

Centrica plc Annual Report 1998



What's important to us

Centrica's vision is clear. We are determined to establish ourselves as the consumer's first choice for energy supply and services.

We're applying all our experience, knowledge and business strength to achieve that aim in the newly competitive energy market. In British Gas, we have a brand that has earned the trust of millions of consumers, giving us a platform from which to expand our offer into areas such as electricity, home security and financial services. Our success so far confirms that this is the right strategy.

Our values remain constant in everything we do. We will continue to provide warmth and comfort, security and expertise to our customers. We will continue to meet our broader responsibilities within society. And we will seek to deepen our understanding of what customers want and to deliver it.

Chairman's statement

1998 was a very important year in the evolution of Centrica as we positioned ourselves to compete in the fast emerging energy market and laid the foundations for future growth.

By the end of May the domestic gas market was fully opened to competition bringing real benefit to customers in the form of freedom of choice and better value.

September saw the start of competition in the domestic electricity market which is expected to be fully opened by June 1999. So far, we are the only major new entrant in this market, which has brought a new dimension to our business. We are delighted with the number of customers choosing British Gas as their electricity supplier and we intend to build on this success. However, certain changes need to take place if competition in the electricity industry is to be fully effective. These include the reform of the electricity pool, increased competition in power generation, separation of supply and distribution and the review of distribution price controls.

For the 20 million domestic customers with both electricity and gas a new market for energy supply is emerging and we aim to be the customer's first choice in this market.

Customer Service

Excellent customer service is our first priority and we continue to monitor customer satisfaction levels very closely. The acceleration of the completion of competition in gas brought high levels of customer contact and the process for switching supplier created a substantial additional workload for our customer service centres. Despite this, I am pleased to report that the trend of improvement in customer satisfaction I referred to last year continued during 1998.

Performance

In 1998 warmer than average weather once again had an adverse impact on sales and profits. Nevertheless, before exceptional charges, group operating profit was

£208 million, up £33 million compared with 1997, and earnings were £174 million, £130 million ahead of last year. After allowing for exceptional charges, profit after tax for the year was £89 million, compared with a loss of £791 million in 1997.

Cash generation has continued to be strong, with a cash inflow before money market investments, financing and exceptional payments of £543 million (1997 £877 million).

Dividend

While recognising the resources that may be required to develop our strategy, the Board has proposed a distribution to shareholders by way of a special dividend of 12 pence per share together with a consolidation of the share capital, under which ten existing ordinary shares will be consolidated into nine new ordinary shares.

In respect of 1999, the Board intends to propose, in the absence of unforeseen circumstances, a total dividend of 2.5 pence per share.

The Board

After 28 years with British Gas and Centrica, Peter Lehmann, Commercial Director, left the Company at the end of December 1998. He made an outstanding contribution during Centrica's formative period, for which we are indebted.

1998 was a testing year for our people, systems and processes. I have been delighted by the positive response to these challenges that I have observed throughout the Group. On behalf of the Board I would like to thank all employees for their contribution to the progress that Centrica has made.



Sir Michael Perry, CBE
Chairman



Sir Michael Perry, CBE Chairman

Key achievements of the year

- | strong profit progress
- | substantial cash generation
- | encouraging gas market share in tough competitive environment
- | promising start as electricity supplier
- | Services business in profit
- | continued improvement in customer satisfaction levels

Operating review



Roy Gardner Chief Executive

Chief Executive's review

Our aim is to be the customer's first choice for energy and services to homes and businesses. We have been successful in retaining many of our gas customers and, with the advent of competition in electricity, have made great strides in establishing ourselves in the rapidly converging energy market.

The Chairman has referred to the major changes that occurred during 1998 and against this background I am very pleased with the progress that we have made to develop the business and to deliver substantially improved financial results.

Our Performance

An overview of our performance is covered below.

Gas – British Gas has delivered increased value to its customers, with further price reductions during the year. This has been made possible by increased efficiencies and the continued renegotiation of our 'Take or Pay' contracts, which has reduced the cost of the gas that we buy. Our customer propositions, centred around value for money and excellent customer service, resulted in us retaining a share of just over 80% in a domestic market that is now fully competitive. In the industrial and commercial sector we retained about a quarter of the market.

Electricity – We have made an excellent start in building our electricity supply business and at the end of the year more than 850,000 customers had signed electricity supply contracts with British Gas, a share of over 3% of the domestic electricity supply market. This rate of growth was substantially ahead of our original expectation and we will continue to invest to sustain this momentum.

Services – Our Services business had an excellent year and achieved a profit for the first time with sales up 13%. We gained market share in domestic heating and

maintained our level of annual service contracts, despite our customer losses on the gas supply side.

Retail – British Gas Energy Centres made progress in reshaping the business and reducing losses even though the environment in the high street was difficult. 1999 is the year in which this business must deliver substantial improvements in performance.

Throughout the Group we have continued to identify ways to improve levels of customer service and to eliminate causes of dissatisfaction. We have achieved this whilst reducing our costs, improving financial performance and developing value for our customers.

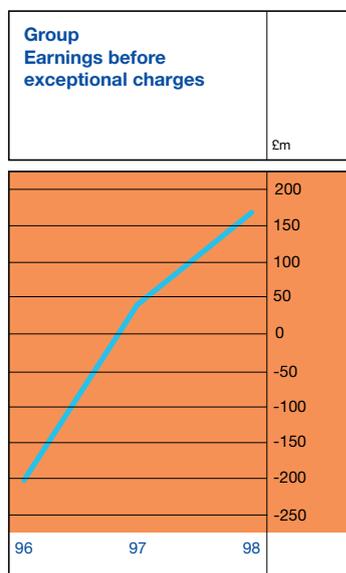
Year 2000

By the end of 1998 we had achieved business readiness of all but a few of our key systems. Our plans are in place to complete this task in 1999, to carry out comprehensive testing and to ensure necessary contingency planning. Further details are included on page 13.

Our Strategy

I began by describing Centrica's aim. We are determined to play a major role in the rapidly transforming energy market and to take advantage of opportunities that will arise. To support this, we will continue to seek opportunities for growth through our low cost channels to market.

Our priority is to expand our electricity business and capitalise on the opportunity to provide a total energy service to customers. We will also use the strength of our service infrastructure to introduce products that support the growth and development of services we offer to the home. We will continue to build our financial services business and look at other opportunities in the service sector where our strengths can be applied. We also see opportunities to apply the experience we have gained to other energy markets as they become accessible.



To support our supply business we will develop our sourcing options and extend our trading relationships in both gas and electricity. The acquisition in 1998 of PowerGen North Sea Limited is an example of this development.

Our Culture

Centrica is now a very different business to the British Gas of a few years ago. While significant change has been achieved already, we are only part way through our journey to transform our approach to and relationship with our customers. We are now beginning to implement a further series of initiatives designed to give a more integrated approach to meeting our

customers' needs and support the consumer-led behaviour that will drive our commercial success.

The flexibility and dedication shown by our employees has served us well so far and I have every confidence that we will rise to the challenge and succeed.

The rest of this report describes our business and reviews the progress we have made during 1998.

Roy Gardner
Chief Executive



Operating Structure

Currently, the Centrica Group has three main business segments supplying products and services offered under both the British Gas and Scottish Gas brands.

Energy Supply – British Gas Trading is responsible for the supply of gas and electricity to domestic, industrial and commercial customers. Domestic customers are supplied under the British Gas Home Energy and Scottish Gas brands. We sell to industrial and commercial customers primarily as Business Gas. Customers outside the reach of the mains network are supplied by our liquefied petroleum gas business.

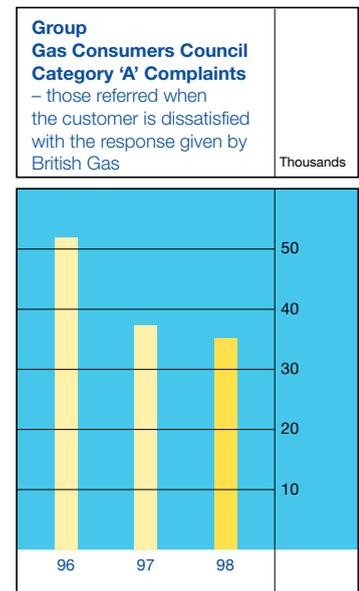
The Centrica Energy Management Group (CEMG) manages all of our gas production activities, gas and electricity purchases and wholesale energy trading.

Services – British Gas Services specialises in the installation and servicing of domestic heating and security alarm systems and is now broadening its range of services provided to the home.

Retail – British Gas Energy Centres is a high street retailer of gas and electric household products with over 240 outlets.

Financial Services – This fourth segment is growing in importance. We are developing these activities primarily using the Goldfish brand, notably the Goldfish credit card and Goldfish Guides. Our home insurance package is offered under both the British Gas and Goldfish brands.

In the following pages, we will look at performance and at significant activities in each of our business areas over the past year, showing how they have balanced the need for cost efficiencies with our drive to improve customer service.



Energy Supply

The completion of the introduction of competition in gas in May and the start of the first phase of competition in domestic electricity in September meant that 1998 was another year of major change in the energy market. Energy Supply operating profit of £242 million in 1998 was down £27 million against 1997, having absorbed an increase of £61 million in electricity business investment.

Whilst the impact of these changes on our business has been profound, our key priorities remain the same. In particular, we have seen continued improvement in customer satisfaction and have positioned ourselves to provide a total energy package based on fair prices, excellent service and unrivalled experience.

Domestic Energy Market

In the domestic energy market an operating loss before exceptionals of £4 million was made in 1998, compared with a profit of £10 million in 1997, reflecting the considerable increase in investment in electricity. Adjusting for these costs in both years, the underlying business achieved a much improved profit.

A loss of market share was inevitable with the introduction of domestic gas competition. Nevertheless, the strength of the British Gas brand, together with our value-based marketing programmes, have helped customer retention. In a tough and competitive market we continue to lose market share but are pleased that at the end of the year just over 80% of domestic customers, representing 15.9 million premises, had decided to stay with British Gas. A significant number of customers have already returned to British Gas.

We have made good progress in managing individual customer relationships. This work has been linked to improvements in communications, including more personalised promotions with bills and statements.

Internal efficiencies, together with lower operating and gas costs and transportation

charges, enabled us to reduce prices in stages throughout 1998.

Underlying Category ‘A’ complaints in the year to the Gas Consumers Council (‘GCC’), excluding complaints relating to the switching of supplier, fell by 6% against 1997. The final roll-out of competition involved some 15 million customers in 1998. This inevitably led to a large increase in customer contact, and the complaints relating to the complex switching process increased from 4% of complaints in 1997 to 15% in 1998.

In electricity, where British Gas is the only major national new supplier in the domestic market, we have exceeded our original expectations. By the end of the year 850,000 customers had signed electricity supply contracts with British Gas. The significant investment in developing our electricity business was £86 million in 1998 (1997 £25 million).

Our high-profile advertising campaigns have resulted in 75% awareness that British Gas is now supplying electricity.

Operational

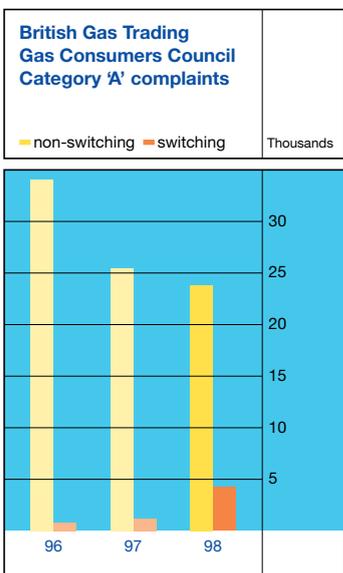
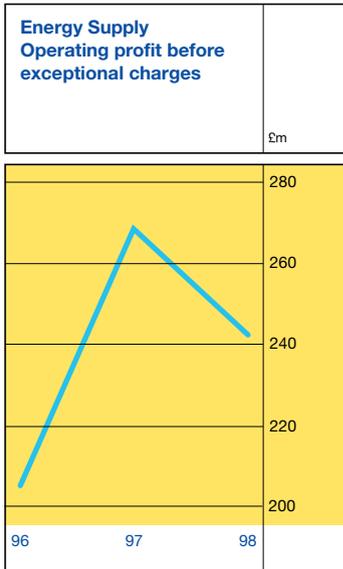
Our operational focus in 1998 was on cost reduction, together with a continued emphasis on service improvement. Our staff played a crucial role in the achievement of these combined goals, and this achievement has also been recognised externally.

Seven sites received Investors in People accreditation and a number of sites achieved ISO 9002 awards. Our Leeds call centre, benchmarked by an international research company, was first in the United Kingdom in terms of overall performance, and in the top ten worldwide.

An internal initiative called ‘Organise to Win’ supported our drive to reduce costs while improving service. As a result, bad debt charges were significantly reduced and considerable savings were made from other changes.

Business Gas

The industrial and commercial market has been fully open to competition since 1992, and British Gas has retained just under a



quarter of this market. The sector is fiercely contested with over 40 active competitors, many prepared to sell at a loss in order to establish market share. In order to protect our 'Take or Pay' position, it has been necessary to sell to customers at significantly reduced market prices when compared with our cost of gas.

With the reduction in our gas costs resulting from our 'Take or Pay' renegotiations and the reduction in the price charged by our own South Morecambe field, our losses in this market have continued to decrease: from £323 million in 1997 to £129 million in 1998, an improvement of £194 million. We expect further margin improvement in 1999.

British Gas LP Gas

Our liquefied petroleum gas (LPG) business supplies bulk-delivered and bottled gas to customers who do not have access to the mains network. In March 1998 we acquired Supergas Limited, which we have integrated with British Gas LP Gas. The combined business has a market share of about 7% and supplies more than 40,000 customers.

This business also markets compressed natural gas and LPG under the British Gas Vehicle Fuels brand.

Regulatory considerations

The rapid roll-out of competition into the gas market was the result of a major joint effort by Ofgas, British Gas, Transco and all other suppliers. With complete separation of supply and transportation, the gas market is now structured to encourage competition.

We have been frustrated by a number of delays in the opening of the electricity market, which is currently running a year behind gas, although it is being advanced where possible.

We welcome the Government's Green Paper review of utility regulation. We also welcome their recognition of the convergence of the gas and electricity markets. The single regulator will bring a

much-needed overview of the rapidly developing energy market, together with consistency of approach.

We also support the Government's recognition of the need for Pool reform, and the separation and removal of any cross subsidies between the supply and distribution businesses of the Public Electricity Suppliers (PES). Centrica has submitted proposals to the regulator on all these issues to help remove the barriers to entry created by the present electricity market structure.

Our current domestic gas price control formula applies to the end of March 2000. Key aspects of the allowable cost base in this formula are an RPI-4 element on supply costs, pass through of gas transportation and storage costs, subject to an economic gas purchasing requirement as appropriate and an allowance of £120 million of costs unrecovered under the previous price control formula. The formula also allows a profit margin of 1.5% of turnover in the regulated domestic market. We will be opening discussions with the Regulator in 1999 with a view to relaxing controls as the market becomes increasingly competitive.

In electricity, a review of the PES Year 2000 Distribution Price Controls – key to lowering prices for customers – was launched in 1998.

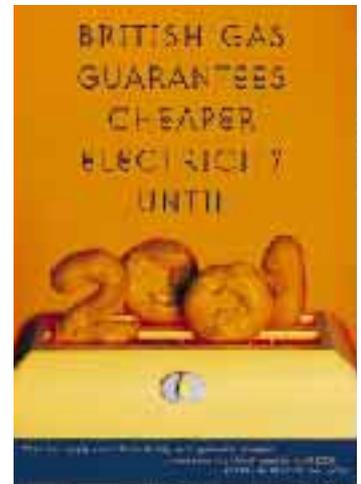
The Competition Act 1998 was enacted in November 1998 and comes into effect in March 2000. This is important new legislation that protects consumers by seeking to prevent and remedy anti-competitive behaviour.

