Investment Risks

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This Section discusses some of the risks associated with investments in the stock market generally and in Envestra specifically.

5.1 General Risks

General movements in local and international stock markets, prevailing economic conditions, investor sentiment and interest rates could all affect the market price of the Securities.

5.2 Risks Specific to an Investment in Envestra

In addition to the general risks associated with investing in the stock market, Investors should be aware of the risks specific to an investment in Envestra. The major risks are described below:

REGULATORY RISK

Envestra's revenue projections for Victoria have been based on the Victorian Tariff Order. Envestra's revenue projections for South Australia have been based upon the Haulage Agreement with Boral Energy and the principles contained within the Access Arrangement currently before the Regulator. Similar principles have been used for revenue projections in Queensland. In South Australia, a determination of Access Charges by the Regulator is expected later this year although for the small volume market segment which contributes the majority of Envestra's revenue, its provisions are not expected to take effect until July 2001. There is a risk that revenues and returns to Investors will be lower than forecast if Regulators determine Access Charges lower than the levels assumed by Envestra.

The forecast Access Charges also assume that Envestra will be considered an "efficient operator" within the meaning of the Code and that therefore all operating costs will be recouped through Envestra's Access Charges. If Envestra is not considered to be efficient for the purposes of the Code, then such charges as exceed the level allowed by the Regulators will be borne by Envestra. These additional charges could affect forecast distributions to Investors.

Envestra's revenue projections have been based on an assumed timetable for natural gas markets moving to Contestability. There is no guarantee that this timetable will be implemented as assumed.

NATURAL GAS VOLUME RISK

Envestra's Access Charges include a component based on the volume of natural gas distributed. Domestic consumers account for most of Envestra's revenue. Consumers may use less natural gas because of warmer weather than has been assumed in the forecasts or actual growth in the number of natural gas consumers may be less than has been assumed in the forecasts. However, because domestic consumers use natural gas for basic household requirements they constitute a stable category of consumer which is relatively insensitive to changes in the level of economic activity.

Natural gas volumes may also be lower than forecast due to the impact of competing energy sources.

REFINANCING RISK

The forecasts assume that Envestra is able to roll over its debt financing obligations at maturity and renegotiate debt finance on terms comparable to those assumed in Envestra's forecasts. Additional costs of refinancing or the imposition of more restrictive terms have the potential to affect Envestra's forecasts. Changes to debt market conditions, including lending policies, may prevent Envestra from implementing forecast levels of additional borrowings or require additional equity funding.

Envestra's acquisition of the Stratus Business was funded in part by a loan from Boral, the terms of which are summarised in Section 7.1.3. The loan from Boral contains a number of terms which make it more costly to Envestra over time if it is not repaid by October 2000. If the loan from Boral is not repaid by October 2000, all of Envestra's available cash (subject to Boral agreeing otherwise) from the Stratus Business must be used to repay the loan from Boral and the forecast distributions referred to in this Prospectus are unlikely to be met. Funds raised under the Prospectus will be used to repay the loan from Boral, thereby eliminating any refinancing risk associated with it.

Rising interest rates in the future could adversely affect distributions to Investors if the Regulators do not allow changes in interest rates to be recovered through corresponding adjustments to Envestra's Access Arrangements.

Should EnVic Holdco be required to redeem the Convertible Notes, Envestra may need to use available cash resources, raise further finance debt or issue further Securities. Such action could affect the levels of distributions to Security Holders. Should EnVic Holdco not redeem or otherwise make any payment required to be made under the terms of the Convertible Notes (such as interest), Envestra will not be able to make any distribution to Security Holders where such payment remains due and payable.

BY-PASS RISK

By-pass occurs where competitors incur the costs of replicating portions of networks rather than purchasing access to existing networks. By-pass is only likely to be commercially viable for major industrial consumers whose loads are large enough to support the capital required to build an alternative pipeline.

While by-pass could potentially result in loss of revenue to Envestra, the risk of this having a material impact on Envestra's revenue is considered to be small.

SUPPLY AND NETWORK OPERATIONAL RISK

Disruption to the Network resulting in the complete loss of pressure across the Network would have a significant impact on operations because extensive testing would be required to ensure safety standards were met before supply could recommence. In September 1998, an explosion and fire occurred at Esso/BHP's natural gas processing plant at Longford and the natural gas supply was shut down for approximately 2 weeks. The explosion at the Longford gas processing plant highlights the risk of interruption to supply. The Victorian

Government has committed itself to accelerating two major infrastructure projects to facilitate alternative sources of supply thereby raising system security to higher levels than previously existed.

While disruptions pose a potential risk, it is most unlikely that, other than in circumstances such as those described above or a major transmission pipeline failure (which could be repaired within days), supply would be lost to more than a small part of a network at any one time.

Envestra has insurance against damage to the Network and consequential loss arising from that damage.

