excess remain after reducing the amounts that otherwise would have been assigned to those assets, the remaining excess is recognized as an extraordinary gain. Goodwill arising in companies for which the equity method is applied is calculated on the same principles that are applicable to fully consolidated companies.

Foreign Currency Transactions

The Company's transactions denominated in currencies other than the euro are translated at the current exchange rate at the time of the transaction and adjusted to the current exchange rate at each balance sheet date; any gains and losses resulting from fluctuations in the relevant currencies are included in other operating income and other operating expenses, respectively.

The assets and liabilities of the Company's foreign subsidiaries with a functional currency other than the euro are translated using year-end exchange rates, while the statements of income are translated using annual-average exchange rates. Significant transactions of foreign subsidiaries occurring within the fiscal year are included in the financial statements using the exchange rate at the date of the transaction. Differences arising from the translation of assets and liabilities, as well as gains or losses in comparison with the translation of prior years, are included as a separate component of stockholders' equity and accordingly have no effect on net income.

The following major currencies of countries outside the European Monetary Union (1) have experienced the exchange-rate fluctuations shown below for the periods indicated:

Currencies	ISO-Code	1, Rate as of December 31,		1, Annual Average Rate		
		2002	2001	2002	2001	2000
Swiss franc	CHF	1.45	1.48	1.47	1.51	1.56
British pound	GBP	0.65	0.61	0.63	0.62	0.61
Japanese yen	JPY	124.27	115.33	118.04	108.68	99.47
Swedish krona	SEK	9.16	9.30	9.16	9.26	8.45
U.S. dollar	USD	1.04	0.88	0.95	0.90	0.92

(1) The Countries within the European Monetary Union are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, the Netherlands, Portugal and Spain.

Revenue Recognition

The Company generally recognizes revenue upon delivery of products to customers or upon fulfillment of services. Delivery has occurred when the risks and rewards associated with ownership have been transferred to the buyer. Following is a description of E.ON's major revenue recognition policies by segment.

E.ON Energie and Powergen

Sales of E.ON Energie AG (E.ON Energie), Munich, Germany, and Powergen Limited (Powergen), London, U.K., consist mainly of revenue from the sales of electricity and gas to industrial and commercial customers; sales of electricity, gas and telephony services to domestic customers; revenue from the distribution of electricity and steam under combined heat and power schemes; and sales of electricity in the U.K. under the New Electricity Trading Arrangements (NETA).

Income from the sale of electricity and gas to industrial, commercial and domestic customers is recognized when earned and reflects the value of units supplied, including an estimated value of units supplied to customers between the date of their last meter reading and year end.

In 2002, the Emerging Issues Task Force (EITF) reached the consensus that all gains and losses on energy trading contracts should be shown net in the statement of income (EITF 02-03).

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Chemicals

Sales are recognized net of discounts, bonuses and rebates at the time of transfer of risk or when the services are rendered. For products, this is normally when the goods are dispatched to the customer.

Real Estate

Sales are recognized net of discounts, sales incentives, customer bonuses and rebates granted, when title passes, the remuneration is contractually fixed or determinable and satisfaction of the connected claims is probable.

Accounting for Sales of Stock of a Subsidiary

The accounting method adopted by the Company for the issuance of a subsidiary's stock to third parties is through recognition of gains or losses in other operating income or other operating expenses, respectively, in accordance with SEC Staff Accounting Bulletin (SAB) No. 51, Accounting for Sales of Stock of a Subsidiary (SAB 51).

Electricity Tax

The electricity tax is levied on electricity delivered to end customers by domestic utilities in Germany and Sweden and consists of a fixed tax rate per kilowatt-hour (kWh). This rate varies between different classes of customers.

Advertising Costs

Advertising costs are expensed as incurred and totaled 226 million (2001: 273 million, 2000: 173 million).

Research and Development Costs

Research and development costs are expensed as incurred.

Earnings Per Share

Earnings per share (EPS) are computed in accordance with SFAS No. 128, Earnings per Share (SFAS 128). Basic EPS is computed by dividing consolidated net income by the weighted average number of ordinary shares outstanding during the relevant period. The computation of diluted EPS is identical to basic EPS as the Company does not have any potentially dilutive equity securities.

Goodwill and Intangible Assets

Goodwill

Effective for fiscal years beginning after December 15, 2001, SFAS No. 142, Goodwill and other Intangible Assets (SFAS 142), requires that goodwill no longer be periodically amortized, but rather be tested for impairment at the reporting unit level on an annual basis. Goodwill must be evaluated for impairment between these annual tests if events or changes in circumstances indicate that goodwill might be impaired. The Company identified its reporting units as the operating units one level below its reportable segments.

The testing of goodwill for impairment involves two steps:

The first step is to compare each reporting unit's fair value with its carrying amount including goodwill. If a reporting unit's carrying amount exceeds its fair value, this indicates that its goodwill may be impaired and the second step is required.

The second step is to compare the implied fair value of the reporting unit's goodwill with the carrying amount of its goodwill. The implied fair value is computed by allocating the reporting unit's fair value to all of its assets and liabilities in a manner that is similar to a purchase

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combination in accordance with SFAS 141. The remainder after this allocation is the implied fair value of the reporting unit's goodwill. If the fair value of goodwill is less than its carrying value, the difference is recorded as an impairment.

When the Company adopted SFAS 142, it performed a transitional impairment test that resulted in no impairment and recognized existing negative goodwill in income. This reflects a change in accounting principle and is therefore recognized separately in the income statement.

Intangible Assets Not Subject to Amortization

SFAS 142 also requires that intangible assets other than goodwill be amortized over their useful lives unless their lives are considered to be indefinite. Any intangible asset that is not subject to amortization must be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the asset with its carrying value. Should the carrying value exceed the fair value, an impairment loss equal to the difference is recognized in other operating expenses.

Intangible Assets Subject to Amortization

Intangible assets subject to amortization are classified into marketing-related, customer-related, contract-based, and technology-based, all of which are valued at cost and amortized using the straight-line method over their expected useful lives, generally for a period between 7 and 20 years.

Intangible assets subject to amortization are reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144) whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Please see Note 12 a) for additional information about goodwill and intangible assets.

Property, Plant and Equipment

Property, plant and equipment are valued at historical or production costs and depreciated over their expected useful lives, as summarized in the following table.

Useful Lives of Property, Plant and Equipment	
Buildings	10 to 50 years
Chemical plants	5 to 25 years
Power plants	
Conventional components	
Powergen	up to 60 years
Other	10 to 15 years
Nuclear components	up to 25 years
Hydro power stations and other facilities used to generate renewable energy	10 to 50 years
Equipment, fixtures, furniture and office equipment	3 to 25 years
Technical equipment for distribution and transmission	
Powergen	15 to 65 years
Other	15 to 35 years

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment is recognized in accordance with SFAS 144 when a long-lived asset's carrying amount exceeds its fair value. The carrying value of such an impaired asset is written down to its fair value. The remaining useful life of the asset, if appropriate, is correspondingly revised.

Interest has been capitalized on debt apportioned to the construction period of qualifying assets as a part of their cost of acquisition or construction. The additional acquisition cost is depreciated over the expected useful life of the related asset, commencing on the completion or commissioning date. Repair and maintenance costs are expensed as incurred.

Table of Contents**Leasing**

Leasing transactions are classified according to the lease agreement which specifies the benefits and risks associated with the leased property. E.ON concludes some agreements in which it is the lessor and other agreements in which it is the lessee.

Leasing transactions in which E.ON is the lessee are defined as capital leases or operating leases. In a capital lease, E.ON receives the economic benefit of the leased property and recognizes the asset and associated liability on its balance sheet. All other transactions in which E.ON is the lessee are classified as operating leases. E.ON records the payments it makes under operating leases as an expense.