Energy Management Group

Centrica's Energy Management Group (CEMG) manages our energy portfolio, including long-term third party gas contracts, the Morecambe reservoirs and electricity purchases. CEMG also includes Accord Energy, which trades in the wholesale and European energy markets.



Customers far from a gas pipeline can still enjoy gas central heating and cooking, thanks to clean, efficient and environmentally-friendly liquefied petroleum gas



Our popular marketing campaign brings home the message of cheaper electricity prices



An independent survey showed customer satisfaction levels continued to improve

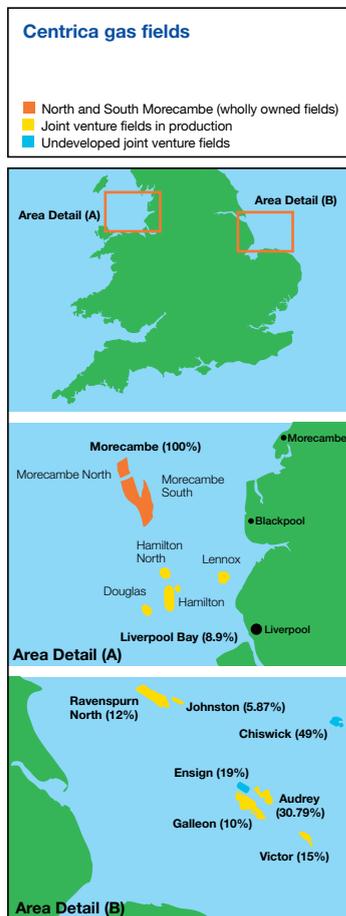
Operating review



Improvements to our South Morecambe platform increased production rates



The new Interconnector gas pipeline gives Centrica access to Europe



Morecambe

The Morecambe gas fields have proven and probable reserves of approximately 3.4 trillion cubic feet (tcf) as at 31 December 1998. Production was 3.2 billion therms (0.3 tcf) in both 1997 and 1998. Operating profit pre exceptionals for Hydrocarbon Resources Limited, which operates the Morecambe fields, was £344 million, down from £566 million in 1997. This reflects our success in reducing the South Morecambe contract price to market levels, as previously agreed with the Oil Taxation Office.

During the year we have introduced various improvements to these fields. Phase one of the South Morecambe development plan was completed with a number of modifications to the offshore processing plant, drilling of a new well and additional perforations to six wells.

Outline terms were agreed with Burlington Resources (Irish Sea) Limited to produce, transport and process gas from Burlington's Millom and Dalton fields using the nearby North Morecambe infrastructure. First gas production is planned for the third quarter of 1999.

Centrica Resources Limited

As production from South Morecambe begins to decline over the next few years, Centrica will need access to new gas supplies. We acquired PowerGen North Sea Limited for this reason. The company has been renamed Centrica Resources Limited.

This purchase is our first upstream acquisition since demerger and provides a very close fit with Centrica's existing gas portfolio. The assets consist of about 428 billion cubic feet of gas (86%) and 12 million barrels of oil (14%). In total, 47% of the gas is already contracted to us and 31% remains uncontracted.

European trading

On 1 October 1998 the UK-Continent Interconnector pipeline started flowing gas from the UK to Europe, connecting the UK's high-pressure transmission system at

Bacton to Zeebrugge in Belgium. This enabled Centrica to start delivering gas to Germany and the Netherlands under previously arranged contracts for supplies of about 75 billion cubic feet of gas per year.

The low oil price and high value of sterling have, however, meant that continental prices have been lower than in the UK, restricting opportunities for additional long-term sales. These cheaper European gas prices have led to gas being sold into the UK during December, with Accord Energy actively participating in wholesale European trades.

Electricity sourcing

CEMG manages the price risk associated with electricity procurement. We are evaluating alternative ways of securing competitively-priced electricity.

Risk management

An innovative ten-year gas purchase deal was reached with Enron during the year, which linked the purchase price of gas to the National Balancing Point index provided by the International Petroleum Exchange. We are implementing a number of risk management strategies to strengthen the on-going management of energy commodity price and volume risk. After evaluating weather risk management products, we took out a small amount of cover for 1999 to provide partial protection against the effects of warm weather.

Foreign exchange risk arises from the exposure within our long-term gas purchase contracts to movements in oil prices and hence to the US dollar/sterling exchange rate. This is managed by the purchase of a portfolio of forward exchange contracts, which effectively reduce the exposure arising in future periods.

In October 1998, the UK and European gas transportation networks became physically connected by the Interconnector pipeline. It is now considered possible that the influence of European prices on the UK market may provide a natural hedge to our

US dollar/sterling exchange rate exposure. Therefore, maturing hedge contracts are not currently being renewed.

The risk of consequential loss arising from major damage to the Morecambe gas facilities is covered by business interruption insurance.

'Take or Pay' contracts

Prior to Centrica's demerger from British Gas plc in February 1997, it became evident that there was a major problem with long-term commitments to purchase more gas than we needed and at higher prices than prevailed in the market. These contracts were originally established as part of British Gas's statutory obligation to maintain supplies. From 1996, we embarked on a programme to address these problems by renegotiating contract volumes and prices with many of our suppliers while committing to sell some of our excess volumes through a number of long-term export sales contracts. By the end of 1997 our contracts had been brought into a largely manageable state when measured against long-term market prices at an aggregate exceptional cost of £1,313 million, of which £608 million was incurred in 1997. During 1998 several deals have been concluded with a number of companies, covering 1.4 billion therms, and costing £63 million.

British Gas Services

British Gas Services is the leading company in the installation, servicing and maintenance of domestic heating systems and other gas heating and cooking appliances in Britain. In 1998 we extended our product range to offer home security on a national basis and air-conditioning products in the South East. We are now a leading national supplier of domestic security alarm systems for both installation and service. Trials took place to evaluate the potential for electrical appliance maintenance and plumbing services.

Following a successful trial in 1997, British Gas Connections expanded its

activities, which are to provide gas connections in the new housing market nationally. These developments extend our range of services to the home and provide opportunities for sales growth.

In 1998, British Gas Services' sales grew by 13% to £526 million. Productivity improvements and more effective marketing led to higher margins in all main product areas. As a result, the businesses achieved an operating profit of £9 million before exceptional charges, compared with a loss in 1997 of £49 million. This is the first year in which the business was in profit; in 1996 the loss was £196 million.

Despite losing nearly 20% of our domestic gas supply customers, we succeeded in maintaining our number of service contracts year on year. In domestic central heating installations we achieved a 3% increase in market share.

Our customer service performance improved significantly during the year. Customer satisfaction levels also improved and Category 'A' complaints to the Gas Consumers Council were down by 36% compared with 1997.

As part of our ongoing commitment to ISO 9001, the National Parts Centre and the majority of the Area Service Centres have now gained certification.

The continuing integration of administration, service centres, computer systems and technological support gives the business a sound basis on which to develop further our services to our customers.

British Gas Energy Centres

Operating principally on the high street, but also in a number of out-of-town locations, British Gas Energy Centres offer a comprehensive range of gas and electric cooking, heating and other household products. These stores are sited throughout Great Britain.

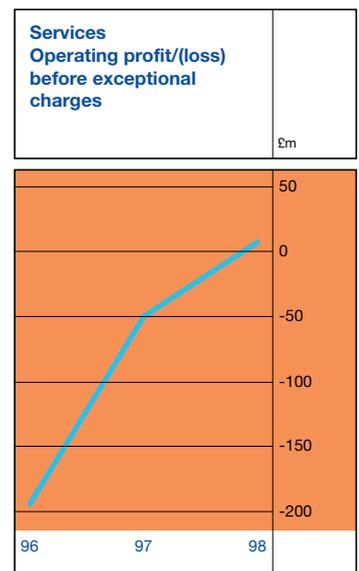
Economic slowdown, resulting in depressed consumer spending during the year, resulted in difficult trading conditions. Our sales of £169 million were down 8% compared with 1997 but our continued



We are a leading national supplier of home security products



British Gas radiators come in an extensive range of styles and sizes



Operating review



Located in high streets across the country, British Gas Energy Centres shops offer the opportunity to promote other products and services from British Gas



The redesigned Goldfish credit card: now even more distinctive

drive to reduce operating costs enables us to report a loss before exceptional charges of £31 million, an improvement of £14 million on 1997.

During 1998 we started a significant programme of performance improvement. We brought in a new management team with extensive retail expertise. The actions they have taken include radical restructuring and appropriate investment in operational functions. A direct result has been improved buying terms, decreased store operating costs and more efficient marketing spend.

One of our two warehouses was closed in 1998 and we have begun to rationalise the delivery operations to a single service provider. These changes are part of an initiative to increase customer satisfaction levels and reduce costs. British Gas Services now carries out the more complex installation work. These changes are already resulting in an improved installation service and fewer customer complaints.

Our drive to increase operational effectiveness has both reduced costs and improved levels of customer satisfaction, with Category 'A' complaints to the Gas Consumers Council down 30% year on year.

Investment in computer system support has continued and this activity is being integrated with British Gas Services.

The cross-selling of other Group products has developed well, with a significant number of electricity contracts and domestic heating installation leads being generated during the year.

Although the short-term outlook for the retail sector is not encouraging, the actions taken have laid the foundations for further improvement in operational performance.

Financial Services

In the second half of 1996 we began to introduce financial services to complement our energy supply, service and retail operations. The majority of these are marketed under our Goldfish brand.

Goldfish is now a household name, with

900,000 credit cards issued and a 3% share of the credit card market. The card, which offers money off home-related products and services through the collection of points, was launched via a joint venture with HFC Bank in September 1996. The scheme offers savings of up to £75 per annum on both our gas and electricity bills, and points can also be redeemed with partners such as Boots, Asda, BT, TV Licensing and Marks & Spencer.

We have launched the Goldfish Guides, a series of comprehensive, independently-prepared buying guides concentrating on high value consumer goods. By the end of December, over 135,000 guides had been sent out, with 19 titles now available.

Peace of mind and home comfort are intrinsic values for British Gas. Our home insurance product is flexible, easy to buy for both home and contents cover and excellent value for money.

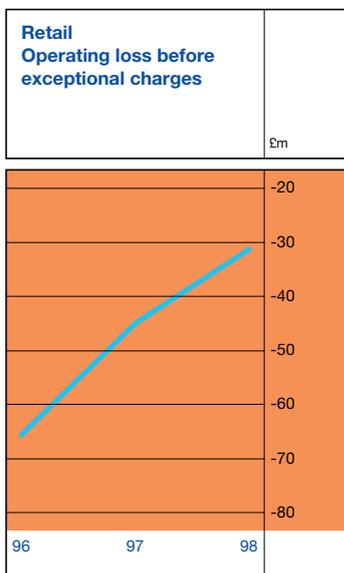
Other Ventures

Centrica has a 40% equity interest in AG Solutions, an information systems venture with Amdahl. AG Solutions is playing a big part in Centrica's Year 2000 programme. AccuRead is a joint venture with Group 4 providing meter reading services to British Gas and other clients. AccuRead has further reduced British Gas's meter reading costs, whilst continuing to outperform business targets. Both companies have performed well and contributed to profits in 1998.

Health, Safety and the Environment

New guidelines on the management of Health, Safety and the Environment, based on industry best practice, were introduced across the Group in 1998. In 1999 we will develop our ISO 14001 environmental management programme.

Centrica shares society's concerns about key environmental issues such as global warming and air quality, and we aim to play our part in meeting Government targets in these important areas. As the leading supplier of natural gas in the UK,



we recognise the vital contribution that it can make in meeting tough emission targets. Gas is the cleanest of the fossil fuels, with the lowest carbon content and it can play a critical role in both minimising greenhouse gas emissions and improving air quality.

A particularly challenging area is road transportation – a significant source of air pollution. Wide usage of gaseous-transport fuel, for example, could dramatically improve air quality and British Gas Vehicle Fuels has pioneered developments in this area. British Gas is now the UK's leading supplier of compressed natural gas for use in vehicles. During 1998, the road fuels business was expanded to cover the supply of LPG, making British Gas the first supplier to promote both of these alternative vehicle fuels.

Centrica and the community

We take our responsibilities to the community and the environment very seriously.

In 1998 the Centrica group contributed £1.85 million (1997 £1.75 million) to projects throughout Great Britain under the British Gas brand. We encourage employees to become involved in such projects, which are generally developed with national charity partners and delivered at a local level. Part of the budget is allocated to smaller local initiatives.

Older or disabled customers

We are conscious of the requirements of our older customers and those with special needs. More than one million customers in this group benefit from a range of services provided through the GasCare scheme. Our community support in this area aims to deliver further benefits that are of real, practical value including:

Through Other Eyes This is a sensory simulation training workshop for staff run by Age Concern. After experiencing our shops and service as an older customer would, participants have been able to make our service more relevant to this customer group.

HandyPerson British Gas funds fifteen HandyPersons schemes across the country, administered by Age Concern. HandyPerson is a successful scheme, with more than 20,000 individuals benefiting from the service.

KnoWay British Gas is working with Help the Aged and the Metropolitan Police to make the lives of older customers in London a little safer. It includes installation of 500 specially adapted telephone and door alarm buttons free of charge. These connect the homeowner to SeniorLink, Help the Aged's 24-hour call centre, where highly trained operators can advise and assist.

Carers National Association (CNA) We support the six million carers who provide vital care for older or disabled customers.

Our work with CNA has made us more aware of the needs of carers as customers and employees. We meet regularly with British Gas carers and have developed carer friendly employment policies.

In June we supported National Carers Week by promoting CarersLine, and provided funding for its operation.

Energy efficiency

We have a responsibility to help our customers use energy safely, efficiently and in the most cost-effective way possible. Projects include:

SchoolEnergy The average school in Britain spends three times as much on energy as it does on books, so the chance to save energy can make a real difference. Research has shown that schools could save as much as 35% on energy bills through simple energy efficiency measures, with little capital outlay.

The SchoolEnergy programme looks to provide schools with rebates for a limited number of specialised energy efficiency measures. In total, British Gas and the Energy Saving Trust will provide more than £1 million in rebates to approximately 500 schools over a two-year period.

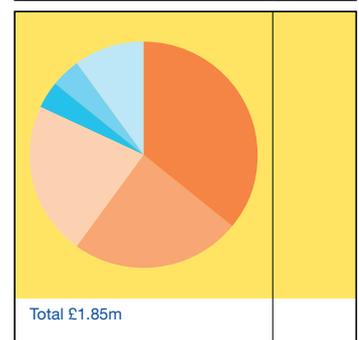


Bogus caller campaigns were part of our support for older customers.



Energy-conscious school children welcome our Powersaver robot

Community spend	
Older/Disabled	36%
Energy Efficiency	24%
Education	22%
Job Creation/Training	4%
Miscellaneous	4%
Employee volunteering	10%



Operating review



Drumming up support for the Scottish Gas Youth Challenge – community Initiative of the Year in the 1998 Utility Industry Achievement Awards

Powersavers This national energy efficiency programme run by British Gas and the Department of Environment, Transport and the Regions encouraged pupils to take an interest in energy efficiency and help cut school fuel bills.

More than 10,000 schools requested Powersavers teaching materials, which encourage pupils to carry out a practical energy efficiency exercise. The solutions they devise can be entered to win regional and national prizes.

Job creation

We also support projects which offer local communities greater access to training and development.

New Deal project Centrica is working with Employers Forum on Disability, The Carers National Association and the North West Disability Service (Employment Service) to resource 50 opportunities for disabled people and carers at Centrica sites in the North West.

The project was judged by the Government to be an ‘innovative scheme’ within the New Deal Sick and Disabled programme. It provides a clear, short route into employment for long-term disabled people and carers.

Charity partners are developing a transferable model of best practice for other employers. We hope that our actions will encourage the introduction of similar schemes across the country.

Scottish Gas Youth Challenge Part of the successful East End Partnership in Glasgow, the Scottish Youth Challenge targeted young jobless people to tackle spiralling youth unemployment and related issues in the East End of Glasgow. More than 80% of the young people who participated moved on to employment or further education. The project won the 1998 Utility Industry Achievement Award for Community Initiative of the Year.