INFLATION

Inflation increases the interest expense on the Capital Indexed Bonds (through the indexation of the principal component of the Bonds) and the operating costs of Envestra. However, under the incentive-based regulation provided for under the Code, an increase in inflation gives rise to a greater increase in tariffs, resulting in higher revenue. This principle is reflected in the Victorian Tariff Order and has been applied in the Access Arrangement currently before the South Australian Regulator and will be applied in the Access Arrangement for Queensland when it is lodged.

GOVERNMENT TAXES AND CHARGES

There can be no assurance that Commonwealth or, where relevant, State or Territory Governments will not alter tax regimes applying to Envestra including the introduction of a Goods and Services Tax ("GST"). Such alterations could have the effect of reducing the amount of Available Cash for distribution to Investors, or altering the tax treatment of distributions in the hands of Investors.

It is possible that governments may also, through taxation incentives or subsidies, encourage the use of alternative and renewable energy sources. This may affect the volume of natural gas transported through the Network and therefore Envestra's revenues. Natural gas is a relatively "clean" or environmentally friendly source of energy. Government initiatives designed to reduce Greenhouse Gas emissions are not expected to have any negative impact on Envestra's business and may even be positive if they encourage consumers to switch from other less environmentally friendly energy sources to natural gas.

It is expected that any new Government taxes or imposts such as a GST will be allowed within the Access Charges and passed through to Retailers. The collection of the GST and the associated administrative activity will not impose a significant burden on Envestra.

CAPITAL EXPENDITURE

Envestra's forecasts are based upon certain assumptions in relation to the level of capital expenditure required to maintain the Network and to grow the Network including the accelerated mains replacement programme. If the level of capital expenditure incurred is higher than expected and the additional expenditure is not allowed by the Regulator as an addition to Envestra's asset base and not reflected in Access Charges, returns to Investors may be negatively affected in the long term.

ACHIEVEMENT OF OPERATIONAL EFFICIENCIES

Envestra's forecasts are based upon certain assumptions in relation to the level of cost savings that BEAM will be able to achieve in the operation of the Stratus Network and pass on to Envestra. There is the risk that these forecast cost savings will not be achieved. This would negatively impact upon returns to Security Holders.

CONTINGENT LIABILITY ARISING FROM STRATUS ACQUISITION

Envestra, Boral and their advisers have conducted a substantial due diligence in relation to the Stratus acquisition. However, there is a risk of an adverse matter being discovered which negatively impacts the value of the Stratus Business. If such a matter did arise, returns to Investors may be negatively impacted because the acquisition arrangements with the State of Victoria contractually limit the liability of the State of Victoria to a nominal amount for any future claims. Envestra sought extensive tax advice in connection with the acquisition of the Stratus Business which indicates that Envestra's exposure to tax risk is extremely low.

EXTENSION FOR MURRAY VALLEY TOWNS

In July 1995, Stratus' former owner, Gascor, was chosen on the basis of open tenders, as the supplier of gas on a bundled basis (Retailer, Distributor and Transmission Company) to 19 towns in the Murray Valley (9 in Victoria and 10 in New South Wales) from Howlong in the east extending downstream to Tocumwal.

Natural gas is already available to 8 of the Victorian towns and 5 in New South Wales, leaving Nathalia (Victoria) and Barooga, Berrigan, Deniliquin, Jerilderie and Mathoura (New South Wales) yet to be supplied.

An undertaking was given to the Central Murray Regional Development Corporation ("CMRDC") in the original tender to have natural gas available to all nineteen towns by 31 December 1999. However, a number of regulatory changes have occurred since, the more important of these resulting in significant distribution tariff reductions. This has had a negative impact on the economics of the project overall and a review is underway which may lead to discussions with the CMRDC with the objective of suspending the project until the economics become more favourable.

If required to complete the project, capital expenditure in the order of $21m may be incurred upon which an inadequate return will be provided unless special terms can be negotiated.

LITIGATION

Esso Australia Resources Limited ("Esso") is defending a number of legal actions against it relating to the interruption to natural gas supplies that resulted from the explosion at its Longford gas processing plant in September 1998. As part of its defence, Esso has made cross-claims against a number of parties, including Gascorp SNPL Pty Limited and Gascorp SAPL Pty Limited whose liabilities have been assumed by VicGas the economic risk of which is borne by EnVic, seeking contribution in respect of any damages awarded against Esso. On the basis of the information presently before the courts, the cross-claims cover actions in negligence and in misleading or deceptive conduct. Envestra has retained legal advisers to advise it on these issues. Should Esso be found liable in the actions against it and if it is successful in its cross-claims, Envestra's potential liability could be significant. However, on the basis of information presently available, Envestra considers the possibility of this outcome to be remote and will vigorously defend any cross-claims.

YEAR 2000

The Company has undertaken an extensive review of its exposure to problems associated with computer systems and equipment not recognising 1 January 2000 and associated dates. It is not anticipated that any disruption will occur to the flow of gas through the Network, but the Company cannot give a guarantee that this will not occur. This results from a number of factors, including Envestra's reliance on third parties such as trading partners, including gas producers and transmission pipeline operators, as well as suppliers and contractors.