Leasing transactions in which E.ON is the lessor and the lessee enjoys the benefits and bears the risks of the leased property are classified as sale-type leases or direct financing leases. In these two types of leases, E.ON records the present value of the minimum lease payments as a receivable. The lessee's lease payments to E.ON are allocated between a reduction of the lease obligation and interest income. All other transactions in which E.ON is the lessor are categorized as operating leases. E.ON records the leased property as an asset and shows the scheduled lease payments as income.

Financial Assets

Shares in associated companies are accounted for in accordance with the equity method. E.ON's accounting policies are also generally applied to its associated companies. Certain other share investments and investments in debt securities are accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). SFAS 115 requires that a security be accounted for according to its classification as either trading, available-for-sale or held-to-maturity. Debt securities which the Company does not have the positive intent and ability to hold to maturity and all marketable securities are classified as securities available-for-sale. The Company does not hold any securities classified as trading or held-to-maturity. Securities classified as available-for-sale are carried at fair value, with unrealized gains and losses net of related deferred taxes reported as a separate component of stockholders' equity until realized. Realized gains and losses are recorded based on the specific identification method. Unrealized losses on all marketable securities and investments that are other than temporary are recognized in financial earnings within Write-downs of financial assets and long-term loans. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion are included in interest income. Realized gains (losses) on such securities are included in other operating income (expenses). Other share investments that are non-marketable are accounted for at cost.

Inventories

The Company values inventories at the lower of acquisition or production costs or market values. Raw materials, products and goods purchased for resale are valued at LIFO, average cost or other allowed methods. In addition to production materials and wages, production costs include proportionate material and production overhead based on standard capacity. Interest on borrowings is capitalized if the production activities are performed over an extended period (qualifying assets). The costs of general administration, voluntary social benefits and pensions are not capitalized. Inventory risks resulting from excess and obsolescence are provided for by appropriate valuation allowances.

Receivables and Other Assets

Receivables and other assets are recorded at their nominal values. Valuation allowances are provided for identified individual risks for these items, as well as for long-term loans. If the loss of a certain part of the receivables is probable, valuation allowances are provided to cover the expected loss.

Discontinued Operations and Assets Held for Sale

Effective January 1, 2002, E.ON adopted SFAS 144. SFAS 144 requires that not only a reportable segment of a business, but also a substantial component of an entity that either has been disposed of or is classified as held

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for sale must be reported as discontinued operations if certain criteria are met. Gains or losses from the disposal of and the operations of components classified as discontinued operations are included in Income (loss) from discontinued operations. For discontinued operations recorded in 2002, E.ON did not reclass the prior year balance sheet accounts attributable to these discontinued operations as this is not required by SFAS 144.

If assets are identified as held for sale, depreciation is discontinued, and the Company determines the fair value of such assets. If the fair value of such assets, less selling costs, is less than the net book value of the assets, a loss is recognized immediately. Fair value is determined based on the assets' discounted cash flows. The underlying interest rate that management deems reasonable is contingent on the type of property and prevailing market conditions. Appraisals and, if appropriate, current estimated net sales proceeds from pending offers are also considered.

Liquid Funds

Liquid funds include certain securities available-for-sale, checks, cash on hand and bank balances. E.ON considers liquid funds with an original maturity of three months or less to be cash equivalents.

Stock-based Compensation

The stock-based compensation plans are accounted for on the basis of their intrinsic values as per SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123) as allowed in connection with FASB Interpretation (FIN) No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans (FIN 28). The corresponding expense is recognized in the income statement.

U.S. Regulatory Assets and Liabilities

SFAS No. 71, Accounting for the effects of Certain Types of Regulation (SFAS 71) sets out the appropriate accounting treatment for U.S. utilities whose regulators have the power to approve or regulate charges to customers.

Under SFAS 71, as long as the utility is substantially assured of recovering its allowable costs from, or is obligated to refund amounts to, customers through the regulatory process, any costs not yet recovered, or revenues not yet refunded, may be deferred and reported as regulatory assets/liabilities.

Pensions

The valuation of pension liabilities is based upon actuarial computations using the projected unit credit method in accordance with SFAS No. 87, Employers' Accounting for Pensions (SFAS 87), and SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions (SFAS 106).

Other Provisions and Liabilities

Other provisions and liabilities are recorded when an obligation to a third party has been incurred, the payment is probable and the amount can be reasonably estimated.

Deferred Taxes

Under SFAS No. 109, Accounting for Income Taxes (SFAS 109), deferred taxes are recognized for all temporary differences between the applicable tax balance sheets and the Consolidated Balance Sheet. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. SFAS 109 also requires the recognition of the future tax benefits of net operating loss carryforwards. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefit will not be realized.

Deferred tax assets and liabilities are measured using the enacted tax rates expected to be applicable for taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income for the period that includes the

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enactment date. The deferred taxes for German companies are generally calculated based on a tax rate of 39 percent (2001: 39 percent; 2000: 39 percent) on the basis of a federal statutory rate of 25 percent for corporate income tax, a solidarity surcharge of 5.5 percent on corporate tax, and the average trade tax rate applicable for E.ON. The German corporate income tax rate will increase to 26.5 percent for 2003 only. For this reason, temporary differences that are reversed in 2003 have been calculated using a cumulative tax rate of 40 percent. Foreign subsidiaries use the applicable national tax rates.

Note 8 shows the major temporary differences and their net effect on the Consolidated Financial Statements.

Derivative Instruments and Hedging Activities

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), as amended by SFAS No. 137 *Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133* an amendment of FASB Statement No. 133 (SFAS 137) and SFAS No. 138 *Accounting for Certain Derivative Instruments and Certain Hedging Activities* an amendment of FASB Statement No. 133 (SFAS 138) and as interpreted by the Derivatives Implementation Group (DIG), was adopted by the Company as of January 1, 2001. SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The cumulative effect of adopting SFAS 133 at January 1, 2001, representing the initial revaluation of derivatives and other items, was an after-tax charge of 26 million.

Instruments commonly used are foreign currency forwards, interest rate swaps and cross currency swaps, as well as electricity, gas, coal and oil related forwards and options, both physically and financially settled.

SFAS 133 requires that all derivatives be recognized as either assets or liabilities in the Consolidated Balance Sheet and measured at fair value. Depending on the documented designation of a derivative instrument, any change in fair value is recognized either in income or stockholders' equity (as a component of accumulated other comprehensive income, OCI).

SFAS 133 prescribes requirements for designation and documentation of hedging relationships and ongoing retrospective and prospective assessments of effectiveness in order to qualify for hedge accounting. The Company does not exclude any component of derivative gains and losses from the assessment of hedge effectiveness. Hedge accounting is considered to be appropriate if the assessment of hedge effectiveness indicates that the change in fair value of the designated hedging instrument is 80 to 125 percent effective at offsetting the change in fair value due to the hedged risk of the hedged item or transaction. If possible, the shortcut method in assessing effectiveness of interest rate hedges is applied.

For qualifying fair value hedges, the change in the fair value of the derivative and the change in the fair value of the hedged item that is due to the hedged risk(s) is recorded in income. If a derivative instrument qualifies as a cash flow hedge, the effective portion of the hedging instrument's gain or loss is reported in stockholders' equity (as a component of accumulated other comprehensive income) and is reclassified into earnings in the period(s) during which the transaction being hedged affects earnings. The ineffective portion of a hedging derivative's fair value change is recorded in current earnings. For derivative instruments designated as a hedge of the foreign currency risk in a net investment, in a foreign operation derivative as well as non-derivative financial instruments are used. Gains or losses due to fluctuations in market rates are recorded in the cumulative translation adjustment within stockholders' equity (as a currency translation adjustment in accumulated other comprehensive income).

Fair values of derivative instruments are classified as operating assets or liabilities. Fair value changes of derivative instruments affecting income are classified as other operating income or expenses. Realized gains and losses of derivative instruments relating to sales of the Company's products are principally recognized in sales or cost of goods sold.