Financial review

Financial highlights

Results for the year ended 31 December

	1998 £m	1997 £m
Operating profit before exceptional charges	208	175
Earnings before exceptional charges	174	44
Earnings/(loss) after exceptional charges	89	(791)
Group cash flow before use of liquid resources, financing and exceptional payments	543	877
Exceptional payments	(211)	(653)
Group cash flow before use of liquid resources and financing	332	224

Position as at 31 December

Cash and money market investments, net of debt	223	41
Market capitalisation	5 371	4 004

Profit and loss account

Turnover

Turnover at £7,481 million was £361 million lower than in 1997. Price reductions to domestic gas customers accounted for £290 million of the reduction. Loss of domestic market share as the market fully opened to competition from May 1998 was partially offset by market growth. Whilst by 31 December over 850,000 domestic customers had contracted to take their electricity supplies from us, the way that competition is being phased in from September 1998 means that only 111,000 customers were in fact being supplied by us at the year end. As a result, electricity turnover was only £5 million during 1998. Our Services business made sales of £526 million, which were 13% higher than in 1997 as we grew our market share in domestic heating installation and 'on demand' work. In Retail, turnover at £169 million was down 8% in what turned out to be a difficult year for many retailers.

Cost of sales

Gas and transportation costs are the main elements making up cost of sales.

The average unit cost of gas purchases varies year on year because of contractual price escalators and as a result of changes in the mix

of fields from which gas is purchased. During the year the average unit cost of externally purchased gas to satisfy the demands of the domestic, industrial and commercial markets was 18 pence per therm compared with 19 pence in 1997. More significantly, and as a result of renegotiations of long-term purchase commitments concluded since the beginning of 1996, the average cost of our externally sourced gas fell to 16 pence in the final quarter of 1998.

We also produced 3.2 billion therms of gas from our own fields, mainly at Morecambe, satisfying 20% of our requirements for the domestic, industrial and commercial markets. Agreement was reached with the tax authorities that, from 1 January 1998, the value per therm of production from South Morecambe for tax purposes would track market prices, rather than the higher price which had previously applied. This has substantially reduced our corporation tax charge and cost of sales, through lower petroleum revenue tax (PRT) and royalty charges. Due to the prospective method of accounting for PRT, the benefit of this change was first seen in 1997 and will continue in future years.

Unit transportation charges reduced by an average of 13% from October 1997. With effect from October 1998 transportation charges on



"Our results reflect the fact that, having effectively tackled the once heavy burden of gas purchase contracts, we are now seeing healthy improvements in our earnings. We have again been successful in generating substantial cash flows, and have made investments in future gas supplies, in the development of our electricity supply business and in other product opportunities. In short, we have built very solid foundations for the Group's future development and earnings growth."

Mark Clare Finance Director

Financial review

average increased by 2%. At the same time there was a rebalancing with a greater proportion being fixed as opposed to variable with units purchased. In the domestic market, the average cost per therm transported in 1998 was 8% lower than in 1997.

Gross profit

Gross profit before exceptional charges at £1,263 million was £52 million higher than in 1997, with gross profit in our Services business up by £63 million. In Energy Supply, gross profit from gas production was down £222 million due to the reduction in prices to our own supply business. Domestic market gross profit was little changed as cost reductions, including those from our own Morecambe fields, were largely passed through to customers. Gross losses in Business Gas were reduced from £290 million in 1997 to £93 million in 1998, mainly as a result of gas cost reductions including those from our own gas production business.

Operating costs

Operating costs at £1,055 million before exceptional charges were up by 2% compared with those in 1997. Underlying operating cost reductions of 5% were more than offset by revenue investment of £100 million (1997 £25 million) in the development of our electricity supply business and the promotion of other new products.

Operating profit before exceptional charges

Before exceptional charges, the Group made an operating profit of £208 million. This was £33 million more than in 1997. Our Services business turned a £49 million loss in 1997 into a £9 million profit in 1998 through increased margins and higher sales. This improvement, together with cost reductions in our Retail business, was partly offset by costs we incurred in supporting our entry into domestic electricity and developing our financial service activities. As in 1997, our gas sales volumes were lower than they might otherwise have been because the winter months were not as cold as normal. Under average weather conditions we would have expected our profits to have been

about £80 million higher in each of the last two years.

Exceptional charges

During 1998 we took the opportunity to reduce further our gas contract portfolio exposure at a cost of £63 million. This was in addition to charges of £608 million in 1997 and £705 million in 1996.

We incurred £21 million in 1998 on Year 2000 computer system business-readiness, of which £19 million of bought-in services has been treated as exceptional. The remainder represented internal resources which have been diverted from other activities. In 1997 we incurred £3 million, none of which was treated as exceptional. Further explanation is given on page 13.

In 1997 we made full provision for an exceptional Windfall Tax amounting to £192 million, half of which was paid in December 1997 and the remainder paid in December 1998. In 1998 we also incurred £3 million on restructuring costs compared with £35 million in 1997.

Interest

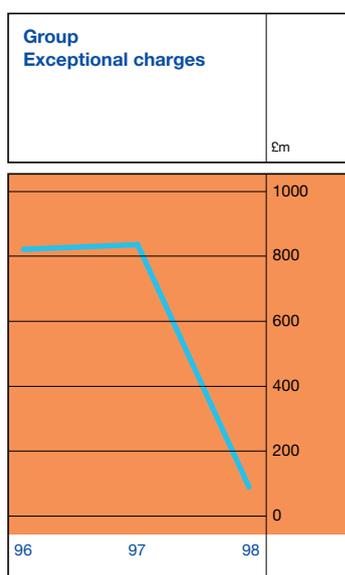
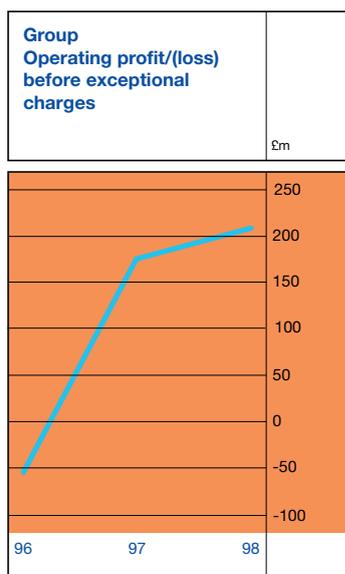
Net interest receivable of £42 million (1997 £38 million) was after notional interest charges of £23 million (1997 £8 million) in connection with the unwinding of liabilities discounted to a net present value. The increase in notional charges was more than offset by a £19 million increase in interest arising on higher average net short-term investment balances.

Taxation

Our tax charge at £75 million was £93 million lower than that incurred in 1997. This tax charge arises primarily on our offshore gas activities and the reduction has come about following agreement with the tax authorities that the value for tax purposes of gas sales from our South Morecambe field would track gas market prices from 1 January 1998.

Earnings

Group earnings, before exceptional charges, were £174 million, an increase of £130 million compared with 1997. Improvements arose in all



three main business areas of Energy Supply, Services and Retail.

Year 2000 and euro costs

Progress against our detailed plans to deal with the risks associated with Year 2000 business-readiness is monitored monthly by the Board.

By the end of 1998 we had achieved business-readiness of all but a few of our key systems. In 1999 we will work with our IT and service suppliers to complete this task, to carry out comprehensive testing and to ensure that the necessary contingency plans are put in place. We continue to play an active part in a cross-utility interest group and in the Government body 'Action 2000'. We are also working closely with our suppliers to ensure that they meet our timetable.

During 1998 we expensed £21 million in addressing Year 2000 business-readiness. This was in addition to the £3 million spent in 1997. During 1999 we expect to spend approximately £16 million, of which £1 million was committed as at 31 December 1998. The total cost over a three-year period is now expected to be £40 million, well within the estimate quoted in our 1997 Annual Report of £61 million, primarily due to finding better and more cost-effective solutions.

Detailed impact analysis has identified areas that would require euro conversion and the required lead times for the amendment of key systems. We are now developing plans to enable us to amend our systems in the event that a decision is made in favour of UK adoption of the euro.

Cash flow

Net cash flow

During 1998 the Group generated £332 million of cash, prior to movements in liquid resources and financing, compared with £224 million in 1997. In both years, substantial sums came from reducing the amounts tied up in debtors. In 1998 £211 million was paid for exceptional items compared with £653 million in 1997, reflecting the reduced level of gas contract renegotiations. Corporation tax payments were £215 million in 1998, much higher than the £112 million in 1997 which included only half a year's tax

charge on our Morecambe gas field activities. Within acquisition payments of £101 million, the main item was £87 million (net of £36 million cash acquired) paid in November 1998 to acquire 100% of the share capital of PowerGen North Sea Limited, subsequently renamed Centrica Resources Limited. In addition the Group settled a loan of £134 million included within the PowerGen North Sea Limited balance sheet at the time of the acquisition, and this is shown within financing activities. Centrica Resources Limited has interests in a number of gas and oil fields which fit well with our energy portfolio of assets and contracts. This purchase also supports our physical gas requirements for the future, as extraction rates from our Morecambe fields decline from their current level.

Loans in place when companies were acquired, including the Centrica Resources Limited loan, were refinanced in part by selling and leasing back two of the platforms deployed on our offshore South Morecambe field.

Cash, investments and debt

As at 31 December 1998 the Group had cash and investments, net of debt, of £223 million, up £182 million on the net balance of £41 million at the beginning of the year.

Credit rating and borrowing facilities

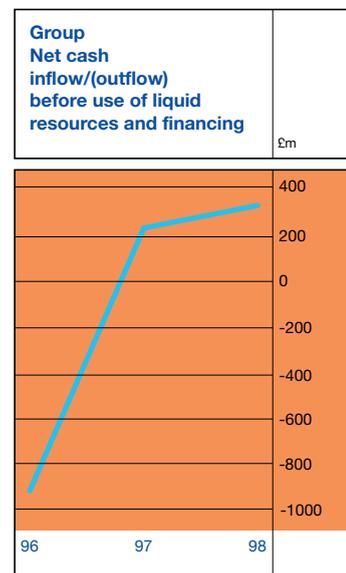
On 4 March 1999, Moody's Investors Service announced a long-term credit rating for Centrica plc of A2. On the same day Standard and Poor's announced a similar long-term rating of A, as well as a short-term rating of A-1.

The Group has a three-and-a-half year £1,000 million committed facility, which is scheduled to expire in June 2000. In addition the Group has a number of uncommitted facilities with a range of banks.

Assets and liabilities

Fixed assets

In November 1998 we completed the purchase of Centrica Resources Limited, which added £275 million to our gas production field interests. These, together with the remaining net book value of £1,355 million (1997 £1,480 million) of our Morecambe gas fields,



Financial review

dominate our investment in fixed assets. The proved and probable gas reserves represented by our field interests amounted to 3.8 trillion cubic feet (tcf) at 31 December 1998 (1997 3.7 tcf).

Working capital

The total investment in working capital as at 31 December 1998 was £421 million (1997 £897 million). Trade debtors and accrued energy income reduced by £333 million, following management action to improve the aged debtor profiles, which also had the benefit of reducing bad and doubtful debt charges by 30%. This was achieved through enhanced credit vetting, proactive debt follow up, successes in tracing home movers and increased usage of prepayment meters. Part of the reduction was due to lower prices and to loss of market share, though some of this reduction is being replaced as the number of electricity customers builds up. During 1998 we were also successful in reducing monies tied up in prepaid 'Take or Pay' gas, despite the impact that warm weather had on demand. Prepaid transportation charges as at 31 December 1998 were £242 million compared with £271 million at the end of 1997. This prepayment arrangement will expire during 1999.

Short-term creditors increased from £1,448 million as at 31 December 1997 to £1,603 million at the end of 1998. This reflects the proposed special dividend of £530 million payable in June 1999. The final £96 million instalment of Windfall Tax was paid in December 1998. The reduction in the corporation tax creditor resulted from the lower tax charge in the profit and loss account. Long-term borrowings increased by £72 million, largely as a consequence of two South Morecambe platforms being sold and leased back.

Treasury policy

Group treasury operations are managed centrally within a formal set of treasury policies and objectives approved by the Board. It is Group treasury policy not to undertake transactions of a speculative nature. The treasury team manages Group cash flows and the financial risks arising from funding and investment activities.

Surplus cash is invested in short-term sterling financial instruments. Short-term interest rate risk is managed by the purchase and sale of forward rate agreements. Short-term liquidity is assured from undrawn committed borrowing facilities and the Group does not currently have a net debt position.

Further explanation of the Group's foreign exchange risks is given in the section 'Risk Management' on pages 6 and 7 and in note 27 on page 46.

Accounting policy changes

A description of accounting policies is provided in note 1 to the accounts on pages 29 and 30. For the year ended 31 December 1998, Financial Reporting Standard (FRS) 9 'Associates and Joint Ventures', FRS 10 'Goodwill and Intangible Assets', FRS 11 'Impairment of Fixed Assets and Goodwill' and FRS 14 'Earnings Per Share' became mandatory and have been adopted.

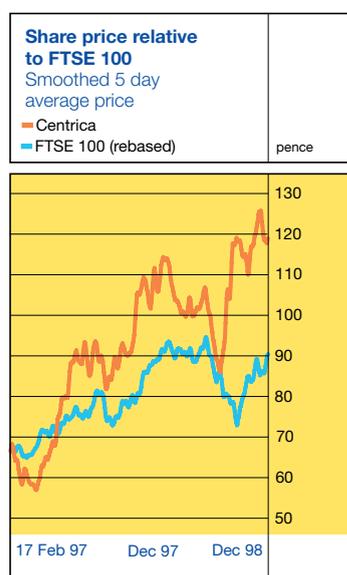
Under FRS 10, it is no longer permissible to write off goodwill arising on acquisitions directly to reserves. Accordingly, from 1 January 1998 goodwill is capitalised on the balance sheet and is amortised over its estimated useful life. The standard does not require the reinstatement of goodwill previously written off unless a related disposal arises.

Shareholders' funds and market capitalisation

The net assets of the Group, as represented by shareholders' funds, decreased during the year from £1,311 million to £872 million because the proposed special dividend, totalling £530 million, exceeded the profit after tax for the year.

The Company's mid-market share price on the last trading day of 1998 (30 December) was 121 pence (1997 90.25 pence), providing a market capitalisation of £5,371 million (1997 £4,004 million). The highest price during the year was 126.75 pence and the lowest was 83 pence.

During 1998 Centrica's share price outperformed the FTSE 100 by 18%. In the period from demerger to the end of 1998, the outperformance was 37%.





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Board of directors

1 Sir Michael Perry, CBE, Chairman (65)*‡# Sir Michael Perry became Chairman of Centrica plc on 1 July 1997. He was a Non-Executive Director of British Gas plc from June 1994 until demerger. He is Non-Executive Chairman of Dunlop Slazenger Group Ltd, Non-Executive Deputy Chairman of Bass plc and a Non-Executive Director of Marks & Spencer plc.

2 Mike Alexander, Managing Director British Gas Trading (51)†° Mike Alexander joined British Gas plc in 1991, becoming Director CIS and Eastern Europe (E&CP) in 1992, and Managing Director of Public Gas Supply in 1994. He is also a Non-Executive Director of The Energy Saving Trust Limited. He was previously with BP from 1966, where he held a variety of management positions, both in the UK and overseas.

3 Mark Clare, Finance Director (41)° Mark Clare joined British Gas plc in March 1994 as Group Financial Controller. He was previously with STC plc, which he joined in 1989 as Finance Manager in the telecoms business, where he rose to become Finance Director of STC Submarine Systems.

4 Bill Cockburn, CBE, Non-Executive Director (56)*# Bill Cockburn is Group Managing Director of British Telecommunications plc. He was previously Chief Executive at both W H Smith Group plc and the Post Office Corporation. He is a Non-Executive Director of Lex Service plc and a member of the Board for Business in the Community.

