16 December 2005

Centrica 2005 Trading Update

Centrica plc has today issued the following trading statement ahead of the Company entering close period on 1 January 2006.

The Company will announce its 2005 full year results on 23 February 2006.

2005 Update

Centrica expects full year Group earnings to be in line with consensus.

Gas prices for the winter months have continued to be volatile and have remained high on fears of a cold winter and gas shortages. For the year as a whole, British Gas's weighted average cost of gas will be around 37% higher than 2004 and its weighted average cost of electricity will be 30% higher. At a Group level, in this period of gas price volatility, the upstream business provides a valuable hedge against downstream margin squeeze. However in British Gas Residential Energy, although the business will be profitable for 2005 as a whole, it will make an operating loss in the second half of the year and full year operating margins will be around 2.5 percentage points lower than 2004.

Good progress has been made in identifying areas where costs can be removed. In addition to the savings already delivered and the 2,000 job reductions in British Gas announced in July 2005, we have reviewed our corporate and support activities and will reduce costs further through more job cuts between now and the end of 2006. As a consequence we now expect British Gas to reduce its reported cost base by £180m by 2007 compared with 2004, an increase on the £150m reduction that we announced in September. In total we expect to incur a post-tax exceptional charge of around £60m in 2005 relating to the corporate function reductions and those previously announced in British Gas.

The key challenge for British Gas during the second half of the year has been to manage the impact of the retail price increase implemented in September. At the same time as the increase was announced new propositions were launched accompanied by greater investment in marketing and sales. As a result the overall effect of the price rise on customer churn to date has been much less severe than we had predicted and considerably better than that resulting from the 2004 increase. Sales of new energy accounts were quickly restored to previous high levels following the price increase and have continued to grow. Gross losses have begun to slow. In the second half of the year, British Gas has grown its electricity customer base and expects to lose net only 160,000 energy accounts compared with 764,000 in the second half of 2004.

The pilot of the new billing system is progressing to plan and we are in the final stages of preparation for the first major migration of customers.

British Gas Home Services has continued to grow revenue and profit by leveraging its infrastructure to increase sales across its product range. This has been further supported by the launch of the new Homecare range of bundled products. We expect the full year result for Home Services to be materially up on 2004. We are pleased that the GMB has agreed to talks chaired by ACAS in an attempt to resolve the dispute regarding the changes to the defined benefit pension scheme for new employees. In the meantime we are doing all we can to ensure that vulnerable customers are not affected by the engineers' action.

British Gas Business has continued to perform well in tough market conditions. Profit in the second half will be broadly flat on 2004 but will be up for the year as a whole. The September price rise has not damaged SME retention or sales with contract renewals holding at 98%, overall churn lower than 2004 and a higher level of acquisitions. In the corporate division a successful autumn tender round for electricity has resulted in annualised growth of around 33% in connected load.

Gas production from Morecambe will be down by around 29% year on year due to the field being switched off for a period in the autumn in response to low intraday wholesale prices due to the mild weather. As in the first half of the year production from other fields in the portfolio has been higher than in 2004, benefiting in particular from production at Horne & Wren, Goldeneye and Rose. Upstream gas production profits will be significantly higher than 2004 although this increase will be partially offset at the earnings level due to higher PRT charges.

The industrial sales contracts included in the Industrial & Wholesaling division result continue to be loss making with increases in selling prices lagging the rise in input costs. Full year losses in that business will be around £150m.

Centrica Storage achieved close to 100% operational reliability over the injection season. Higher production rates resulting from the ongoing investment programme enabled 30 million therms of additional native Rough gas, along with associated deliverability, to be sold for this winter at a cleared price of 70.3p secured by auction. Centrica Storage remains on track to deliver significantly improved results in the second half of the year compared to the first half as a result of the operational reliability, sale of native gas and 20% higher average standard bundled unit (SBU) prices in the period. Full year operating profit will be materially above 2004.

Our customer base in North America has continued to grow with continued success in Texas and re-entry into the Ontario electricity market. In Texas our hedging strategy and tariff structure have enabled us to manage the impact of the extreme weather variability experienced in the second half of the year. We have also successfully refiled our "price to beat" in our incumbent areas. Elsewhere in North America we have expanded our footprint into the commercial and industrial market in a number of other states, principally on the Eastern seaboard. Profit in North America in the second half of the year is expected to be broadly in line with the first half.

The importance of continental Europe is its increasing influence on UK wholesale markets. The European Competition Commission has stated that the market is not yet functioning on a competitive basis and will identify appropriate remedies which remove the barriers to effective competition. This lack of liberalisation will continue to impact gas prices for UK consumers. In Spain our business has been affected by government tariffs being set below wholesale market prices. However, we have progressed our aspirations in Northern Europe with the completion of our acquisition with Gaz de France of a controlling 51% stake in SPE. The acquisition has created a vertically integrated business which is the clear number two in the Belgian energy market. In Holland we are now serving around 600,000 customers in Oxxio. We remain optimistic that further opportunities will be available for us to expand our European footprint.

Discussions are continuing on the sale of Onetel.

Spencer Stuart has been appointed to carry out the search for a successor to Sir Roy Gardner. The Company is currently assessing both internal and external candidates.

The Company completed its first £500m share buyback programme in September and commenced execution of its second £500m programme. To date 36 million shares have been repurchased under that programme for a total consideration of £87m.

The full year dividend is expected to increase materially on 2004 in line with our commitment to lift our payout ratio.

2006 Trading Outlook

With continuing wholesale commodity price volatility, 2006 will be a challenging year for Centrica.

Consumers will face another year of price increases as all suppliers look to recover higher wholesale costs. Our pricing policy remains to recover fully the wholesale cost of energy from our customers over time, recognising both the level and volatility in the forward curve and the competitive dynamics of the market. Following the extraordinary rises experienced in November, the wholesale cost of gas for Q1 2006 has recently been around 40% higher than it was when we adjusted our retail prices in September. Whilst production from Morecambe is expected to be 20-25% lower than 2005 based on current scheduling, incremental production from our other assets is expected to offset around 40% of the decline. In 2006 we will remain patient and disciplined in the pursuit of further quality upstream assets at value-creating prices.

The Chancellor's announced increase in the Gas Supplementary Charge tax rate will impact future earnings. In 2006, without any mitigation, we currently estimate the overall effect to be around £80m.

We will make progress on our cost reduction initiatives and the systems investments and process re-engineering necessary to yield an advantaged cost base by 2007. We will continue to deliver growth outside our core UK energy business. Against the background of extreme volatility in wholesale costs, these factors and our retail pricing decision are key to earnings delivery in 2006.

Conference call details

The Company will host a conference call from 8-9am (GMT) today with Group Finance Director Phil Bentley. The telephone number for UK callers is 0845 2453471. Overseas callers should dial +44 1452 542 300. The password for the call is "Trading Update". A recording of the call will be available on the Investor Relations section of the Centrica website from 2pm (GMT) today.

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