In the normal course of operations, certain entities are involved in energy trading and risk management activities. In accordance with Emerging Issues Task Force No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF 98-10) all contracts entered into for trading purposes by an entity involved in such activities (energy trading contracts) are measured at fair value and recorded in the Consolidated Balance Sheet, with gains and losses included in current income. At its meeting on October 25,

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2002, the EITF reached a conclusion to rescind EITF 98-10. The full rescission of this guidance will be effective for fiscal periods beginning after December 15, 2002. However, all new energy trading contracts entered into subsequent to October 25, 2002 that do not also meet the definition of a derivative pursuant to SFAS 133 are no longer to be measured at fair value. The EITF also reached a consensus that all gains and losses on energy trading contracts should be shown net in the statement of income (please see page F-7, Revenue Recognition).

The Company does not expect the rescindment of EITF 98-10 to have a material impact on its operating results or financial position because most of the energy trading contracts it has entered into prior to October 25, 2002, fall within the scope of SFAS 133. Please see Note 29 for additional information regarding the Company's use of derivative instruments.

Consolidated Statement of Cash Flows

The Consolidated Statement of Cash Flows is classified by operating, investing and financing activities pursuant to SFAS No. 95, Statement of Cash Flows (SFAS 95). The separate line item, Other non-cash income and expenses, mainly comprises undistributed income from companies valued at equity. Effects of changes in the scope of consolidation are shown in investing activities and have been eliminated from the items in the three classification areas. This also applies to valuation changes due to exchange rate fluctuations, whose impact on cash and cash equivalents is separately disclosed.

Segment Information

The Company's segment reporting is prepared in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). The management approach required by SFAS 131 designates that the internal reporting organization that is used by management for making operating decisions and assessing performance should be used as the source for presenting the Company's reportable segments.

Use of Estimates

The preparation of the Consolidated Financial Statements requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent amounts at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications to the prior years presentation have been made to conform with the current year presentation.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, Accounting for Asset Retirement Obligations (SFAS 143), which is effective for fiscal years beginning after June 15, 2002. SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. When the liability is recorded, the Company must capitalize the costs of the liability by increasing the carrying amount of the long-lived asset. Over the estimated life of the asset, the liability is accreted to its present value and the related capitalized charge is depreciated over the useful life of the asset. Upon the initial application of SFAS 143 beginning January 1, 2003, the Company expects an increase in provisions, an increase in property, plant and equipment, and a net transition expense.

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS 146), which rescinds EITF Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (EITF 94-3). SFAS 146 requires that a liability for costs associated with an exit or disposal activity be

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recognized and measured initially at fair value only when the liability is incurred. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the adoption of SFAS 146 to have a material impact on its operating results or financial position.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* an amendment of FASB Statement No. 123 (SFAS 148). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. SFAS 148 is effective for fiscal years ending after December 15, 2002. The Company does not expect the adoption of SFAS 148 to have a material impact on its operating results or financial position.

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). This interpretation expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees and requires the guarantor to recognize a liability for the fair value of an obligation assumed under a guarantee. The disclosure requirements of FIN 45 are effective for the Company as of December 31, 2002, and require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee, and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002. Significant guarantees that have been entered into by the Company are disclosed in Note 26. Due to the new recognition and measurement requirements of FIN 45, the application of these rules from January 1, 2003 could have a material effect on the Company's operating results.

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). The objective of this interpretation is to provide guidance on how to identify a variable interest entity (VIE), and to determine when a VIE's assets, liabilities, non controlling interests, and results of operations of a VIE need to be included in a company's Consolidated Financial Statements. The Company is currently assessing the impact, if any, FIN 46 will have on its operating results or financial position.

(3) Scope of Consolidation

Changes to the scope of consolidation in 2002 are listed below:

Scope of Consolidation	Domestic	Foreign	Total
Consolidated companies as of December 31, 2001	403	850	1,253
Additions	89	324	413
Disposals	219	423	642
	<u> </u>	<u> </u>	<u> </u>
Consolidated companies as of December 31, 2002	273	751	1,024
	■	■	■

In 2002, a total of 132 domestic and 90 foreign associated and non-consolidated companies were valued at equity (2001: 187 and 85, respectively). See Note 4 for additional information on significant acquisitions, disposals and discontinued operations.

Table of Contents**(4) Acquisitions, Disposals and Discontinued Operations**

All energy-related acquisitions are consistent with the Company's strategy of focusing on and expanding its electricity and gas activities.

*Acquisitions in 2002***Significant Acquisitions in 2002****E.ON AG***Powergen Limited*

In July 2002, E.ON acquired 100 percent of the issued share capital of Powergen, an integrated international utility business based in England, for total cash consideration of 7.8 billion. The acquisition was made following a conditional offer with a fixed price to Powergen shareholders in April 2001. In addition, the Company assumed 7.4 billion of debt. Goodwill in the amount of 8.9 billion resulted from the purchase price allocation. Powergen was fully consolidated as of July 1, 2002. An impairment charge of 2.4 billion of the recorded goodwill was recorded in the third quarter of 2002. For further information regarding this charge, please see Note 12 a).

Powergen*TXU Europe Group plc.*

In October 2002, Powergen acquired the U.K.-based retail business operations of TXU Europe Group plc (TXU Europe), Ipswich, U.K., for total consideration of 2.2 billion. Powergen also agreed to fund working capital requirements associated with these operations in the amount of 0.4 billion. In addition to the retail business, Powergen acquired three coal-fired power plants and certain long-term gas supply contracts. Goodwill in the amount of 2.3 billion resulted from the purchase price allocation. The operations acquired from TXU Europe were fully consolidated as of October 21, 2002.

The following table provides details of a condensed balance sheet disclosing the amount assigned to each major asset and liability caption of the acquired entities at their respective acquisition dates.

in millions	July 1, 2002	October 21, 2002
	Powergen without TXU	TXU
Intangible assets	523	714
Goodwill	8,916	2,343
Property, plant and equipment	8,164	28
Financial assets	779	
Non-fixed assets	1,960	558
Total assets	20,342	3,643
Accrued liabilities	9,321	679
Liabilities	3,056	381
Other liabilities	136	
Total liabilities	12,513	1,060

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The following unaudited pro forma consolidated results of operations of the Company are presented as if the acquisitions of Powergen, TXU Europe and the significant 2001 acquisitions had taken place at the beginning of the periods presented. Adjustments to the Company's historical information have been made for the acquirees' results of operations prior to the respective dates of acquisition. In addition, adjustments were made for depreciation, amortization and related tax effects resulting from the purchase price allocation. The pro forma figures also include adjustments to include interest costs determined on the basis of E.ON's average interest rate.

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for external debt also considering the respective financing structures. In addition to the consolidated group amounts stated in Note 12 a), the pro forma amounts for 2001 include goodwill amortization of 278 million.

in millions	2002 unaudited	2001 unaudited
Net sales	43,416	53,309
Income before changes in accounting principle	3,085	2,643
Net income	3,276	2,590
Earnings per share (in)	5.02	3.84

This unaudited pro forma information is not necessarily indicative of what the actual combined results of operations might have been had the acquisitions occurred at the beginning of the periods presented.

Other Acquisitions in 2002**E.ON Energie**

E.ON Energie purchased the following companies in 2002 for a total of 3,449 million, with a total amount of goodwill of 1,425 million, of which 1,003 million is preliminary due to ongoing purchase price allocations which are expected to be completed in 2003.

Espeen Sähkö Oyj

In January through April 2002, E.ON Energie acquired a majority interest in Espoon Sähkö Oyj (Espoon), Espoo, Finland, in two steps. At December 31, 2002, E.ON Energie held a 65.6 percent interest in Espoon. Espoon was fully consolidated as of April 1, 2002.

Energie-Aktiengesellschaft Mitteldeutschland

In May 2002, E.ON Energie increased its 46.0 percent interest in Energie-Aktiengesellschaft Mitteldeutschland (EAM), Kassel, Germany, to a majority interest. As of December 31, 2002, E.ON Energie held 73.3 percent of EAM. EAM was fully consolidated as of June 1, 2002.