5 Roy Gardner, Chief Executive (53)‡° Roy Gardner was appointed Finance Director of British Gas plc in November 1994. From November 1995 he had responsibility for the business units which subsequently formed Centrica plc. Prior to joining British Gas plc, he was Managing Director of GEC-Marconi Limited and a director of GEC plc. He is a Non-Executive Director of Laporte plc and President of the Carers National Association.

6 Francis MacKay, lead Non-Executive Director (54)*# Francis MacKay is Chief Executive and Deputy Chairman of the Compass Group plc.

7 Patricia Mann, OBE, Non-Executive Director (61)*†‡# Patricia Mann was a Non-Executive Director of British Gas plc from December 1995 until demerger. She was Vice President International of J Walter Thompson Co Ltd and remains a director of JWT Trustees Ltd. She is on the Board of the UK Centre for Economic and Environmental Development and is a former director of the Woolwich Building Society and Yale and Valor plc.

8 Peter Wood, CBE, Non-Executive Director (52)*†# Peter Wood was founder and former Chairman of Direct Line and a member of the Board of The Royal Bank of Scotland Group plc until June 1997. He is a Director of Linea Directa Aseguradora and also an Advisory Director of Bankinter SA in Spain and a Non-Executive Director of the Economist. He is Vice Chairman of Direct Response Corporation and Homeowners Direct Corporation – auto and homeowners insurance companies in the US.

9 Roger Wood, Managing Director British Gas Services (56)†° Roger Wood joined British Gas plc in April 1996. From 1993 to 1996 he was Director General of Matra Marconi Space NV. Previously he was Managing Director of STC Telecommunications and Group Vice President of Northern Telecom Limited. Prior to 1988 he was UK Director at ICL.

Member of: * Audit Committee † Customer Service Committee ° Executive Committee
‡ Nominations Committee # Remuneration Committee

Corporate governance

The Company has considered the principles and provisions of the Combined Code: Principles of Good Governance and the Code of Best Practice ('the Code').

The Board

The Company is headed by an effective Board of Directors which leads and controls the Company. It meets regularly and has a formal schedule of matters reserved to it for decision. There are a number of Committees of the Board which also meet regularly and deal with specific aspects of the management of the Company. The Board has delegated authority to these Committees and they have defined terms of reference. Details of the membership of the Committees are shown on page 15. The current Committees of the Board are the Audit, Customer Service, Executive, Remuneration and Nominations Committees.

The Board is provided with timely and accurate information which enables it to carry out its role effectively. There is an agreed procedure by which members of the Board may take independent professional advice in the furtherance of their duties. All Directors have access to the advice and services of the Company Secretary.

The Board endorses and complies with the principle of the separation of the roles of Chairman and Chief Executive. The principle of a senior independent director is supported and Francis MacKay has been appointed to this role.

There is a balance on the Board with four Executive and five independent Non-Executive Directors (see page 15 for names of the Directors and their biographical details).

A Nominations Committee (for membership see page 15) is in place to make recommendations to the Board on all new Board appointments.

Directors' remuneration

Details of how the Company applies the principles of the Code and any areas of non-compliance in respect of Directors' Remuneration are set out in the report on remuneration on pages 18 to 22.

Relations with shareholders

The Company has a programme of regular meetings with its major institutional shareholders which provides an opportunity to discuss the progress of the business.

The Board believes that the Annual General Meeting provides a useful forum to communicate with its private shareholders, many of whom are also customers.

Accountability and Audit

The Board seeks to present a balanced and understandable assessment of the Company's position and prospects through the

report and accounts and other price-sensitive public reports and reports to regulators.

There is an Audit Committee which is comprised entirely of Non-Executive Directors (details of the members are given on page 15) which meets four times a year.

Internal Control

The Directors are responsible for the Group's system of internal control which aims to safeguard group assets, to ensure that proper accounting records are maintained, to ensure compliance with statutory and regulatory requirements and the effectiveness and efficiency of operations. Any system of internal control can only provide reasonable and not absolute assurance, particularly against misstatement or loss.

The Directors have reviewed internal control in accordance with their understanding of the Code. The scope of their review has extended beyond financial control to cover operational effectiveness and efficiency and matters of legal and regulatory compliance as required. Detailed guidance on how to apply the code in respect of the wider aspects of internal control has not yet been produced and therefore the confirmation of compliance given by Directors is restricted to internal financial control as permitted by the Stock Exchange.

Key features of the Group's system of internal control are as follows:

Control environment

Centrica is dedicated to the highest standards of business conduct with its customers, suppliers and partners. Practical guidance on these matters is given by policies and codes of practice throughout the Group.

The Group has an appropriate organisational structure as set out above for planning, controlling and monitoring the business.

Identification of risks

Risk Awareness Committees, in operation throughout the Group, are responsible for the identification, evaluation and management of key risks. These risks may arise from a variety of internal and external sources and include control breakdowns, changes in the business and regulatory environment, competition and natural catastrophe. In addition, the Financial Risk Management Committee manages specific corporate financial risks such as exposure to commodity prices and interest rate fluctuations.

Information and communication

Group businesses undertake annual strategic reviews which include consideration of long-term projections and evaluations of business options. This ensures that agreed targets and objectives are communicated throughout the Group. There is an extensive programme of communication with employees including briefings by the Chief Executive to senior management and also site visits.

Control procedures

Group businesses operate procedures designed to ensure complete and accurate accounting and to limit exposure to loss of assets and fraud. In addition, a framework of procedures is operated to ensure compliance with statutory and regulatory requirements and the effectiveness and efficiency of operations.

The internal financial control framework encompasses a comprehensive budgeting system with an annual budget approved by the Board, the monthly comparison of actual results against budget, regular financial forecasts, corporate and business unit manuals of accounting, and clearly defined expenditure control policies.

Monitoring and corrective action

The Audit Committee, advised by the Head of Internal Audit, approves a coordinated programme of control self assessment and internal audits to review the effectiveness of the Company's system of internal control. This review covers all main risks and associated controls on an annual basis including financial, operational and compliance controls. The results of this review are reported to the Audit Committee along with any associated remedial actions required. The internal control review is supported by control reports from the Company's external Auditors and by a letter of assurance in which Business Unit Management confirms the adequacy of systems of control and their compliance with Company policies.

Going concern

After making enquiries the Board has a reasonable expectation that the Company and Group have adequate resources to continue in operational existence for the foreseeable future. For this reason we continue to adopt the going concern basis in preparing the financial statements which are shown on pages 26 to 47.

The Code

Throughout the period the Company has complied with the provisions in Section 1 of the Code except and to the extent referred to below and in the report on remuneration on pages 18 to 22.

Requirement for Directors to be re-elected every three years

In accordance with one of the provisions of the Code, a minor change is being proposed to the Company's Articles of Association at the Annual General Meeting to ensure that directors submit themselves for re-election every three years. Given that the Company was only formed two years ago this has not been an issue, but it is intended that best practice should be observed in this area.

Remuneration report

The Board has considered the principles and provisions of the Combined Code: Principles of Good Governance and the Code of Best Practice ('the Code') and this report explains how the Company has applied those parts of the Code which relate to Directors' remuneration.

The Board has a Remuneration Committee, which consists entirely of independent Non-Executive Directors, chaired by Patricia Mann. The other members of the Committee are Bill Cockburn, Francis MacKay, Sir Michael Perry and Peter Wood. To assist in reaching its decisions, the Committee uses survey and other data and advice provided by independent consultants.

During the year the Committee determined the remuneration policy which was endorsed by the Board. Since the Code was published in the Listing Rules in January 1999, the terms of reference of the Committee have been amended in order to comply with the Code. In future, the Committee will make recommendations to the Board, within agreed terms of reference, on the Company's framework of executive remuneration and its cost. The Committee will retain responsibility for determining specific remuneration packages for each of the Executive Directors.

Framework and Policy on Executive Directors' Remuneration

In order to attract, retain and motivate Executive Directors of the necessary calibre, the remuneration packages offered are performance related and market competitive. A benchmark market position of near the median on remuneration packages has been adopted and a comparator group drawn from FTSE100 companies has been identified, reflecting the fact that the Company competes for its senior executives with other major companies in the energy, manufacturing and service sectors.

In line with market practice, the Company has adopted a policy of providing remuneration packages for Executive Directors which comprise a number of different component parts: base salary, annual performance bonus and a long term incentive scheme, together with pension and other employment benefits.

Implementation of Policy

The Committee retains responsibility for the implementation of the above-mentioned policy and determining specific remuneration packages for each of the Executive Directors. In discharging its responsibilities the Committee recognises and takes into account the following criteria when agreeing the component elements of the remuneration package for each Executive Director.

Base Salary: The Committee seeks to establish a base salary for each Executive Director in line with mid-market levels, relative to similar executive positions in the comparator group, taking into account individual performance and drawing upon independent market data. Base salaries are reviewed annually.

Annual Performance Bonus: In order to recognise performance against agreed goals, the Committee has approved an annual bonus scheme for Executive Directors similar to that applying to other senior executives in the Company. Bonus payments earned by Executive Directors are determined by actual achievement against demanding individual and corporate objectives. If all objectives are achieved in full, the scheme provides for a maximum payment of 50% of base salary.

Bonus objectives and targets are approved by the Committee and currently relate to financial, customer satisfaction and personal performance; for Executive Directors with business unit responsibilities, the scheme is structured to reflect their business unit's as well as the Company's performance.

Executive Directors' previous terms and conditions of employment with British Gas plc prior to demerger provided for full pensionability of annual performance bonuses. At present, and in common with other senior executives in the Company, any annual performance bonus payments made to Executive Directors, other than the Chief Executive, are pensionable. Since demerger, however, such pensionability is restricted in the case of Executive Directors to no more than 20% of base salary, while in the case of other senior management all annual performance bonus earned continues to be pensionable.

The Committee has agreed that pensionability of bonuses for Executive Directors will be phased out. In recognition of existing contractual rights, the Committee has acknowledged that this should take place over a period of time. Accordingly, the Committee has agreed that the present arrangement will continue for current Executive Directors until their next change of responsibilities within the Company, from which time any annual performance bonus earned within their package will be non-pensionable. For all new appointments to the Board, any annual performance bonus earned will be non-pensionable.

Long Term Incentive Scheme: The Company operates a long-term incentive scheme which links the notional allocation of shares to Executive Directors and other senior executives to the total shareholder return.

Under the terms of the scheme, notional allocations of shares may be made annually. Under normal circumstances, the shares will not be released to the participant for at least five years: that is, a performance period of either three or four years, followed by a retention period of two years. This ensures that executives have a long-term interest in the Company's performance. Shares to satisfy the notional allocations are bought by the Company in the market at the time of allocation.

The number of shares eventually released to the participant depends on the relative performance of the Company's total shareholder return over the entire performance period compared to

that of the companies comprised in the FTSE100 at the start of the performance period (the "LTIS Comparator Group"). The maximum allocation of shares, representing 100% of salary for Executive Directors, would only vest if the Company's total shareholder return over the performance period is ranked in 25th position or above in the LTIS Comparator Group. No shares will vest if the total shareholder return over the performance period is ranked below 50th position in the LTIS Comparator Group.

At demerger, existing notional allocations of shares in British Gas plc were cancelled and replaced by notional allocations of shares in the Company.

The annual notional allocation of shares was made to Executive Directors and senior executives in October 1998. Details of the maximum number of shares which could be transferred to individual Executive Directors under the terms of the scheme are given on page 21.

Other employment benefits: In common with certain other senior management, Executive Directors are entitled to a range of benefits, including a company car, private medical insurance and a financial counselling scheme. They are also eligible, on the same basis as all other employees, to participate in the Company's Sharesave and Profit Sharing Schemes.

Service Contracts: All Executive Directors have service contracts which are terminable by either party serving two years' notice, subject to the principle of mitigation. Executive Directors have now been advised that their notice periods will be reduced from two years to one, with effect from 2001. In the case of new external appointments to the Board, the Committee wishes to retain a level of flexibility in order to attract and retain suitable candidates. It therefore reserves the right to offer contracts which contain initial notice periods in excess of one year, provided that after the first such period the notice will reduce to one year.

In addition to the above-mentioned criteria, in setting the level of base salaries for Executive Directors and the annual performance bonus scheme, the Committee bears in mind the potential total remuneration available to Executive Directors. Accordingly, the Committee retains a discretion to vary individual elements of the remuneration package.

External appointments to broaden the experience of Executive Directors

It is the Company's policy to allow each Executive Director to accept a maximum of one external appointment as a non-executive director of another company, fees for which are normally retained by the individual Director. Details of individual Directors' external appointments are given in their biographies on page 15.

Non-Executive Directors

Non-Executive Directors joining the Board are appointed for a period of three years, subject to review thereafter. They are subject to reappointment at the Company's Annual General Meeting in accordance with the Company's Articles of Association.

Non-Executive Directors' fees are set by the Board as a whole. The Non-Executive Directors, including the Chairman, do not participate in any of the Company's share schemes, incentive plans or pension schemes.

Compliance with the Code

The Board, in conjunction with the Committee, has taken the necessary steps to ensure that in the future the Company will comply with the provisions of the Code which relate to Directors' remuneration. The Company has not complied with certain of the principles and provisions of the Code during the accounting period, namely pensionability of bonuses and notice periods in Executive Directors' contracts of employment; and the Committee's terms of reference. Nevertheless, prior to the introduction of the Code, the Committee complied with the best practice provisions in the former Section A of the Annex to the Listing Rules of the London Stock Exchange and in implementing its policy, the Committee gave full consideration to the provisions of the former Section B of the Annex to the Listing Rules.

Re-election of Directors

Mr Mike Alexander and Mr Roger Wood, the Executive Directors proposed for re-election at the forthcoming Annual General Meeting, have service contracts which at present are terminable on two years' notice. Miss Patricia Mann, Non-Executive Director, proposed for re-election, does not hold a service contract.

Remuneration report

Directors' Emoluments	Base Salary/Fees £000	Annual performance bonus £000	Benefits ^a £000	Total emoluments excluding pension	Total emoluments excluding pension
				1998 £000	1997 £000
Executive Directors					
M R Alexander	204	71	17	292	276
M S Clare	207	71	16	294	277
R A Gardner	384	130	29	543	493
P J Lehmann ^b	177	56	11	244	244
R N B Wood	220	83	18	321	307
	1 192	411	91	1 694	1 597
Non-Executive Directors					
W Cockburn	25	–	–	25	25
F H MacKay	25	–	–	25	25
P K R Mann	25	–	–	25	25
Sir Michael Perry ^c	150	–	–	150	96
P J Wood	25	–	–	25	25
	250	–	–	250	196
Total emoluments	1 442	411	91	1 944	1 793

^a Benefits incorporate all assessable tax benefits arising from employment by the Company, which relate in the main to the provision of a company car.

^b Peter Lehmann, Commercial Director, left the Company's employment on 31 December 1998. In addition to the emoluments shown above, he received a payment of £191,000 as compensation for termination of his employment (see also pension disclosure on page 21).

^c 1997 emoluments include those as Deputy Chairman up to 30 June 1997 and as Chairman thereafter.

Directors' pensions

The following information relates to the pension arrangements provided for the Executive Directors. All the Executive Directors were members of the British Gas Staff Pension Scheme until 31 March 1998. On 1 April 1998 they transferred their past service on the same terms and commenced membership of the Centrica Staff Pension Scheme ("the Staff Scheme").

The Staff Scheme is a funded, Inland Revenue approved, final salary occupational pension scheme. Its main features are:

- 1) a normal retirement age of 65;
- 2) the right to retirement at age 60 without reduction to a member's accrued pension;
- 3) the right to an immediate unreduced pension on leaving service on reorganisation or for redundancy after age 50;
- 4) accrual at the rate of 1/60th of pensionable salary for each year of pensionable service;
- 5) life assurance cover of four times pensionable salary;
- 6) spouse's pension on death in service payable at the rate of two thirds of the member's prospective pension; on death after retirement, two thirds of accrued pension. Children's pensions are also payable;
- 7) members' contributions payable at the rate of 4% of pensionable salary;

- 8) pensions payable in the event of retirement due to ill health;
- 9) pensions in payment and in deferment are guaranteed to increase in line with the increase in the Retail Prices Index; and
- 10) no discretionary practices are taken into account in calculating transfer values.

All benefits are subject to Inland Revenue limits. Where such limitation is due to the earnings 'cap', benefits are increased to the level that would otherwise have been paid and are provided via the Centrica Unapproved Pension Scheme, (Peter Lehmann was the only Executive Director not affected by the 'cap'). This scheme is unfunded but the benefits are secured by a charge over certain specified Centrica assets in order to provide security equivalent to that for the pensions provided to other employees. An appropriate provision in respect of their accrued value has been made in the Company's balance sheet.

Pension benefits earned by Directors	Age at	Pensionable Service at	Directors' contributions	Increase in accrued	Accrued annual pension at
	31 December 1998	31 December 1998 Years	paid during 1998 ^a £	pension during 1998 ^b £ pa	31 December 1998 ^c £ pa
M R Alexander ^{d,f}	51	20 ^{9/12}	7 110	9 800	83 700
M S Clare ^f	41	4 ^{10/12}	7 230	7 000	22 500
R A Gardner ^e	53	4 ^{1/12}	13 005	16 700	52 900
P J Lehmann ^g	54	27 ^{5/12}	8 460	12 500	97 900
R N B Wood ^e	56	2 ^{9/12}	7 529	9 700	23 800

^a Contributions were paid in the year by the Executive Directors under the terms of the Staff Scheme. With effect from 1 April 1998, all Executive Directors paid contributions to the Staff Scheme up to the maximum rate of 15% of the earnings 'cap'.

^b The increase in accrued pension during the year excludes any increase for inflation and any pension in relation to Additional Voluntary Contributions paid by members.

^c Accrued pension is that which would be paid annually on retirement at age 65, based on service to 31 December 1998.

^d The pensionable service shown for M R Alexander includes a service credit in relation to a transfer value from a previous employer's pension scheme.

^e The pension for R A Gardner and R N B Wood accrue at the rate of 1/30th (3.33%) of pensionable salary per year of service.

^f With effect from 1 January 1998, the pensions for M R Alexander and M S Clare accrue at rates of 2.26% and 2.28% of pensionable salary respectively for each year of pensionable service. Pensionable service prior to 1 January accrued at the rate of 1/60th (1.67%) of pensionable salary.

^g The accrued annual pension for P J Lehmann relates to his pensionable service up to his leaving date on 31 December 1998, which was paid in accordance with the Rules of the Staff Scheme outlined above.

Directors' interests in shares

The Directors' beneficial interests in ordinary shares in the Company (which include those of their families) and Executive Directors' interests in the Long Term Incentive Scheme are shown below:

Directors as at 31 December 1998	Beneficial interests		Long Term Incentive Scheme		
	Ordinary shares ^a		Notional allocations		
	As at 31 December 1998	As at 31 December 1997	As at 31 December 1998 ^b	Notional allocations made on 1 October 1998 ^c	As at 31 December 1997
M R Alexander	30 000	22 034	774 746	178 024	596 722
M S Clare	25 855	25 471	715 923	181 431	534 492
R A Gardner	125 863	125 479	1 571 094	340 716	1 230 378
P J Lehmann	13 236	12 852	545 350	—	545 350
R N B Wood	50 384	50 000	729 347	189 949	539 398
W Cockburn	1 400	1 400	—	—	—
F H MacKay	—	—	—	—	—
P K R Mann	2 820	2 820	—	—	—
Sir Michael Perry	1 000	1 000	—	—	—
P J Wood	—	—	—	—	—

Ordinary Shares

^a Interests shown are beneficial interests in the ordinary shares of the Company. The beneficial interests of each Executive Director include 384 shares appropriated under the terms of the Company's Profit Sharing Scheme. For details of the operation of this Scheme see page 40.

Long Term Incentive Scheme

^b Figures given represent the maximum award possible if all performance criteria are met at the end of the performance period (3 or 4 years) and would not be made until the expiry of the retention period (a further two years). Details of the performance criteria are given on pages 18 and 19.

The notional allocations shown above include allocations made under the British Gas plc Long Term Incentive Scheme prior to demerger. These awards were replaced at demerger by awards over Centrica shares, with a base price of £0.817. The awards were on the same terms as existing awards, but the number of shares comprised in the award and the performance condition were adjusted to relate to the total shareholder return of Centrica plc since the original date of the award in October 1995. The total shareholder return of Centrica plc for the period up to demerger will be a proportion of the total shareholder return of British Gas plc in that period based on the ratio of the price of a Centrica plc share just after demerger to the price of a British Gas plc share just before demerger. These shares would normally be released at the discretion of the trustees, subject to performance conditions, in October 2001. The figures above include such replacement notional awards for the following Executive Directors: M R Alexander (108,695 shares); M S Clare (46,465 shares); R A Gardner (367,341 shares); and P J Lehmann (108,695 shares).

P J Lehmann left the employment of the Company on 31 December 1998. The notional allocations of shares held by him will be subject to time apportionment rules. This means that at the end of the performance periods the notional allocations may vest, subject to the normal performance conditions, but the amounts will be reduced by reference to the proportion of the performance period that P J Lehmann was employed by the Company. The maximum number of shares that could vest is 319,207.

^c Notional allocations of shares made on 1 October 1998 under the Company's Long Term Incentive Scheme at a base price of £0.9949.

None of the Directors had any non-beneficial interests in shares.

At no time during the year or at the end of the financial year did the Directors or their families have any beneficial interests in the share capital of any of the Company's subsidiary or associated undertakings. The following changes in the interests of the Directors in the share capital of the Company have been notified to the Company between 1 January 1999 and 5 March 1999: on 25 February 1999 P J Wood purchased 100,000 shares; on 26 February 1999 F H Mackay purchased 10,000 shares and on 5 March 1999 R A Gardner purchased 20,000 shares.

Remuneration report

Directors' interests in share options

Full details of the options over Centrica plc shares held by Executive Directors who served during the year and any movements in those options over the year are shown below.

	Options held as at 31 December 1997	Options granted during year	Options exercised during year	Options held as at 31 December 1998	Exercise Price £	Date from which exercisable	Expiry date
M R Alexander							
Executive Share Option Scheme ^a	86 145	–	–	86 145	0.90266	Oct 1996	Oct 2003
	288 969	–	288 969	–	0.81060	Oct 1997	Oct 2004
Sharesave Scheme ^b	7 435	–	–	7 435	0.46400	Jun 2002	Nov 2002
	–	14 967	–	14 967	0.92200	Jun 2003	Nov 2003
	382 549	14 967	288 969	108 547			
M S Clare							
Executive Share Option Scheme ^a	177 645	–	–	177 645	0.81060	Oct 1997	Oct 2004
Sharesave Scheme ^b	37 176	–	–	37 176	0.46400	Jun 2002	Nov 2002
	214 821	–	–	214 821			
R A Gardner							
Executive Share Option Scheme ^a	1 336 446	–	–	1 336 446	0.81889	Nov 1997	Nov 2004
Sharesave Scheme ^b	37 176	–	–	37 176	0.46400	Jun 2002	Nov 2002
	1 373 622	–	–	1 373 622			
P J Lehmann							
Executive Share Option Scheme ^a	161 254	–	–	161 254	0.66975	Dec 1994	Dec 1999
	106 331	–	–	106 331	0.67711	Apr 1995	Dec 1999
	54 239	–	–	54 239	0.90266	Oct 1996	Dec 1999
	72 835	–	–	72 835	0.81060	Oct 1997	Dec 1999
Sharesave Scheme ^b	14 870	–	–	14 870	0.46400	Dec 1998	Jun 1999
	409 529	–	–	409 529			
R N B Wood							
Sharesave Scheme ^b	37 176	–	–	37 176	0.46400	Jun 2002	Nov 2002
	37 176	–	–	37 176			

Executive Share Option Scheme

^a Options granted to Company employees under the British Gas plc Executive Share Option Scheme were cancelled and replaced by non-Inland Revenue approved options to acquire Centrica shares at demerger. The replacement options were granted on the same terms as British Gas Executive Share Options, with the same exercise date and aggregate exercise price per share and the number of shares placed under option was adjusted to take account of the demerger.

Options are no longer granted under this Scheme.

On 28 September 1998, Mr Alexander exercised an Executive Share Option over 288,969 shares at an option price of £0.81060 and sold 281,387 shares. The market value of Centrica shares on this date was £1.1775.

Sharesave Scheme

^b The Company operates a savings-related share option scheme, the Sharesave Scheme, which is open to all eligible employees. The Scheme is designed to provide a long-term savings and investment opportunity for employees and is described in note 20 on page 40.

No options lapsed during the year.

The middle market price of a Company ordinary share on the last trading day of 1998 (30 December) was 121 pence. The range during the year was 126.75 pence (high) and 83 pence (low).

5 March 1999

Directors' report

The Directors present their report and the audited group accounts of Centrica plc for the year ended 31 December 1998.

Principal activities

The principal activity of the Centrica group for the financial year ended 31 December 1998 was the provision of gas, electricity and energy-related products and services to homes and businesses in Great Britain.

Business review

The Chairman's Statement and the Operating Review comprise pages 1 to 10 and report on the activities of the Centrica group during the year, recent events and any likely future developments of the business of the Centrica group.

Financial results

The financial results of the Centrica group are discussed in the Financial Review on pages 11 to 14 of this report.

Dividends

While recognising the resources that may be required to develop our strategy, the Board has proposed a distribution to shareholders by way of a special dividend of 12 pence per share together with a consolidation of the share capital, under which ten existing ordinary shares would be consolidated into nine new ordinary shares.

In respect of 1999, the Board intends to propose, in the absence of unforeseen circumstances, a total dividend of 2.5 pence per share.

Related party transactions

Details of related party transactions are set out in note 26 on page 46.

Creditor payment policy

Centrica aims to pay all of its creditors promptly. Special contractual terms apply for gas supplies. For all other trade creditors, it is the Company's policy to:

- agree the terms of payment at the commencement of business with that supplier;
- ensure that suppliers are aware of the terms of payment; and
- pay in accordance with contractual and other legal obligations.

The number of days' purchases outstanding as at 31 December 1998 is calculated at 31 days (1997 31 days) for the Group and 45 days (1997 37 days) for the Company.

Research and development

Research and development is undertaken by individual businesses to develop new products, improve customer service techniques and enhance gas and oil production processes. In 1998 £0.6 million (1997 £0.7 million) was charged to the profit and loss account.

Employment policies

The Centrica group employed an average of 16,427 people in the United Kingdom during 1998. The Group is committed to pursuing an active Equal Opportunities policy covering recruitment and selection, training, development, appraisal and promotion. The Group recognises the diversity of its employees and that of its customers and the community at large and seeks to use employees' talents and abilities to the full. This approach extends to the fair treatment of people with disabilities, in relation to their recruitment, training and development. Full consideration is given to the retention of staff who become disabled during employment.

Centrica has developed a Carers Policy and Roy Gardner is President of the Carers National Association.

Centrica supports the Government's New Deal for disabled people, the aim of which is to recruit unemployed disabled and carers into the Group's Manchester-based operations. In due course, Centrica's experience will be shared with other UK employers.

The Group continues to support Investors in People and a number of operating units achieved accreditation during the year.

The Group has developed and run a series of executive workshops for its top 120 staff and these will be extended to other senior managers during 1999.

Employee communications

The Group is committed to effective employee communications, which it maintains through formal and informal briefings, company magazines, videos, tapes and electronic media. Formal communications with trades unions take place through regular meetings between representatives from the Company and trades unions. The Group has procedures for the timely and accurate communication of financial results and other significant business issues to its employees.

Employee share option schemes

Sharesave Scheme

Employees are strongly encouraged to become shareholders in the Company and in 1998 6,717 staff were in aggregate granted 21,538,410 options to purchase shares in the Company under the Centrica Sharesave Scheme at 92.2 pence per share.

Profit Sharing Scheme

In 1998 the Company made the first appropriation of shares under the Company's Profit Sharing Scheme. 12,057 full time employees were each awarded 384 shares and 1,452 part-time employees were each awarded 256 shares. The Company recently announced to its employees that it would be operating the Profit Sharing Scheme for a second year. All eligible employees will again receive an equal number of shares which will be held in trust for a period of three years.

Political and charitable donations

A full description of the Centrica group's involvement in the community appears on pages 9 and 10. Charitable donations of £1.85 million (1997 £1.75 million) were made during the year in the UK. No donations were made for political purposes.

Share capital

The Company's authorised share capital as at 31 December 1998, together with details of shares issued during the year, is set out in note 20 on page 39.

Substantial shareholdings

As at 5 March 1999, the Company had received notification from the Prudential Corporation plc that it had a material interest in 164,401,630 ordinary shares, which represents 3.7% of the Company's issued ordinary share capital.

Directors

The present Directors of the Company are listed, together with their biographies, on page 15. All served as Directors throughout the year. Peter Lehmann, an Executive Director, left the Company on 31 December 1998.

In accordance with the Articles of Association Mike Alexander, Roger Wood and Patricia Mann retire by rotation at the forthcoming Annual General Meeting and will be proposed for re-election.

Full details of the Directors' contracts, emoluments and share interests can be found in the Remuneration Report on pages 18 to 22.

Auditors

Price Waterhouse and Coopers & Lybrand merged during the year to form a new firm 'PricewaterhouseCoopers'. PricewaterhouseCoopers were appointed as auditors to the Company

with effect from 1 July 1998. They have expressed their willingness to be reappointed as auditors of the Company. A resolution to reappoint them as the Company's auditors and authorise the directors to settle their remuneration will be proposed at the Annual General Meeting.

Annual General Meeting resolutions

The resolutions to be proposed at the Annual General Meeting to be held on 10 May 1999, together with explanatory notes, appear in the separate Notice of Annual General Meeting enclosed with this Annual Report. The Directors are authorised by the shareholders to purchase the Company's own shares, within certain limits and as permitted by the Company's Articles of Association. Although no such purchases have been made, the Directors will seek to renew the authority at the Annual General Meeting.

Extraordinary General Meeting Resolutions

Following the Annual General Meeting there will be an Extraordinary General Meeting to consider the proposed resolutions in respect of the special dividend and the related consolidation of shares in the Company. The notice of the Extraordinary General Meeting is contained in the circular enclosed with this Annual Report.



By order of the Board

Grant Dawson
Company Secretary
5 March 1999

Registered Office:
Charter Court, 50 Windsor Road,
Slough, Berkshire, SL1 2HA
Registered in England No: 3033654

Statement of directors' responsibilities for preparing the financial statements

The Directors are required by the Companies Act 1985 to prepare financial statements for each year which give a true and fair view of the state of affairs of the Company and of the Group as at the end of the financial year and of the profit or loss for the financial year.

The Directors consider that in preparing the financial statements on pages 26 to 47, the Company has used appropriate accounting policies, consistently applied (except as permitted on the implementation of FRS 10, 'Goodwill and Intangible Assets', as noted on page 29) and supported by reasonable and prudent judgements and estimates, and all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and the Group and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Report of the auditors to the members of Centrica plc

We have audited the financial statements on pages 26 to 47 which have been prepared under the historical cost convention and the accounting policies set out on pages 29 and 30.