E.ON Wesertal Beteiligungsgesellschaft mbH

In June 2002, E.ON Energie purchased a 100 percent interest in E.ON Wesertal Beteiligungsgesellschaft mbH (EWB), formerly Fortum Energie GmbH, Hamburg, Germany. EWB is a holding company for 100 percent of the shares of Elektrizitätswerk Wesertal GmbH (EWW), Hameln, Germany. Both companies were fully consolidated as of July 1, 2002.

Elektrizitätswerk Minden-Ravensberg GmbH

In July 2002, E.ON Energie acquired a majority in Elektrizitätswerk Minden-Ravensberg GmbH (EMR), Herford, Germany. E.ON Energie added to its existing interest in EMR as of December 31, 2001, of 25.1 percent by acquiring an additional 30.1 percent interest. EMR was fully consolidated as of August 1, 2002.

Thüga Aktiengesellschaft

In August 2002, E.ON Energie increased its existing interest in Thüga Aktiengesellschaft (Thüga), Munich, Germany, to a total of 87.1 percent by acquiring an additional 25.1 percent interest. Thüga was fully consolidated in 2001.

Západoslovenská Energetika a.s.

In September 2002, E.ON Energie acquired a 49.0 percent interest in Západoslovenská Energetika a.s. (ZSE), Bratislava, Slovakia. ZSE is accounted for under the equity method.

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Észak-dunántúli Áramszolgáltató Rt.

In November 2002, E.ON Energie acquired an additional 62.9 percent stake in Észak-dunántúli Áramszolgáltató Rt. (Édász), Győr, Hungary. Prior to this acquisition, E.ON Energie owned 27.7 percent of Édász. Édász was fully consolidated effective December 1, 2002.

Powergen

Powergen Renewables Holdings Limited

In October 2002, Powergen acquired the remaining 50.0 percent interest in its former joint venture Powergen Renewables Holdings Limited, London, U.K., for 92 million. In addition, Powergen assumed 57 million of debt. As of December 31, 2002, Powergen holds a 100 percent interest. Total goodwill of 64 million was recorded in the purchase price allocation.

Viterra

Frankfurter Siedlungsgesellschaft mbH

On January 1, 2002, Viterra AG (Viterra), Essen, Germany, acquired a 86.3 percent interest in Frankfurter Siedlungsgesellschaft mbH (FSG), Frankfurt, Germany. FSG focuses on the management and the sale of residential real estate. The total purchase price amounted to 312 million. No amounts were assigned to goodwill and intangible assets during the purchase price allocation. In December 2002, Viterra sold a 0.2 percent interest in FSG to an investor. Viterra's ownership interest amounted to 86.1 percent as of December 31, 2002. In January 2003, Viterra acquired an additional 13.7 percent interest in FSG for a price of 49 million.

Dispositions and Discontinued Operations in 2002 **Significant Dispositions in 2002**

E.ON AG

Orange S.A.

In June 2002, E.ON exercised its put option to sell all of its shares in Orange S.A. (Orange), Paris, France, to France Télécom S.A. (France Télécom), Paris, France. The exercise price was 9.25 per share. E.ON received approximately 950 million in the transaction. E.ON had received the Orange shares as part of the purchase price for its interest in the Swiss operations of Orange Communications S.A. (Orange Communications), Lausanne, Switzerland, which it sold to France Télécom in November 2000. The sale resulted in a net loss of 103 million.

Schmalbach-Lubeca AG

In December 2002, E.ON concluded an agreement to sell the remaining activities of Schmalbach-Lubeca AG (Schmalbach-Lubeca), Ratingen, Germany. Ball Corporation, Indiana, U.S., a packaging manufacturer, purchased the company for 1.2 billion from AV Packaging GmbH (AV Packaging), Munich, Germany, a joint venture of Allianz Capital Partners, Munich, Germany, and E.ON AG. In July 2002, Schmalbach-Lubeca had sold the PET and White Cap business units to Amcor Ltd., Abbotsford/ Victoria, Australia, a packaging manufacturer, for about 1.8 billion. The resulting net gain on the sales was 558 million, which is recognized in income from companies accounted for at equity.

E.ON Energie

In 2002, the following transactions of E.ON Energie resulted in a total gain of 286 million.

Rhenag Rheinische Energie Aktiengesellschaft

In January 2002, E.ON Energie split up the partnership which owned shares in Rhenag Rheinische Energie Aktiengesellschaft (Rhenag), Cologne, Germany.

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Watt AG

In July 2002, E.ON Energie sold its entire 24.5 percent interest in Watt AG (Watt), Dietikon, Switzerland, for 429 million.

The dispositions of the above-mentioned investments were accounted for as disposals of financial assets, see Note 12 c).

Discontinued Operations in 2002

In 2002, the Company discontinued the operations of its former Oil and Distribution/ Logistics business segments, following its disposal of VEBA Oel AG (VEBA Oel), Gelsenkirchen, Germany, and Stinnes AG (Stinnes), Mülheim an der Ruhr, Germany, which are described in more detail below. These segments are accounted for as discontinued operations in accordance with SFAS 144. In addition, Degussa AG (Degussa), Düsseldorf, Germany, and Viterra have either disposed of or have classified certain businesses as held for sale in 2002 and, accordingly, present the related results of these operations as discontinued. Amounts in the Consolidated Financial Statements and notes thereto for the year ended December 31, 2002, as well as the Consolidated Statements of Income for 2002 and 2001 and notes thereto have been reclassified to reflect the discontinued operations.

Income/ (loss) from operations for discontinued operations until the date of disposal, as well as the gains or losses from disposals are reported in Income/ (loss) from discontinued operations, net in the accompanying Consolidated Statements of Income.

For financial reporting purposes, the assets and liabilities of the disposal groups held for sale at year end are classified in the accompanying Consolidated Balance Sheet as of December 31, 2002, in Assets of disposal groups and Liabilities of disposal groups .

Cash flows from the discontinued operations have been eliminated from the Consolidated Statements of Cash Flows for all periods presented.

E.ON AG

VEBA Oel AG

In July 2001, E.ON AG and BP plc (BP), London, U.K., entered into an agreement pursuant to which BP agreed to acquire a 51.0 percent stake in VEBA Oel, a 100 percent subsidiary of E.ON AG, by way of a capital increase. The agreement also provided E.ON with a put option that allowed it to sell the remaining 49.0 percent of shares in VEBA Oel to BP at any time from April 1, 2002. In December 2001, the German Federal Cartel Office (Bundeskartellamt) cleared the transaction.

The capital increase of VEBA Oel took place on February 7, 2002, in which BP contributed approximately 2.9 billion. Simultaneous to this capital increase, intercompany loans granted to VEBA Oel in the amount of 1.9 billion were repaid.

Prior to this, VEBA Oel, on January 29, 2002, sold its entire exploration and production business (Upstream business) to Petro Canada Limited, Alberta, Canada, for approximately 2.4 billion.

As of June 30, 2002, E.ON AG exercised its put option and sold the remaining 49.0 percent of shares and received approximately 2.8 billion. During 2003, E.ON expects the contractual purchase price adjustments to be finalized.

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The following table provides details of selected financial information from the discontinued operations of the Oil segment:

in millions	2002	2001	2000
Sales	1,703	26,422	28,062
Gain on disposal, net	1,367		
Other income/ (expenses), net	(1,284)	(25,565)	(27,289)
Income before income taxes and minority interests	1,786	857	773
Income taxes	(5)	(556)	(505)
Minority interests	3	(6)	(2)
Income from discontinued operations	1,784	295	266

Stinnes AG

In July 2002, E.ON completed negotiations with Deutsche Bahn AG (Deutsche Bahn), Berlin, Germany, on the sale of its 65.4 percent shareholding in Stinnes as part of a public takeover offer by Deutsche Bahn. The proceeds from this sale were 1.6 billion. Stinnes was deconsolidated as of September 30, 2002.