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the Annual Report including, as described above, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on pages 16 and 17 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its internal controls.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 1998 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers

Chartered Accountants and Registered Auditors
1 Embankment Place, London WC2N 6NN
5 March 1999

Group profit and loss account

for the year ended 31 December

	1998			1997		
	Underlying business performance £m	Exceptional charges £m	Results for the year £m	Underlying business performance £m as restated ^a	Exceptional charges £m	Results for the year £m as restated ^a
Turnover: Group and share of joint ventures	7 519	–	7 519	7 884	–	7 884
Less share of joint ventures' turnover	(38)	–	(38)	(42)	–	(42)
3 Turnover	7 481	–	7 481	7 842	–	7 842
4 Cost of sales	(6 218)	(63)	(6 281)	(6 631)	(608)	(7 239)
Gross profit	1 263	(63)	1 200	1 211	(608)	603
4 Operating costs	(1 055)	(22)	(1 077)	(1 036)	(227)	(1 263)
3 Group operating profit/(loss)	208	(85)	123	175	(835)	(660)
3 Share of operating loss in associates and joint ventures	(1)	–	(1)	(1)	–	(1)
	207	(85)	122	174	(835)	(661)
6 Net interest	42	–	42	38	–	38
Profit/(loss) on ordinary activities before taxation	249	(85)	164	212	(835)	(623)
7 Tax on profit/(loss) on ordinary activities	(75)	–	(75)	(168)	–	(168)
Profit/(loss) on ordinary activities after taxation for the financial year	174	(85)	89	44	(835)	(791)
8 Dividend			(530)			–
21 Transfer from reserves			(441)			(791)
	Pence		Pence	Pence		Pence
9 Earnings/(loss) per ordinary share – basic			2.0			(17.9)
– diluted			2.0			(17.8)
– adjusted	3.9			1.0		

^a The comparative information for 1997 has been restated as set out in note 2.

There were no recognised gains or losses other than those shown above, and all results were derived from continuing operations.

The notes on pages 29 to 47 form part of these financial statements.

Balance sheets

as at 31 December

Notes	Group		Company		
	1998 £m	1997 £m	1998 £m	1997 £m	
	Fixed assets				
10	Intangible assets	10	–	–	–
11	Tangible assets	1 861	1 716	1	1
12	Investments				
	– Joint ventures:				
	Share of gross assets	18	25	–	–
	Share of gross liabilities	(39)	(39)	–	–
	– Subsidiary undertakings	–	–	222	222
	– Other investments	54	40	22	13
		33	26	244	235
		1 904	1 742	245	236
	Current assets				
14	Stocks	127	168	–	–
15	Debtors (amounts falling due within one year)	1 410	1 952	2 007	1 003
15	Debtors (amounts falling due after more than one year)	173	165	155	–
		1 583	2 117	2 162	1 003
16	Investments	341	56	323	44
	Cash at bank and in hand	33	18	1	–
		2 084	2 359	2 486	1 047
	Creditors (amounts falling due within one year)				
17	Borrowings	(60)	(14)	(24)	(2)
18	Other creditors	(1 603)	(1 448)	(1 978)	(976)
		(1 663)	(1 462)	(2 002)	(978)
	Net current assets	421	897	484	69
	Total assets less current liabilities	2 325	2 639	729	305
	Creditors (amounts falling due after more than one year)				
17	Borrowings	(91)	(19)	–	–
18	Other creditors	(78)	(74)	–	–
		(169)	(93)	–	–
19	Provisions for liabilities and charges	(1 284)	(1 235)	(12)	(9)
3	Net assets	872	1 311	717	296
	Capital and reserves – equity interests				
20	Called up share capital	222	222	222	222
21	Share premium account	2	–	2	–
21	Merger reserve	467	467	–	–
21	Profit and loss account	181	622	493	74
22	Centrica shareholders' funds	872	1 311	717	296

The financial statements on pages 26 to 47 were approved by the Board of directors on 5 March 1999 and were signed on its behalf by:



Sir Michael Perry, CBE
Chairman



Mark Clare
Finance Director

The notes on pages 29 to 47 form part of these financial statements.

Group cash flow statement

for the year ended 31 December

	1998 £m	1997 £m as restated ^a
Operating activities		
24a Cash inflow from operating activities before exceptional expenditure	870	1 028
24a Expenditure relating to exceptional charges	(211)	(653)
24a Cash inflow from operating activities after exceptional expenditure	659	375
Dividends received from associates and joint ventures	1	2
24b Returns on investments and servicing of finance	58	43
24c Taxation paid	(215)	(112)
24d Capital expenditure and financial investment	(70)	(87)
24e Acquisitions	(101)	3
Cash inflow before use of liquid resources and financing	332	224
24f Management of liquid resources	(285)	(44)
24g Financing	(42)	(178)
Net increase in cash for the year	5	2

^a The comparative information for 1997 has been restated as set out in note 2.

Reconciliation of net cash flow to movement in cash and money market investments, net of debt

for the year ended 31 December

	1998 £m	1997 £m
Net increase in cash for the year	5	2
Cash outflow from decrease in debt and lease financing	44	178
Cash outflow from increase in liquid resources	285	44
Change in cash and money market investments, net of debt, resulting from cash flows	334	224
New finance lease obligations	(7)	(5)
13 Loans acquired	(139)	–
13 Debt issued on acquisition	(6)	–
Movement in cash and money market investments, net of debt	182	219
24h Cash and money market investments, net of debt, as at 1 January	41	(178)
24h Cash and money market investments, net of debt, as at 31 December	223	41

The notes on pages 29 to 47 form part of these financial statements.

Notes to the financial statements

1 Principal accounting policies

Accounting principles

The accounts have been prepared in accordance with applicable accounting standards and under the historical cost convention.

Basis of preparation

a) Merger accounting

In accordance with the principles of merger accounting as set out in Financial Reporting Standard (FRS) 6 'Acquisitions and Mergers', the accounts have been prepared as if the Group had been in existence prior to the demerger of the Centrica businesses from BG plc (formerly British Gas plc) on 17 February 1997.

b) Consolidation

The Group accounts comprise a consolidation of the accounts of the Company and all of its subsidiary undertakings and incorporate the results of its share of all associates and joint ventures.

c) Acquisitions

The results of undertakings acquired are consolidated from the date the Group gains control.

Turnover

Turnover includes the value of energy supplied and reflects an assessment of supplies to customers between the date of the last meter reading and the period end ('unread'). Unread gas is estimated for each individual customer based on seasonal temperature profiles.

Petroleum revenue tax

Provision is made on a unit of production basis for petroleum revenue tax expected to arise in the foreseeable future and is included within cost of sales. Changes in estimates are dealt with prospectively.

Long term incentive schemes

The cost of potential share awards under the Group's long term incentive schemes is charged to the profit and loss account over the period to which the performance criteria of each allocation relates.

Research and development expenditure

Research and development expenditure is charged to the profit and loss account as incurred.

Intangible fixed assets

Goodwill arising on the acquisition of a business is included in the balance sheet at cost, less accumulated amortisation. On the acquisition of a subsidiary undertaking, associate or joint venture, fair values are attributed to the net assets acquired. Goodwill, which represents the difference between the purchase consideration and the fair values of those net assets, is capitalised and amortised on a straight-line basis over the expected useful life.

Prior to 1 January 1998, goodwill was taken directly to reserves. From 1 January 1998 this policy has been changed to comply with the requirements of FRS 10 'Goodwill and Intangible Assets'. Under the transitional provisions of FRS 10, there is no requirement to reinstate goodwill previously taken to reserves unless there is a related disposal. The effect of the policy change in 1998 was to reduce profit before and after tax by £0.4 million and to increase net assets by £9.6 million.

Goodwill is being amortised over a 20-year period, which represents the directors' estimate of its useful economic life.

Tangible fixed assets

Tangible fixed assets are included in the balance sheet at cost, less accumulated depreciation and less any provisions for impairment.

Freehold land is not depreciated. Other tangible fixed assets, except exploration and production assets, are depreciated on a straight-line basis at rates sufficient to write off the cost, less estimated residual values, of individual assets over their estimated useful lives. The depreciation periods for the principal categories of assets are as follows:

Freehold and leasehold buildings	up to 50 years
Plant	5 to 20 years
Equipment and vehicles	3 to 6 years

1 Principal accounting policies continued

Assets held under finance leases are depreciated over the shorter of the lease term or their useful economic life.

Exploration and production assets are depreciated from the commencement of production in the fields concerned, using the unit of production method based on the proved developed reserves of those fields. Changes in these estimates are dealt with prospectively. The net carrying value of fields in production is compared on a field-by-field basis, with the likely future net revenues to be derived from the estimated remaining commercial reserves. A provision is made where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues.

Leases

Assets held under finance leases are capitalised and included in tangible fixed assets at cost. The obligations relating to finance leases, net of finance charges in respect of future periods, are included within borrowings. The interest element of the rental obligation is allocated to accounting periods during the lease term to reflect the constant rate of interest on the remaining balance of the obligation for each accounting period. Rentals under operating leases are charged to the profit and loss account as incurred.

Fixed asset investments

Fixed asset investments are included in the balance sheet at the lower of cost or directors' valuation, less accumulated provisions for amortisation and any impairment.

Stocks

Stocks are valued at the lower of cost or estimated net realisable value.

'Take or Pay' contracts

Where payments are made to external suppliers under 'Take or Pay' obligations for gas not taken, they are treated as prepayments and are included within debtors. Where necessary, a provision is made against these prepayments to reflect the directors' estimate of the difference between the payment made for gas not taken and the estimated net realisable value of that gas when taken.

Abandonment costs

Provision is made over the life of the field for the estimated cost of well site restoration and pipeline and platform removal at the end of the producing lives of fields. The provision is calculated using the unit of production method and is based on proved developed reserves, price levels and technology at the balance sheet date. Changes in estimates are dealt with prospectively.

Pensions

The cost of providing retirement pensions and related benefits is charged to the profit and loss account over the periods benefiting from employees' service. The difference between the charge to the profit and loss account and the contributions paid to the Pension Schemes is shown as a provision in the balance sheet. The regular pension cost, variations from the regular pension cost and interest are all charged within employee costs and the straight-line method is applied for amortising surpluses and interest.

Long-term sales contracts

Provision is made for the net present value, using a risk-free discount rate, of any expected losses on long-term sales contracts. The provision is based on the difference between the contracted sales price and the expected weighted average cost of gas.

Deferred tax

Deferred tax, in respect of accelerated capital allowances and other timing differences, including pension provisions, is provided only to the extent that it is probable that a liability or asset will crystallise.

Financial instruments

Derivative financial instruments are used by the Group mainly for the management of its foreign currency and interest rate exposures.

Forward exchange contracts are used to hedge exposures to movements in foreign currencies. Such contracts are matched at their inception to expected future cash flows from specific exposures within financial years. Gains and losses are released to the profit and loss account to match the income and costs of the underlying transactions they are intended to hedge. At a year-end, outstanding forward exchange contracts used as a hedge are not revalued but are carried forward to match against corresponding gains or losses from the original exposures.

Gains and losses under forward rate agreements used to reduce exposure to movements in short-term interest rates are amortised evenly over the notional period of each forward rate agreement.

2 Merger accounting, comparative information and restatements

On 17 February 1997, BG plc (formerly British Gas plc) demerged certain businesses (grouped together under GB Gas Holdings Limited (GBGH)) to Centrica plc. As explained on page 29 under note 1: 'Basis of preparation', these group accounts have been prepared as if the Centrica Group had been in existence for the whole of 1997. The profit for the GBGH group from 1 January to 17 February 1997, included within these financial statements, was £90 million.

Prior to demerger, the companies comprising the Centrica businesses were transferred to GBGH, a subsidiary undertaking of BG plc. Upon demerger the share capital of GBGH was transferred to Centrica plc and was recorded at the nominal value of shares issued to BG plc shareholders. In accordance with Sections 131 and 133 of the Companies Act 1985, no premium was recorded on the shares issued. On consolidation, the difference between the nominal value of the Company's shares issued and the amount of share capital and share premium of GBGH at the date of demerger was credited to a merger reserve.

The comparative figures have been restated to reclassify the Group's share of associates' and joint ventures' interest to 'Net interest' from 'Share of operating loss in associates and joint ventures' within the profit and loss account, and to identify separately 'Dividends received from associates and joint ventures' in the cash flow statement. These adjustments have been made to comply with FRS 9 'Associates and Joint Ventures'.

3 Segmental analysis

Turnover, operating profit/(loss) after exceptional charges, and net assets are analysed below. Exceptional charges are explained in note 4 and have been charged to the following segments: Energy Supply £77 million (1997 £608 million), Services £6 million (1997 £33 million) and Retail £2 million (1997 £2 million). Windfall Tax charged in 1997 of £192 million did not relate to a specific segment. All turnover arose in the United Kingdom, of which £13 million (1997 £nil) related to exports to the rest of Europe. All net assets were located in the United Kingdom.

	Turnover ^b		Operating profit/(loss) ^b		Net assets	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
Energy Supply	6 784	7 192	165	(339)	1 253	1 543
Services	526	467	3	(82)	(51)	(30)
Retail	169	183	(33)	(47)	8	(14)
Other	2	–	(12)	–	(2)	–
Windfall Tax	–	–	–	(192)	–	(96)
	7 481	7 842	123	(660)	1 208	1 403
Unallocated net liabilities ^a	–	–	–	–	(336)	(92)
Centrica Group	7 481	7 842	123	(660)	872	1 311
Share of operating profit/(loss) in						
– associates			1	4		
– joint ventures			(2)	(5)		
			(1)	(1)		
			122	(661)		

^a Unallocated net liabilities comprised:

	1998 £m	1997 £m
Fixed asset investments	33	26
Interest bearing transportation prepayments	242	271
Accrued interest	9	3
Special dividend payable	(530)	–
Taxation	(313)	(433)
Cash and money market investments, net of debt	223	41
	(336)	(92)

^b The turnover and operating profit of businesses acquired during the year were not material.

4 Costs

	1998			1997		
	Underlying business performance £m	Exceptional charges £m	Total £m	Underlying business performance £m	Exceptional charges £m	Total £m
Cost of sales ^a	6 218	63	6 281	6 631	608	7 239
Operating costs ^a	1 055	22	1 077	1 036	227	1 263
	7 273	85	7 358	7 667	835	8 502

^a Gas transportation costs of £2,192 million (1997 £2,501 million) were included within cost of sales. Distribution costs were not material and operating costs were all considered to be administrative expenses.

	1998			1997		
	Underlying business performance £m	Exceptional charges ^b £m	Total £m	Underlying business performance £m	Exceptional charges ^b £m	Total £m
Group operating profit/(loss) is stated after charging/(crediting):						
Contract renegotiations	–	63	63	–	573	573
Sales contract loss provisions	–	–	–	–	35	35
	–	63	63	–	608	608
Euro preparation costs	1	–	1	–	–	–
Restructuring costs	–	3	3	–	35	35
Windfall Tax	–	–	–	–	192	192
Year 2000 costs	2	19	21	3	–	3
	3	22	25	3	227	230
Depreciation:						
– owned assets	200	–	200	202	–	202
– leased assets	3	–	3	9	–	9
	203	–	203	211	–	211
Impairment of fixed asset investments	–	–	–	3	–	3
Operating lease rentals:						
– plant and machinery	17	–	17	15	–	15
– property	26	–	26	24	–	24
– other	–	–	–	1	–	1
Profit on sale of tangible fixed assets	(7)	–	(7)	–	–	–
Research and development	1	–	1	1	–	1
Auditors' remuneration:						
– statutory audit						
– Company	0.2	–	0.2	0.2	–	0.2
– Subsidiaries	0.5	–	0.5	0.5	–	0.5
– other audit	0.4	–	0.4	0.5	–	0.5
– other	1.6	–	1.6	0.6	–	0.6
	2.7	–	2.7	1.8	–	1.8

^b Exceptional charges are explained on pages 32 and 33. None had any effect on the tax charge for either 1998 or 1997.

Contract renegotiations

The Group has renegotiated certain long-term 'Take or Pay' contracts which potentially would have resulted in commitments to pay for gas that would be excess to requirements and/or at prices above likely market rates. These renegotiations resulted in exceptional charges, representing the net present value of payments, due to the suppliers as consideration for the renegotiations, of £63 million (1997 £573 million). During the year £52 million was paid in respect of the exceptional charges booked in 1998, with a further £34 million relating to costs incurred in 1997, bringing total payments in 1998 to £86 million (1997 £464 million). Unpaid elements of the 1997 and 1998 charges amounting to £54 million were included in creditors due within one year (£43 million relating to 1997 charges and £11 million relating to 1998 charges) and £127 million (after discounting adjustments) was included within provisions (which all related to 1997 charges). The amount included in provisions represents the net present value of the estimated payments due in periods between the years 2002 and 2008.

Sales contract loss provisions

The exceptional charge of £35 million in 1997 was made to provide for losses expected to arise from certain long-term sales contracts. Provision was made for the net present value, using a risk-free discount rate, of expected losses based on the difference between sales price and the expected weighted average cost of gas.

4 Costs continued

Year 2000

The Group incurred and paid £21 million (1997 £3 million) on Year 2000 computer systems business-readiness preparations, of which £19 million (1997 £nil) represented bought-in services, which have been treated as exceptional.

Restructuring costs

In 1997 a restructuring charge of £35 million, comprising severance and related pension costs, arose in Services and Retail. The exceptional payments of £10 million in the year (1997 £93 million) represented £9 million against the 1997 restructuring charge and £1 million against earlier provisions. The £3 million restructuring charge in 1998 principally represented the costs of further reorganisation within Retail.

Windfall Tax

A one-off Windfall Tax charge of £192 million was incurred in 1997. This was not a tax on current profits and was therefore included within operating costs as an exceptional charge. The first instalment of £96 million was paid in December 1997 and the remainder was paid in December 1998.

5 Directors and employees

a) Employee costs

	1998 £m	1997 £m
Wages and salaries	355	342
Social security costs	28	28
Other pension costs (see note 23)	30	30
Long Term Incentive Scheme	5	2
Employee Profit Sharing Scheme	7	5
	425	407

Details of directors' remuneration, share options, long term incentive scheme interests and pension entitlements on pages 20 to 22 of the Remuneration Report form part of these financial statements. Details of employee share schemes are given on page 24 and in note 20 on pages 39 and 40.

b) Average number of employees during the year

	1998 Number	1997 Number
Energy Supply	6 595	5 365
Services	8 148	8 306
Retail	1 648	1 752
Other	36	–
	16 427	15 423

All staff were employed in the United Kingdom.

6 Net interest

	1998 £m	1997 £m as restated ^a
Interest receivable	84	69
Share of joint ventures' interest receivable	1	–
Total interest receivable	85	69
Interest payable on bank loans and overdrafts	(16)	(19)
Finance lease charges	(2)	(3)
Notional interest arising on discounted items	(23)	(8)
Share of joint ventures' interest payable	(2)	(1)
Total interest payable	(43)	(31)
Net interest receivable	42	38

^a The comparative figures have been restated to reclassify share of associates' and joint ventures' interest receivable and interest payable from 'Share of operating loss in associates and joint ventures' to 'Net interest', in accordance with FRS 9 'Associates and Joint Ventures'.

7 Tax

	1998 £m	1997 £m
UK – corporation tax at 31% (1997 31.5%)	103	204
– deferred corporation tax:		
– deferred petroleum revenue tax relief	(8)	(8)
– other timing differences	(17)	(18)
– change in corporation tax rate from 31% to 30% (1997 33% to 31%)	(6)	(14)
	72	164
– associates	–	2
– joint ventures	3	2
Tax charge ^a	75	168

^a The tax charge arose principally in respect of the profits from tax ring-fenced gas production activities. Losses that have arisen elsewhere in the Group cannot be offset against these ring-fenced profits.

8 Dividend

A special dividend of 12 pence per share, together with a related consolidation of the Company's share capital will be proposed at an Extraordinary General Meeting on 10 May 1999. Under this proposal every ten existing ordinary shares will be consolidated into nine new ordinary shares.

9 Earnings/(loss) per ordinary share

Earnings/(loss) per ordinary share has been calculated by dividing the earnings for the financial year of £89 million (1997 loss £791 million) by the weighted average number of ordinary shares in issue during the year of 4,419 million (1997 4,416 million). The number of shares excludes 19 million ordinary shares (1997 17 million), being the weighted average number of the Company's own shares on the Group balance sheet during the year (see note 12). For the period to 17 February 1997, the weighted average number of BG plc shares in issue has been used on the basis of a one for one allotment on demerger.

The Directors believe that the presentation of an adjusted earnings per ordinary share, being the basic earnings/(loss) per ordinary share adjusted for exceptional charges, assists with understanding the underlying performance of the Group. The reconciliation of basic to adjusted basic earnings per ordinary share is as follows:

	1998		1997	
	£m	Pence per ordinary share	£m	Pence per ordinary share
Earnings/(loss) – basic	89	2.0	(791)	(17.9)
Contract losses and renegotiations	63	1.4	608	13.8
Restructuring costs	3	0.1	35	0.8
Windfall Tax	–	–	192	4.3
Year 2000 costs	19	0.4	–	–
Earnings – adjusted basic	174	3.9	44	1.0

In addition to basic and adjusted basic earnings/(loss) per ordinary share, information is presented for diluted earnings/(loss) per ordinary share. Under this presentation, there are no adjustments to the reported earnings for either 1998 or 1997, but the weighted average number of shares used as the denominator is adjusted. The adjustments relate mainly to notional share awards made to employees under the Long Term Incentive Scheme and the share options granted to employees under the savings-related Share Option Scheme, as follows:

	1998 Number millions	1997 Number millions
Weighted average number of shares in issue	4 419	4 416
Estimated vesting of Long Term Incentive Scheme shares	16	8
Shares issued at a discount under the savings-related Share Option Scheme	28	13
Potentially dilutive shares issuable under the Executive Share Option Scheme	1	–
Weighted average number of shares used in the calculation of diluted earnings/(loss) per ordinary share	4 464	4 437

10 Intangible fixed assets – goodwill

	£m
Cost and net book value	
As at 1 January 1998	–
Acquisitions (see note 13)	10
As at 31 December 1998	10

The amortisation charge for the year was £0.4 million (1997 £nil). There were no intangible fixed assets for the Company (1997 £nil).

11 Tangible fixed assets

	Land and buildings £m	Plant, equipment and vehicles £m	Exploration and production £m	Total £m
Group				
Cost				
As at 1 January 1998	82	286	2 546	2 914
Additions	–	80	23	103
Acquisitions (see note 13)	–	3	275	278
Disposals	(27)	(28)	–	(55)
As at 31 December 1998	55	341	2 844	3 240
Depreciation				
As at 1 January 1998	25	107	1 066	1 198
Charge for the year	2	52	149	203
Disposals	(7)	(15)	–	(22)
As at 31 December 1998	20	144	1 215	1 379
Net book value				
As at 31 December 1998	35	197	1 629	1 861
As at 31 December 1997	57	179	1 480	1 716

The cost and net book value of the Company's tangible fixed assets comprised equipment of £1 million (1997 £1 million).

^a The net book value of the Group's land and buildings as at 31 December 1998 comprised freehold of £15 million (1997 £36 million), long leasehold of £14 million (1997 £15 million) and short leasehold of £6 million (1997 £6 million).

^b The net book value of tangible fixed assets held under finance leases as at 31 December 1998 within plant, equipment and vehicles was £25 million (1997 £34 million) and within exploration and production was £92 million (1997 £nil). The £92 million within exploration and production represented assets sold and leased back during the year (see note 24h). The Company had no assets held under finance leases (1997 £nil).

12 Fixed asset investments

	Group					Company ^c
	Own shares ^a	Joint ventures and associates			Total	£m
		£m	Shares ^b	Loans		
	£m	£m	£m	£m	£m	£m
Cost						
As at 1 January 1998	13	2	28	3	46	235
Additions	9	–	9	–	18	9
As at 31 December 1998	22	2	37	3	64	244
Amortisation and provisions						
As at 1 January 1998	(2)	–	–	(3)	(5)	–
Long term incentive schemes	(5)	–	–	–	(5)	–
As at 31 December 1998	(7)	–	–	(3)	(10)	–
Share of retained profits less losses						
As at 1 January 1998	–	(15)	–	–	(15)	–
Retained profits less losses for the year	–	(6)	–	–	(6)	–
As at 31 December 1998	–	(21)	–	–	(21)	–
Net book value						
As at 31 December 1998	15	(19)	37	–	33	244
As at 31 December 1997	11	(13)	28	–	26	235

^a The Centrica Employees Share Trust holds 25 million (1997 17 million) shares in the Company, representing 0.56% of the called up ordinary share capital (1997 0.39%), which had a market value as at 31 December 1998 of £30 million and a nominal value of £1 million (1997 £16 million and £1 million respectively). All other investments are unlisted and are held at the lower of cost or directors' valuation.

^b Investments in joint ventures and associates represented the following underlying assets/(liabilities):

	1998 £m	1997 £m
Investments in joint ventures:		
Share of gross assets	18	25
Share of gross liabilities	(39)	(39)
	(21)	(14)
Investments in associates	2	1
	(19)	(13)

The Group share of joint ventures' gross liabilities includes loans payable to the Group amounting to £19 million (1997 £14 million).

^c The Company's investments represented £222 million (1997 £222 million) of ordinary shares in GB Gas Holdings Limited and a £22 million investment in own shares (1997 £13 million).

The principal undertakings of the Group are listed in note 29 on page 47.

13 Acquisitions

The Group acquired Centrica Resources Limited (formerly known as PowerGen North Sea Limited) on 26 November 1998 and Supergas Limited and its subsidiary undertakings on 13 March 1998. The acquisition method of accounting has been adopted. The analysis of net assets/(liabilities) acquired and the fair value to the Group was as follows:

	Centrica Resources Limited ^a			Supergas Limited ^a	
	Book value £m	Accounting policy alignment ^b £m	Fair value adjustment ^c £m	Fair value £m	Book and fair value £m
Fixed assets	236	(1)	40	275	3
Stocks	1	–	–	1	–
Debtors	7	–	–	7	3
Cash at bank and in hand	36	–	–	36	–
Creditors (amounts falling due within one year)	(40)	–	–	(40)	(1)
Loans (amounts falling due within one year)	(134)	–	–	(134)	(5)
Creditors (amounts falling due after more than one year)	(7)	–	–	(7)	(3)
Provisions for liabilities and charges	(6)	(9)	–	(15)	–
Net assets/(liabilities) acquired	93	(10)	40	123	(3)
Goodwill arising (see note 10)				–	10
				123	7
Consideration:					
Cash				123	1
Deferred consideration ^d				–	6
Total consideration				123	7

^a The profit after tax for Centrica Resources Limited, from 30 March 1998 to 25 November 1998, was not material, and for the year ended 29 March 1998 was £8 million. Supergas Limited was not a material acquisition.

^b Adjustments were made to align the accounting policies of Centrica Resources Limited with those of the Group. Fixed assets were reduced by £1 million to reflect a change in policy for accounting for exploration costs from the full cost to the successful efforts method. Centrica Resources Limited had previously expensed petroleum revenue tax when paid. Provisions for liabilities and charges were increased by £9 million to reflect the Group's policy of recognising petroleum revenue tax on a unit of production basis.

^c The book value of fixed assets has been adjusted to align with the fair value of the assets acquired. The fair value equated to the value in use of those assets at the acquisition date, being the net present value of the estimated future cash flows from those assets.

^d Deferred consideration consists of loan notes issued on acquisition, which are included within borrowings.

14 Stocks

	1998 £m	1997 £m
Gas in storage	82	120
Other raw materials and consumables	17	15
Finished goods and goods for resale	28	33
	127	168

There were no stocks for the Company (1997 £nil).

15 Debtors

	Group				Company		
	1998		1997		1998		1997
Amounts falling due	within one year £m	after one year £m	within one year £m	after one year £m	within one year £m	after one year £m	within one year £m
Trade debtors	225	–	475	2	–	–	–
Accrued energy income ^a	683	–	764	–	–	–	–
Amounts owed by Group undertakings	–	–	–	–	2 003	155	998
Other debtors	172	3	272	–	4	–	3
Prepayments and other accrued income:							
– 'Take or Pay'	47	158	146	163	–	–	–
– Transportation	242	–	271	–	–	–	–
– Other	41	12	24	–	–	–	2
	1 410	173	1 952	165	2 007	155	1 003

^a Accrued energy income is an estimate of money due from customers for energy consumed but not yet billed.

16 Current asset investments

Money market investments^a

Group		Company	
1998 £m	1997 £m	1998 £m	1997 £m
341	56	323	44

^a Current asset investments included £18 million (1997 £12 million) held by the Group's insurance subsidiary undertakings and £2 million (1997 £nil) held by the Law Debenture Trust, on behalf of the Company, as security to cover unfunded pension liabilities. These amounts were not readily available to be used for other purposes within the Group.

17 Borrowings

Amounts falling due

	Group				Company	
	1998		1997		1998	1997
	within one year £m	after one year £m	within one year £m	after one year £m	within one year £m	within one year £m
Bank loans and overdrafts	38	–	4	–	24	2
Obligations under finance leases ^a	17	90	10	19	–	–
Loan notes issued on acquisition (see note 13)	5	1	–	–	–	–
	60	91	14	19	24	2

^a Group obligations under finance leases after more than one year as at 31 December 1998 were repayable as follows: between one and two years £18 million (1997 £5 million); between two and five years £48 million (1997 £14 million); and after five years £24 million (1997 £nil). As at 31 December 1998 the Company had no finance lease obligations (1997 £nil).

18 Other creditors

Amounts falling due

	Group				Company	
	1998		1997		1998	1997
	within one year £m	after one year £m	within one year £m	after one year £m	within one year £m	within one year £m
Gas Levy payable	–	–	44	–	–	–
Trade creditors	496	–	476	–	2	1
Amounts owed to Group undertakings	–	–	–	–	1 438	866
Taxation and social security	162	–	251	–	–	–
Accruals and deferred income	335	15	343	4	7	11
Windfall Tax	–	–	96	–	–	96
Special dividend payable	530	–	–	–	530	–
Other	80	63	238	70	1	2
	1 603	78	1 448	74	1 978	976

19 Provisions for liabilities and charges

	As at 1 January 1998 £m	Acquisition (see note 13) £m	Profit and loss charge/(credit) £m	Notional interest £m	Utilised in the year £m	As at 31 December 1998 £m
Group						
Abandonment costs	72	6	10	–	–	88
Deferred petroleum revenue tax	653	9	27	–	–	689
Deferred corporation tax ^a	198	–	(31)	–	–	167
Pension costs (excluding restructuring)	18	–	18	–	–	36
Restructuring costs:						
– Pension	6	–	–	–	(3)	3
– Other	12	–	3	–	(7)	8
Sales contract loss and renegotiation provisions	260	–	–	19	(8)	271
Other	16	–	6	–	–	22
	1 235	15	33	19	(18)	1 284
Company						
Pension costs	3	–	–	–	–	3
Other	6	–	3	–	–	9
	9	–	3	–	–	12

^a Group deferred tax (assets)/liabilities comprise:

	Amounts provided		Potential amounts unprovided/(unrecognised)	
	1998 £m	1997 £m	1998 £m	1997 £m
Accelerated capital allowances	359	403	21	16
Deferred petroleum revenue tax relief	(204)	(202)	–	–
Other timing differences including losses carried forward	12	(3)	(368)	(374)
	167	198	(347)	(358)

There were no potential deferred tax assets/liabilities for the Company (1997 £nil).

20 Called up share capital

	1998 £m	1997 £m
Authorised share capital of the Company		
5 500 000 000 ordinary shares of 5 pence each	275	275
100 000 cumulative redeemable preference shares of £1 each	–	–
Allotted and fully paid share capital of the Company		
4 438 448 069 ordinary shares of 5 pence each (1997 4 436 200 823 ordinary shares of 5 pence each)	222	222

During 1998 the following ordinary shares were issued on the exercise of employee share options:

	Executive Share Option Scheme		Savings-related Share Option Scheme	
	1998	1997	1998	1997
Number	2 087 391	467 210	159 855	50 094
Nominal value	£104,370	£23,361	£7,993	£2,505
Consideration	£1,670,588	£350,241	£165,838	£42,780

Executive Share Option Scheme

Options over 3.4 million ordinary shares were outstanding as at 31 December 1998 (1997 5.8 million ordinary shares) and are exercisable at varying dates up to 15 November 2004 at prices from 66.975 pence to 90.266 pence per share. Details of outstanding options held by Executive Directors are given on page 22.