The following table provides details of selected financial information from the discontinued operations of the Distribution/ Logistics segment:

in millions	2002	2001	2000
Sales	8,840	12,270	11,980
Gain on disposal, net	588		
Other income/ (expenses), net	(8,638)	(12,029)	(11,637)
Income before income taxes and minority interests	790	241	343
Income taxes	(125)	(89)	(146)
Minority interests	(62)	(57)	(70)
Income from discontinued operations	603	95	127

Degussa AG:

In accordance with Degussa's program of divesting non-core businesses in order to focus on specialty chemicals, the following operations were sold in 2002 for aggregate proceeds of 866 million and therefore were classified as discontinued operations:

In January 2002, Degussa sold the companies which had conducted its gelatin activities to Sobel N.V., Eindhoven, The Netherlands. The gelatin activities were deconsolidated as of February 10, 2002.

In February 2002, Degussa sold its persulfate operations to Unionchimica Industriale S.p.A., Bergamo, Italy. The persulfate operations were deconsolidated as of March 31, 2002.

In February 2002, Degussa sold its textile additives activities to Giovanni Bozetto S.p.A, Milano, Italy. The textile additives activities were deconsolidated as of February 28, 2002.

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In April 2002, Degussa sold SKW Piesteritz Holding GmbH (SKW Piesteritz), Piesteritz, Germany, to A&A Stickstoff Holding AG, Binningen, Switzerland. SKW Piesteritz was deconsolidated as of June 30, 2002.

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In June 2002, Degussa sold Degussa Bank GmbH (Degussa Bank), Frankfurt am Main, Germany, to the Allgemeine Deutsche Direktbank AG, Frankfurt am Main, Germany. Degussa Bank was deconsolidated as of June 30, 2002.

In August 2002, Degussa sold Viatris GmbH & Co. KG (Viatris), Frankfurt am Main, Germany, a pharmaceutical company, to Advent International Corporation, Boston/ Massachusetts, U.S. Viatris was deconsolidated as of September 30, 2002.

In December 2002, Degussa sold Zentaris AG (Zentaris), Frankfurt am Main, Germany, to Aeterna Laboratories Inc., Québec, Canada. Zentaris was deconsolidated as of December 31, 2002.

The following table provides details of selected financial information from the discontinued operations of Degussa's disposal groups:

in millions	2002	2001	2000
Sales	410	1,061	763
Loss on disposal, net	(93)		
Other income/(expenses), net	(388)	(1,037)	(796)
Income before income taxes and minority interests	(71)	24	(33)
Income taxes	(59)	(14)	17
Minority interests	46	(4)	5
Loss from discontinued operations	(84)	6	(11)

Viterra AG

In accordance with its strategy of focusing on its core business, Viterra has decided to divest Viterra Energy Services AG (VES), Essen, Germany. VES provides heat and water metering services for residential and commercial property.

The following table provides details of selected financial information from the discontinued operations of VES:

in millions	2002	2001	2000
Sales	456	416	377
Other income/(expenses), net	(364)	(324)	(214)
Income before income taxes and minority interests	92	92	163
Income taxes	(39)	(33)	(62)
Minority interests	(1)		
Income from discontinued operations	52	59	101

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The following table provides details of the major classes of assets and liabilities included as part of the VES disposal group held for sale:

in millions	December 31, 2002
Intangible assets	56
Goodwill	72
Property, plant and equipment	30
Financial assets	1
Non-fixed assets	343
Other assets	6
	—
Total assets	508
	—
Accrued liabilities	127
Liabilities	53
Other liabilities	159
	—
Total liabilities	339
	—

Acquisitions in 2001**Significant Acquisitions in 2001***Sydkraft AB*

During the first part of 2001, E.ON Energie acquired a controlling interest in Sydkraft AB (Sydkraft), Malmö, Sweden, a Swedish energy group, through a multiple-step process:

On February 1, 2001, 5.3 percent of the outstanding shares were acquired.

On February 21, 2001, E.ON Energie announced a takeover bid to acquire shares through a public tender through May 2001. A total of 15.7 percent of the outstanding shares were acquired through this takeover bid.

On April 6, 2001, an additional 15.7 percent was acquired.

Prior to these share acquisitions, E.ON Energie owned 24.1 percent of Sydkraft as per December 31, 2000. Subsequent to these share acquisitions, E.ON Energie owned a 60.8 percent interest in and fully consolidated Sydkraft effective May 1, 2001. The total purchase price paid for the above acquisitions amounted to approximately 1.7 billion. As the fair value of the acquired net assets approximated the purchase price, no goodwill was recorded.

In October 2001, E.ON Energie concluded a put option agreement that allows the minority shareholder to exercise its right to sell its remaining stake in Sydkraft to E.ON Energie for approximately 2 billion through the end of 2005.

In March 2002, E.ON Energie sold a 5.8 percent interest in Sydkraft for approximately 223 million. A gain of 66 million was realized in connection with this transaction. In 2002, E.ON Energie acquired an additional interest of approximately 0.2 percent from various minority shareholders, giving it a stake in Sydkraft of 55.2 percent as of December 31, 2002.

Hein Gas Hamburger Gaswerke GmbH

In June 2001, E.ON Energie acquired an additional 61.9 percent interest in Hein Gas Hamburger Gaswerke GmbH (Hein Gas), Hamburg, Germany, for 514 million. The acquisition resulted in goodwill of 74 million. As of December 31, 2001, E.ON Energie's investment in Hein Gas totaled 89.9 percent. Hein Gas was fully consolidated effective June 1, 2001.

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In the second half of 2000, Degussa-Hüls AG (Degussa-Hüls), Frankfurt am Main, Germany, and SKW Trostberg AG (SKW Trostberg), Trostberg, Germany, announced plans to merge into Degussa with Degussa-Hüls acting as the acquirer. In October 2000, the merger was approved by the shareholders of Degussa-Hüls and SKW Trostberg, and in early 2001 the European antitrust authorities approved the merger. On February 9, 2001, the merger was entered into the Commercial Register. The purchase was effected through a share transaction using the following exchange ratios:

one Degussa AG share for one Degussa-Hüls share

five Degussa AG shares for 22 SKW Trostberg shares

This share exchange resulted in E.ON holding a 64.6 percent ownership in Degussa. E.ON accounted for the merger as a transaction between entities under common control. For this reason, there were no fair value adjustments made to E.ON's interest in SKW Trostberg held prior to the merger; however, the minority shareholder interest in SKW Trostberg was accounted for using the purchase method of accounting. The purchase price was 559 million and related goodwill was 397 million. E.ON recognized a SAB 51 gain of 184 million in connection with the transaction, which represents the difference between E.ON's net investment basis in Degussa and its old basis in Degussa-Hüls and SKW Trostberg prior to the merger.

Laporte plc

On January 12, 2001, Degussa made a public offer to purchase 80.4 percent of the shares of Laporte plc. (Laporte), London, U.K., a specialty chemicals company, for 697 British pence per share or approximately 1.8 billion. In December 2000, Degussa had made an initial purchase of 19.6 percent of Laporte for 434 million. The total goodwill amounted to 1.1 billion. Laporte was fully consolidated in the financial statements of Degussa beginning March 31, 2001.

Dispositions and Discontinued Operations in 2001**Significant Dispositions in 2001***VIAG Interkom GmbH & Co*

In January 2001, E.ON exercised its put option to sell its 45.0 percent interest in VIAG Interkom GmbH & Co (VIAG Interkom), Munich, Germany. E.ON had agreed on the put option with British Telecommunications plc (BT), London, U.K., in August 2000. The proceeds from the sale of the interest amounted to roughly 11.4 billion, which comprise the price for the option after adjustment of effects resulting from the auction of a UMTS license in the amount of 7.25 billion and the repayment of additional shareholder loans. A net gain of 110 million was recognized on the sale.

Klöckner & Co AG

In October 2001, Klöckner & Co AG (Klöckner), Duisburg, Germany, was sold to Balli Group plc, London, U.K., (94.5 percent) and to Westdeutsche Landesbank Girozentrale, Düsseldorf, (5.5 percent) for a total amount of 1.1 billion. The purchase price included the assumption of debt and pension provisions of approximately 800 million, with the remainder paid in cash. A gain of approximately 140 million was recognized on the sale.

Degussa Dispositions

In April 2001, Degussa sold its 100 percent stake in Phenolchemie GmbH & Co. KG, Gladbeck, Germany, to the British Ineos group for 388 million, which includes the assumption of 66 million in debt.

In August 2001, Degussa sold the precious metals activities of dmc² Degussa Metals Catalysts Cerdec AG (dmc²), Hanau, Germany, to the U.S. OM Group Inc., Cleveland/ Ohio, U.S., for 1.2 billion.

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In October 2001, Degussa sold ASTA Medica GmbH, Dresden, Germany, an oncology business, to Baxter Healthcare SA, Zurich, Switzerland, a Swiss subsidiary of the U.S.-based Baxter International Inc., Deerfield/ Illinois, U.S., for 525 million.

In October 2001, Degussa sold the Degussa Dental Group, Hanau-Wolfgang, Germany, to the U.S. company Dentsply International Inc., York/Pennsylvania, U.S., for 576 million, which includes the assumption of debt.

A net gain in the amount of 530 million resulted from these dispositions by Degussa.

Other

During 2001, E.ON, in compliance with antitrust requirements, sold investments in LAUBAG Lausitzer Braunkohle AG (LAUBAG), Senftenberg, Germany, in VEAG Vereinigte Energiewerke AG (VEAG), Berlin, Germany, in Berliner Kraft- und Licht AG, (BEWAG), Berlin, Germany, and in Hamburgische Electricitäts-Werke AG (HEW), Hamburg, Germany. The former investments related to VEBA were classified as Financial assets and the former investments related to VIAG were classified as Businesses held for sale in the December 31, 2000 balance sheet. The following summarizes those dispositions:

LAUBAG and VEAG were sold on May 16, 2001 for 837 million, resulting in a 1 million loss.

BEWAG was sold on May 16, 2001 for 1,394 million, resulting in a gain of 63 million. The proceeds consisted of 61.9 percent of the outstanding shares of Hein Gas and 870 million in cash.

HEW was sold on May 17, 2001 for 419 million, resulting in a gain of 63 million.

Discontinued Operations in 2001

In 2001, the Company discontinued the operations of its Silicon Wafer and Aluminum segments. These segments are accounted for as such in accordance with Accounting Principles Board Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (APB 30). SFAS 144 provides that long-lived assets classified as held for disposal as a result of disposal activities initiated prior to its adoption shall continue to be accounted for in accordance with the prior pronouncement applicable for that disposal until the end of the fiscal year in which SFAS 144 is adopted; as such, these segments were accounted for in accordance with ABP 30. Amounts in the financial statements and related notes for the year ended December 31, 2001, have been reclassified to reflect the discontinued operations.

Operating results for discontinued operations after income taxes and minority interests up through the date of disposal as well as the gains or losses from disposals are reported in Income/ (loss) from discontinued operations, net in the accompanying Consolidated Statements of Income.

For financial reporting purposes, the assets and liabilities of the discontinued aluminum operations are combined and classified in the accompanying Consolidated Balance Sheets as of December 31, 2001, under Assets of disposal groups and Liabilities of disposal groups.

The impacts of cash flows from discontinued operations have been eliminated from the Consolidated Statement of Cash Flows for all periods presented. The liquid fund balances of discontinued operations in prior periods are shown as cash and cash equivalents from discontinued operations at the beginning of the period and the end of the period, as applicable.

VAWAG

On January 6, 2002, E.ON entered into a Share Purchase Agreement with Norsk Hydro ASA (Norsk Hydro), Oslo, Norway, to sell 100 percent of its shares and shareholder loans in VAW aluminum AG (VAW), Bonn, Germany. The sales price for the 100 percent interest, the shareholder loans and other interest-bearing loans amounted to 3.1 billion. VAW was deconsolidated as of March 15, 2002.

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The following table provides details of selected financial information from the discontinued operations of the aluminum business:

in millions	2002	2001	2000
Sales	807	3,814	1,760
Gain on disposal, net	893		
Other income/(expenses), net	(763)	(3,463)	(1,632)
Income before income taxes and minority interests	937	351	128
Income taxes	(10)	(74)	(13)
Minority interests		(3)	(1)
Income from discontinued operations	927	274	114

The net gain on disposal of 893 million does not include the reversal of VAW's negative goodwill of 191 million, as this amount was required to be recognized as income in a change in accounting principle upon adoption of SFAS 142 on January 1, 2002.

The following table provides the major classes of assets and liabilities from the discontinued operations of the aluminum business:

in millions	December 31, 2001
Fixed assets	1,193
Non-fixed assets	1,898
Liabilities	(2,613)
Net assets	478

MEMC Electronic Materials, Inc

In September 2001, E.ON entered into an agreement to sell its silicon wafer operations to the Texas Pacific Group (TPG), Fort Worth/ Texas, U.S. The symbolic price of USD 6.00 was for E.ON's 71.8 percent investment and shareholder loans in MEMC Electronic Materials, Inc (MEMC), St. Peters/ Missouri, U.S. The transaction closed on November 13, 2001. The total purchase price is subject to upward adjustments, depending on certain predefined operating objectives for the year ending December 31, 2002. As per the date of this report, the accounts for MEMC for 2002 were not available, adjustments to the purchase price were therefore not made.

The following table provides details of selected financial information from the discontinued operations of the silicon wafer business:

in millions	2001	2000
Sales	555	944
Loss on disposal, net	(990)	
Other income/(expense), net	(752)	944
Income before income taxes and minority interests	(1,187)	
Income taxes	229	(6)
Minority interests	148	12
Loss from discontinued operations	(810)	6

The total loss on discontinued operations of MEMC of \$810 million is composed of losses from the operations of the discontinued business of \$326 million, net of \$277 million in tax expense and net of minority interests, and the loss on disposition of \$484 million, net of a \$506 million tax benefit. MEMC was deconsolidated as of November 13, 2001.

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Significant Transactions in 2000: Acquisitions

Merger of VEBA and VIAG

On June 16, 2000, the merger between VEBA and VIAG was completed and entered into the Commercial Register. For convenience reasons, June 30, 2000, was chosen as the merger date. Operations of VIAG are included in the Consolidated Statements of Income beginning July 1, 2000. The merged entity was subsequently renamed E.ON AG.

The merger between VEBA and VIAG was accounted for under the purchase method of accounting, with VEBA as the acquiring entity. The total purchase price amounted to 10,920 million and included acquisition costs of 57 million. The merger was completed on a step by step basis.

The first step was the acquisition from the Free State of Bavaria on October 7, 1999, of a total of 10 percent of VIAG's shares at 23.00 per share, which resulted in a purchase price of 1,592 million.

The second step was the acquisition of the remaining 90 percent of VIAG's shares exchanging 1 VEBA share for 2.5 VIAG shares, resulting in the issuance of 249,113,480 new shares representing a purchase price of 9,271 million.

The initial difference of 340 million between the purchase price of the acquired net identifiable assets and their fair values as of June 30, 2000, was capitalized as goodwill. Subsequent to the transfer of Schmalbach Lubeca to AV Packaging in the second half of 2000, following which it is accounted for at equity, goodwill associated with the merger decreased by 361 million. The remaining negative goodwill of 21 million is reported as a liability in the December 31, 2000, consolidated balance sheet.

Of the amount allocated to the net realizable value of VIAG's business, 2,020 million was identified as pertaining to businesses which the Company has identified as held for sale during the purchase price allocation. The allocation of the purchase price to the businesses held for sale was determined based on the sales prices for all businesses held for sale less cash out flows through disposal date.

Subsequent to the merger of VEBA and VIAG, the following merger related transactions occurred:

The electricity divisions of both companies, PreussenElektra and Bayernwerk, were merged into E.ON Energie AG.

In September 2000, E.ON acquired the remaining 2.46 percent of E.ON Energie AG through the issuance of 11,387,615 E.ON AG shares, resulting in a purchase price of 686 million. This acquisition was also accounted for under the purchase method. An amount of 548 million was recorded as goodwill.

Gerresheimer Glas was sold for proceeds of 228 million. No gain or loss was recognized on the disposition of this entity, as it was classified as a business held for sale.

VEW AG was sold for proceeds of 731 million. Due to the accounting treatment for businesses held for sale, no gain or loss was recognized.

Other 2000 Acquisitions

As of January 1, 2000, VEBA Oel acquired an additional 28% ownership interest in Aral through the acquisition of additional subsidiaries of Mobil Oil. On January 1, 2001, VEBA Oel increased its ownership in Aral to 100% by acquiring the remaining outstanding 1.12% of Aral's shares. The aggregate purchase price of the above transactions approximated 1,899 million. The acquisition has been accounted for under the purchase method of accounting and resulted in goodwill of 881 million. Aral was fully consolidated starting January 1, 2000.

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In January 2000, Preussen Elektra (now E.ON Energie) acquired 100% of Electriciteitsbedrijf Zuid-Holland N.V. (EZH) which has been renamed E.ON Benelux Generation N.V. a Dutch energy utility headquartered in Voorburg, The Netherlands. The purchase price was 1,082 million. Goodwill resulting from the application of purchase method accounting amounted to 590 million. EZH s results were consolidated effective January 1, 2000.

At the beginning of December 2000, Stinnes acquired 17,675,816 shares of the publicly traded chemical distributor Holland Chemical International N.V., Amsterdam, The Netherlands (HCI). This equals 99.41% of HCI s outstanding shares. The purchase price per share was 16.20. The total purchase price for HCI was 293 million. The acquisition has been accounted for under the purchase method and resulted in goodwill of 185.2 million. HCI was fully consolidated effective December 1, 2000.

Significant Transactions in 2000: Disposals*Telecommunications*

On February 10, 2000, the sale and transfer contract for the shares in E-Plus with BellSouth was concluded. The sale price was 7.4 billion in addition to the extinguishment of stockholder loans in the amount of 1.0 billion, and resulted in a gain of 3,527 million. E.ON s share in both amounts was 51.25 percent.

As of March 28, 2000, Cablecom was sold. The sale price amounted to 851 million and resulted in a gain of 788 million.

The Company sold its 42.5% interest in Orange Communications, the Swiss cellular phone company, to France Telecom on November 10, 2000. The sales price for the interest including the transfer of shareholder loans amounted to 1.8 billion. Cash proceeds were received for the shareholder loans and one fourth of the value of the shareholding in Orange Communications. The remaining sales price was paid via the issuance of 102,675,638 shares in Orange. The first official trading day of Orange stock was February 13, 2001. In connection with its receipt of these shares, France Telecom granted E.ON a put option allowing E.ON to sell the Orange S.A. shares to France Telecom. This put option was exercised in 2002. The sale of the shareholding did not result in a significant gain, as it was accounted for at its fair value as part of the merger.

Other

In October 2000 E.ON sold the operating entities of VEBA Electronics to a consortium of buyers consisting of Arrow Electronics, Melville/New York, U.S., Avnet, Phoenix/Arizona, U.S., and Schroder Ventures, London, U.K.. The purchase price, including the transfer of shareholder loans, amounted to USD2.35 billion (2.6 billion). A gain of 44 million was recorded upon sale. VEBA Electronics was deconsolidated effective September 30, 2000.

(5) Cost of Goods Sold and Services Provided

The following tables provides details of the cost of goods sold and services provided by segment for the periods indicated:

in millions	2002	2001	2000
E.ON Energie	13,884	12,618	9,396
Powergen(1)	3,461		
Chemicals	8,258	12,857	14,169
Real Estate	1,112	725	780
Other/Consolidation	54	3,151	8,101
Total	26,769	29,351	32,446

(1) Cost of goods sold and services provided relate to the period beginning July 1, 2002.

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In 2002, certain entities' operational characteristics changed to a purely sales-oriented nature. Accordingly, the costs associated with these entities are included in selling expenses in 2002. In 2001, the amount included in cost of goods sold and services provided for these entities was 454 million.

(6) Other Operating Income and Expenses

The following table provides details of other operating income/expenses, net:

in millions	2002	2001	2000
Gains from the disposal of businesses and/or fixed assets	1,059	1,526	4,678
SAB 51 gain	105	184	
Research and development costs	(380)	(510)	(485)
Bad debt expense	(73)	(40)	(206)
Miscellaneous	(503)	(621)	216
Total	208	539	4,203

Other operating expenses include income and costs that by nature are not allocable to the core functions of production, administration or selling costs.

In 2002, gains from the disposal of businesses and/or fixed assets primarily comprise gains resulting from the sales of investments in subsidiaries by E.ON Energie and of tangible fixed assets by Viterra. In 2001, gains from the disposal of businesses and/or fixed assets mainly consisted of sales of investments in subsidiaries by Degussa, E.ON Energie and VIAG Interkom. In 2000, such gains resulted from the disposal of shareholdings in E-Plus (3,527 million) and Cablecom (788 million). For further information please refer to Note 4.

A SAB 51 gain in 2002 in the amount of 98 million is related to an increase in equity of the Company's at equity investment in Bouygues Telecom S.A. (Bouygues Telecom), Velizy-Villacoublay, France. The Company did not participate in this capital increase. In addition, in 2001 the common control merger of Degussa-Hüls and SKW Trostberg resulted in E.ON realizing a SAB 51 gain of 184 million.

In 2002, miscellaneous mainly includes a gain recognized on the required marking to market of derivatives according to SFAS 133 of 884 million, 350 million in gains realized on foreign exchange and interest derivatives entered into with financial institutions in the ordinary course of business. In addition, in 2001 losses on the required marking to market of derivatives (1,020 million), losses from the sale of shareholdings included in other share investments (372 million) and external consulting costs (267 million). In addition, miscellaneous includes other operating expenses in the amount of 386 million in losses on foreign exchange and interest derivatives that E.ON entered into with financial institutions in the ordinary course of business. In 2001, miscellaneous included other operating expenses resulting from the cancellation of long-term energy contracts that amounted to 270 million.

Table of Contents**(7) Financial Earnings**

The following table provides details of financial earnings for the periods indicated:

in millions	2002	2001	2000
Income from companies in which share investments are held; thereof from affiliated companies: 28 (2001: 73; 2000: 18)	149	277	160
Income from profit- and loss-pooling agreements; thereof from affiliated companies: 15; (2001: 0; 2000: 5)	34	30	23
Income from companies accounted for at equity; thereof from affiliated companies: 232; (2001: 0; 2000: 255)	1,432	888	810
Losses from companies accounted for at equity; thereof from affiliated companies: 40; (2001: 0; 2000: 4)	(98)	(243)	(949)
Losses from profit- and loss-pooling agreements; thereof from affiliated companies: 3; (2001: 0; 2000: 1)	(6)	(14)	(35)
Write-down of investments	(28)	(83)	(89)
Income/(loss) from equity interests	1,483	855	(80)
Income from long-term securities and long-term loans	165	201	278
Other interest and similar income; thereof from affiliated companies: 11; (2001: 16; 2000: 25)	839	734	526
Interest and similar expenses; thereof from affiliated companies: 23; (2001: 6; 2000: 107)	(1,400)	(1,009)	(755)
Interest and similar expenses (net)	(396)	(74)	49
Write-down of financial assets and long-term loans	(2,374)	(44)	(12)
Financial earnings	(1,287)	737	(43)

During the course of 2002, E.ON Energie wrote down the value of its investment in Bayerische Hypo- und Vereinsbank AG (HypoVereinsbank), Munich, Germany, by 1,854 million as the decline in fair value was considered to be other than temporary. In addition, other securities have also been impaired due to the negative developments in share prices in 2002.

In 2002, income from companies accounted for at equity includes 558 million resulting from the sale of Schmalbach-Lubeca by AV Packaging. For further information, please also see Note 4. In addition, income from companies accounted for at equity includes 173 million resulting from the sale of an investment in STEAG Aktiengesellschaft (STEAG) by Gesellschaft für Energiebeteiligungen mbH (GFE) to RAG Aktiengesellschaft (RAG), Essen, Germany.

The decrease in losses from companies accounted for under the equity method in 2001 compared to 2000 resulted primarily from the disposition of VIAG Interkom in January 2001. Increases in interest income from investment of excess funds were offset by increases in interest expense resulting from debt.

In 2000, a write-down of 356 million was taken on the stakes held by the former VEBA in equity method held companies which were divested during 2001 in line with antitrust requirements associated with the VEBA-VIAG merger. This amount is included in Losses from companies accounted for at equity.

In accordance with SFAS 142, the Company ceased amortizing goodwill of companies accounted for under the equity method when it adopted this standard as of January 1, 2002 (2001: 153 million; 2000: 275 million). The accumulated amortization as of January 1, 2002, was 526 million (2001: 526 million; 2000: 552 million). No impairment charges on goodwill of companies accounted for under the equity method were incurred in 2002 (2001: 0 million, 2000: 0 million).

Interest expense is reduced by capitalized interest on debt totaling 34 million (2001: 31 million, 2000: 9 million).

Table of Contents**(8) Income Taxes**

The following table provides details of income taxes including deferred taxes for the periods indicated:

in millions	2002	2001	2000
Current Taxes			
Domestic corporate income tax	487	57	2,016
Domestic trade tax on income	289	97	32
Foreign income tax	108	221	195
Other	(10)	15	34
Total	874	390	2,277
Deferred Taxes			
Domestic	(1,441)	(123)	(325)
Foreign	(78)	(198)	(155)
Total	(1,519)	(321)	(480)
Income Taxes	(645)	69	1,797

The German Tax Reduction Act (*Steuersenkungsgesetz*) took effect on January 1, 2001, and replaced the corporate imputation system (*Anrechnungsverfahren*) with a classic corporate tax system (*Halbeinkünfteverfahren*). The 30.0 percent corporate income tax rate on distributed profits and the 40.0 percent corporate income tax rate on non-distributed profits were both reduced to 25.0 percent. The corporate income tax is subject to a solidarity surcharge of 5.5 percent. The trade tax on income is still in effect.

In 2002, the Flood Victims Solidarity Act was enacted. Under this legislation Germany's corporate tax rate is increased to 26.5 percent for 2003 only. Included in the 2002 Consolidated Financial Statements is a deferred tax benefit in the amount of 2 million reflecting the net tax impact of items that are expected to reverse in fiscal year 2003 at the increased rate.

The profits of E.ON Benelux Generation N.V. (E.ON Benelux), Voorburg, The Netherlands, E.ON Energie's Dutch subsidiary, were entitled to a tax holiday between 1998 and 2001. Effective January 1, 2002, E.ON Benelux is subject to the ordinary tax rate of 34.5 percent. The revaluation of the assets resulted in the initial recognition of deferred tax assets in the amount of 201 million.

The write-down and the disposal of certain available for sale securities led to reversal effects on deferred taxes accounted for in the other comprehensive income which resulted in a tax benefit of 613 million. After recording an impairment or disposition of securities, an entity has to recognize in income all deferred taxes included in the other comprehensive income that had previously been booked in the income statement owing to changes to enacted tax laws.

In light of the positive developments in three precedent-setting tax proceedings in the lower German tax courts, the Company released a tax provision in 2001 that had previously been established to account for a probable liability stemming from the profit and loss sharing agreements with former non-profit real estate companies. This reduced German income taxes by 527 million. In December 2002, the federal tax court confirmed the favorable decisions of the lower courts. However, the final tax assessments for E.ON have not yet been made.

A release of valuation allowances related to acquired tax benefits recognized in conjunction with the purchase price allocation of the VEBA-VIAG merger reduced goodwill by 178 million in 2001. These benefits were primarily on corporate and trade tax loss carryforwards.

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The differences between the statutory tax rate of 25.0 percent (2001: 25.0 percent; 2000: 40.0 percent) in Germany and the effective tax rate are summarized as follows:

in millions	2002 Amount	2002 Percent	2001 Amount	2001 Percent	2000 Amount	2000 Percent
Corporate income tax (2002: 25%; 2001: 25%; 2000: 40%)	(176)	25.0	672	25.0	2,071	40.0
Credit for dividend distributions(1)	(183)	26.0		0.0	(194)	(3.8)
German municipal trade taxes net of federal tax benefit	118	(16.8)	208	7.8	47	0.9
Foreign tax-rate differentials	(44)	6.2	42	1.6	(31)	(0.6)
Change in valuation allowances	(83)	11.8	(22)	(0.8)	7	0.1
Changes in tax rate/tax law	(2)	0.3	(188)	(7.0)	(759)	(14.7)
Tax effects on						
Tax-free income	(504)	71.6	(143)	(5.4)	(124)	(2.4)
Equity accounting	(330)	46.9	(208)	(7.8)	(88)	(1.7)
Non-deductible goodwill amortization	717	(101.9)	155	5.8	246	4.8
Other permanent differences(2)	(158)	22.5	(447)	(16.6)	622	12.1
Effective income taxes/tax rate	(645)	91.6	69	2.6	1,797	34.7

(1) The tax credit resulting from the dividend for the year 2001 is recognized for U.S. GAAP purposes in 2002.

(2) Including the release of tax provisions in the fiscal year 2001, in the amount of 527 million.
Due to deferred tax benefits, the Company reported a net tax benefit of 645 million in 2002.

The purchase price allocations for Powergen and the acquired operations of TXU Europe result in deferred tax liabilities in the net amount of 28 million.

As discussed in Note 4, the income taxes of discontinued operations VEBA Oel, Stinnes, VAW, MEMC, and certain Degussa and Viterra operations are reported separately in E.ON's Consolidated Statements of Income under Income/ (loss) from discontinued operations, net. The table below provides a breakdown of the tax expenses of discontinued operations for the periods indicated:

in millions	2002	2001	2000
VEBA Oel	5	556	505
Stinnes	125	89	146
Degussa operations	59	14	(17)
Viterra Energy Services	39	33	62
VAW	10	74	13
MEMC		(229)	6
Total	238	537	715

Income from continuing operations before income taxes and minority interests was attributable to the following geographic locations in the periods indicated:

in millions	2002	2001	2000
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Domestic	675	2,156	4,784
Foreign	(1,379)	528	393
	<u> </u>	<u> </u>	<u> </u>
Total	(704)	2,684	5,177
	—————	—————	—————

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Deferred tax assets and liabilities that are mainly of a long-term nature are as follows as of December 31, 2002 and 2001:

in millions	December 31,	
	2002	2001
Deferred tax assets		
Intangible assets	31	32
Fixed assets	575	483
Investments and long-term financial assets	231	360
Inventories	48	96
Receivables	110	359
Net operating loss carryforwards and tax credits	1,158	1,331
Accrued liabilities	3,130	2,209
Liabilities	1,343	590
Other	424	908
Subtotal	7,050	6,368
Valuation allowance	(166)	(254)
Total	6,884	6,114
Deferred tax liabilities		
Intangible assets	880	741
Fixed assets	4,577	2,519
Investments and long-term financial assets	532	904
Inventories	31	73
Receivables	1,048	389
Accrued liabilities	729	440
Liabilities	1,753	2,936
Other	454	360
Total	10,004	8,362
Net deferred tax assets/(liabilities)	(3,120)	(2,248)

Net deferred income tax assets and liabilities in the Consolidated Balance Sheets are as follows:

in millions	December 31, 2002		December 31, 2001	
	Total	Thereof non-current	Total	Thereof