20 Called-up share capital continued**Savings-related Share Option Scheme (Sharesave Scheme)**

The Company operates an Inland Revenue approved Sharesave Scheme, which is open to all eligible employees including Executive Directors. The Sharesave Scheme is designed to provide a long-term savings and investment opportunity. Employees can save for periods of three or five years. Options over 22 million ordinary shares were granted during the year (1997 52 million ordinary shares). Options over 67 million ordinary shares were outstanding as at 31 December 1998 (1997 49 million ordinary shares). These outstanding options are normally exercisable at varying dates up to November 2003 at prices of 46.4 pence and 92.2 pence per ordinary share. Details of options held by Executive Directors under the Sharesave Scheme are given on page 22.

Profit Sharing Scheme

The Company has an Inland Revenue approved employee Profit Sharing Scheme (the Scheme) which is for the benefit of all eligible employees, including Executive Directors. The Scheme provides for the distribution to all eligible employees of a proportion of the Company's profit in the form of shares in the Company. Under the Scheme £7 million (1997 £5 million) has been charged to the profit and loss account for the purchase of ordinary shares of the Company. As described on page 24, an allocation under the Scheme will be made in 1999 in respect of the 1998 financial year. When shares are allocated under the Scheme they will be placed in trust for employees for three years.

Long Term Incentive Arrangements

The Centrica Employees Share Trusts (the Trusts) were established to acquire ordinary shares in the Company, by subscription or purchase, with funds provided by the Company, to satisfy rights to shares on the vesting of allocations made under the Company's long-term incentive arrangements. As at 31 December 1998, the Trusts had acquired 25 million ordinary shares at a cost of £22 million (1997 17 million ordinary shares at a cost of £13 million), financed by interest-free loans from the Company. The shares have a market value as at 31 December 1998 of £30 million (1997 £16 million). All administration costs are borne by the Group.

Details of the Long Term Incentive Scheme, in which Executive Directors participate, can be found in the Remuneration report on pages 18 and 19.

21 Reserves

	Group				Company ^a		
	Share premium account £m	Merger reserve £m	Profit and loss account ^b £m	Total £m	Share premium account £m	Profit and loss account £m	Total £m
As at 1 January 1998	–	467	622	1 089	–	74	74
Transfer (to)/from profit and loss account for the year	–	–	(441)	(441)	–	419	419
Issue of ordinary share capital	2	–	–	2	2	–	2
As at 31 December 1998	2	467	181	650	2	493	495

^a As permitted by Section 230(3) of the Companies Act 1985, no profit and loss account is presented for the Company. The Company's profit for the financial year was £949 million (1997 £74 million).

^b Cumulative goodwill taken directly to reserves as at 31 December 1997 amounted to £85 million. This goodwill had been taken to reserves as a matter of accounting policy and will be charged in the profit and loss account should there be a subsequent disposal of the business to which it related.

22 Movement in shareholders' funds

for the year ended 31 December

Issue of shares

Goodwill written off directly to reserves

Net movement in shareholders' funds for the financial year

Shareholders' funds as at 1 January

Shareholders' funds as at 31 December

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Profit/(loss) for the financial year	89	(791)	949	74
Dividend	(530)	–	(530)	–
	(441)	(791)	419	74
Issue of shares	2	–	2	222
Goodwill written off directly to reserves	–	(85)	–	–
Net movement in shareholders' funds for the financial year	(439)	(876)	421	296
Shareholders' funds as at 1 January	1 311	2 187	296	–
Shareholders' funds as at 31 December	872	1 311	717	296

23 Pensions

Substantially all of the Group's employees as at 31 December 1998 were members of either the Centrica Staff Pension Scheme (staff and management employees) or the Centrica Engineers Pension Scheme (engineers). These schemes are funded to cover future pension liabilities in respect of service up to the balance sheet date. They are subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contributions which, together with the specified contributions payable by the employees and proceeds from the Schemes' assets, are expected to be sufficient to fund the benefits payable under the Schemes.

Centrica employees participated in British Gas Schemes until 31 March 1998. From 1 April 1998 Centrica employees and a small number of pensioners and deferred pensioners joined either the Centrica Staff Pension Scheme or the Centrica Engineers Pension Scheme. These new defined benefit schemes provide identical benefits to the British Gas Schemes as at 31 March 1998. A share of each of the British Gas Schemes' assets was transferred during the year to the corresponding new Centrica Schemes, proportional to the share of the total accrued British Gas Schemes' liabilities as at 31 March 1998 that were attributable to Centrica employees, or former employees, electing to transfer.

The long-term assumptions applied to calculate Centrica pensions costs, as agreed with the independent actuary, are set out below:

	Up to 31 December 1997 %	From 1 January 1998 %
Rate of price inflation and pension increases	4.0	3.0
Annual rate of return on investments	8.25	7.25
Future increases in earnings	6.0	5.0
Dividend growth	4.0	3.75

The independent actuarial valuation as at 31 March 1998 showed that the aggregate actuarial value of the Centrica Staff Pension Scheme's assets was £490 million and the aggregate actuarial value of the Centrica Engineers Pension Scheme was £277 million. The respective actuarial values represented 113% and 116% of the benefits due to members, calculated on the basis of pensionable earnings and services as at 31 March 1998 on an ongoing basis using the projected unit method.

The pension costs arising, together with unfunded pension costs, and the reconciliation to balance sheet provisions were as follows:

	Staff Pension Scheme		Engineers Pension Scheme		Total	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
Regular pension costs	29	35	13	17	42	52
Amortisation of surplus	(4)	(9)	(3)	(2)	(7)	(11)
	25	26	10	15	35	41
Interest	(3)	(9)	(2)	(2)	(5)	(11)
Net pension costs	22	17	8	13	30	30
Contributions paid	(8)	(8)	(4)	(4)	(12)	(12)
Increase in provision for pension costs	14	9	4	9	18	18
Increase in provision for pension related restructuring costs	–	6	–	–	–	6
Utilisation of restructuring provision	(3)	–	–	–	(3)	–
Balance sheet provision as at 1 January	15	–	9	–	24	–
Balance sheet provision as at 31 December	26	15	13	9	39	24

24 Notes to the group cash flow statement

a) Reconciliation of operating profit/(loss) to operating cash flow

	1998 £m	1997 £m
Group operating profit/(loss)	123	(660)
Exceptional charges	85	835
Group operating profit before exceptional charges	208	175
Depreciation and amortisation	203	211
Provisions	58	67
Profit on sale of tangible fixed assets	(7)	–
Decrease/(increase) in working capital:		
– Stocks – decrease/(increase)	41	(44)
– Debtors – decrease	429	670
– Creditors – decrease	(62)	(51)
	408	575
Cash inflow from operating activities before exceptional expenditure	870	1 028
Expenditure relating to exceptional charges: ^a		
– Contract renegotiations	(86)	(464)
– Restructuring	(10)	(93)
– Windfall Tax	(96)	(96)
– Year 2000	(19)	–
	(211)	(653)
Cash inflow from operating activities after exceptional expenditure	659	375

^a The relationship of exceptional payments to exceptional charges is explained in note 4.

b) Returns on investments and servicing of finance

	1998 £m	1997 £m
Interest received	75	66
Interest paid	(15)	(20)
Interest element of finance lease rental payments	(2)	(3)
	58	43

c) Taxation paid

	1998 £m	1997 £m
UK corporation tax paid	(217)	(112)
Consortium tax relief received	2	–
	(215)	(112)

d) Capital expenditure and financial investment

	1998 £m	1997 £m
Purchase of tangible fixed assets	(92)	(59)
Sale of tangible fixed assets	40	4
Purchase of own shares	(9)	(13)
Loan to a joint venture	(9)	(17)
Loan to a trade investment	–	(2)
	(70)	(87)

24 Notes to the group cash flow statement continued

e) Acquisitions

	1998 £m	1997 ^a £m
Payments on acquisition of subsidiary undertakings (see note 13) ^b	(124)	–
Payments of deferred consideration ^c	(13)	(16)
Total cash payments	(137)	(16)
Cash acquired	36	19
	(101)	3

^a In 1997 acquisitions represented the change in the investment in Accord Energy Limited.

^b In addition to the above cash consideration, acquired businesses had debts aggregating £139 million on the date of acquisition which have been repaid by the Group (see note g) below).

^c Payments of deferred consideration represented preference dividends paid in relation to the change in the investment in Accord Energy Limited in 1997. Of the total deferred consideration of £98 million, £29 million had been paid by 31 December 1998 and after discounting adjustments, £79 million (1997 £87 million) remained outstanding within creditors.

f) Management of liquid resources

	1998 £m	1997 £m
Net purchase of money market investments	(285)	(44)

g) Financing

	1998 £m	1997 £m
Debt due within one year:		
– Net increase/(decrease) in short-term borrowings	24	(2)
– Net decrease in funding from BG plc	–	(160)
– Repayment of loans	(139)	–
Capital element of finance lease rentals	(21)	(16)
Sale and leaseback of fixed assets (see note 24 h)	92	–
Issue of ordinary share capital	2	–
	(42)	(178)

h) Analysis of cash and money market investments, net of debt

	As at 1 January 1998 £m	Cash flow £m	Acquisitions (excluding cash and overdrafts) £m	Other non-cash changes £m	As at 31 December 1998 £m
Cash at bank and in hand	18	15	–	–	33
Overdrafts	(4)	(10)	–	–	(14)
		5			
Bank loans	–	(24)	–	–	(24)
Other loans due within one year	–	139	(139)	(5)	(5)
Other loans due after more than one year	–	–	–	(1)	(1)
Finance lease obligations	(29)	(71)	–	(7)	(107)
		44			
Current asset investments	56	285	–	–	341
	41	334	(139)	(13)	223

Other non-cash changes represented finance lease arrangements which the Group entered into during the year in respect of assets with a total capital value at the inception of the leases of £7 million, and deferred consideration of £6 million issued on the acquisition of Supergas Limited (see note 13). An additional £92 million in finance lease obligations arose following the sale and leaseback of certain Morecambe gas field fixed assets. This amount has been included as part of the cash flow movement.

25 Commitments and contingencies

a) Capital expenditure

As at 31 December 1998, the Group had placed contracts for capital expenditure amounting to £7 million (1997 £3 million). There were no capital expenditure commitments for the Company (1997 £nil).

b) Abandonment costs

Total estimated future abandonment costs of the Group relating to exploration and production assets, at 31 December 1998 prices, were £193 million (1997 £187 million). These costs are expected to be eligible for tax relief. The amount provided by the Group as at 31 December 1998 was £88 million (1997 £72 million).

Centrica plc and its wholly owned subsidiary, Hydrocarbon Resources Limited, have agreed to provide security to a subsidiary undertaking of BG plc, BG Exploration and Production Limited, which, as original licence holder for the Morecambe gas fields, will have exposure to abandonment costs relating to the Morecambe gas fields should liabilities not be fully discharged by the Group. The security is to be provided when the estimated future net revenue stream from the Morecambe gas fields falls below 150% of the estimated cost of such abandonment. The nature of the security may take a number of different forms and will remain in force unless and until the costs of such abandonment have been irrevocably discharged and the relevant Department of Trade and Industry abandonment notice in respect of the Morecambe gas fields has been revoked.

c) Lease commitments

As at 31 December 1998 operating lease commitments of the Group for the following year were:

	Land and buildings		Other	
	1998 £m	1997 £m	1998 £m	1997 £m
Expiring:				
Within one year	–	1	3	4
Between one and five years	5	1	12	11
After five years	18	14	–	–
	23	16	15	15

There were £3 million (1997 £nil) of land and building operating lease commitments for the Company. The Company has guaranteed operating lease commitments of a subsidiary undertaking for the following year of £7 million (1997 £5 million) in respect of land and buildings.

There were no commitments as at 31 December 1998 under finance leases entered into, but for which inception occurs after 31 December 1998 (1997 £nil), for the Group and Company.

d) Litigation

The Group has a number of outstanding disputes arising out of its normal activities, for which appropriate provisions have been made.

e) Year 2000/euro

The Group was committed as at 31 December 1998 to £1 million (1997 £1 million) of expenditure on Year 2000 modifications. No expenditure has been committed in respect of the introduction of the euro. Estimated future costs are referred to in the financial review on page 13.

f) Guarantees and indemnities

The Company has a £1,000 million revolving credit facility. The major subsidiary undertakings of the Group have guaranteed, jointly and severally, to pay on demand any sum which the Company does not pay in accordance with the facility agreement.

The Group has indemnified BG plc in respect of payments and/or losses, damages, claims, expenses or liabilities of any nature, arising out of or in connection with the Group's performance under certain long-term interruptible contracts which BG plc has guaranteed to third parties. Under the terms of the indemnity the Group will, in consideration of the guarantee, pay to BG plc a fee on each anniversary during the continuation of the guarantee.

Centrica plc and BG plc have agreed, subject to certain limitations, to indemnify each other against certain actual and contingent liabilities associated with their respective businesses.

In relation to the sale and leaseback of Morecambe gas field fixed assets, the Company has given guarantees amounting to £92 million in respect of the sale and leaseback recorded in these financial statements and £113 million in respect of a similar transaction disclosed as a post balance sheet event in note 28.

The Company has given guarantees to various counter-parties in relation to wholesale energy trading.

25 Commitments and contingencies continued

g) Gas purchase contracts

The Group is contracted to purchase 97 billion therms of gas (1997 108 billion therms) under long-term contracts at prices, mainly determined by various baskets of indices, which may exceed market prices from time to time. In the face of full competition in the market for gas, the Group's exposure has been reduced by the renegotiation of lower volumes and/or prices under certain contracts and by entering into long-term sales contracts. Since January 1996 these actions, affecting 58 billion therms, have been achieved at a net present cost to the Group of £1,376 million. Whilst there remains much uncertainty regarding future prices and market share, in the opinion of the Directors, no general provision for onerous contract losses is required.

The total volume of gas to be taken under these long-term contracts depends upon a number of factors, including the actual reserves of gas that are eventually determined to be extractable on an economic basis. Based upon the minimum volume of gas that the Group is contracted to pay for in any year, the profile of the contract commitments, after taking account of the renegotiations referred to above, is estimated as follows:

	1998 million therms	1997 million therms
Within five years	48 800	55 400
After five years	48 300	52 800
	97 100	108 200

The Directors do not consider it feasible to estimate the actual future cost of committed gas purchases as the Group's external weighted average cost of gas ('WACOG') is subject to indexation. As a consequence of the price renegotiations referred to above, the Group's external WACOG reduced to 16 pence per therm for the three month period ended 31 December 1998. Applying this value would imply a Group financial commitment of approximately £16 billion (1997 £21 billion based on 19 pence per therm for the year ended 31 December 1997) analysed as follows:

	1998 £m	1997 £m
Within one year	1 900	2 700
Between one and five years	5 900	7 900
After five years	7 700	10 400
	15 500	21 000

26 Related party transactions

a) BG plc

In both 1998 and 1997, BG plc was the largest supplier to the Centrica Group and all transactions have been on an arm's length basis on normal commercial terms. On 17 February 1997 the Centrica Group was demerged from BG plc (formerly known as British Gas plc). Prior to that date BG plc exercised control over all of the businesses within the Centrica Group and provided a number of Group services to those businesses. As a consequence the following disclosures were given in the 1997 Annual Report:

During the year, purchases of gas, storage and transportation from the BG Group were material, and amounted to £2,804 million. The Centrica Group also sold gas to BG plc to the value of £128 million and received interest on transportation prepayments amounting to £36 million. It has not been practicable to quantify all other, and less material, services arising between the Groups.

As at 31 December 1997 the Centrica Group had prepaid £271 million for transportation charges and owed the BG Group £53 million for gas purchases and other liabilities, principally finance lease obligations. Prior to demerger on 17 February 1997, the Centrica businesses were funded by BG plc. As at 31 December 1996 the funding balance was £160 million and upon demerger, the Centrica Group repaid the outstanding funding balance at that date of £505 million.

BG plc is no longer a related party of the Centrica Group and therefore the above disclosures are not required for the year ended 31 December 1998.

As described in note 23, employees of the Centrica Group continued their membership of the British Gas Staff Pension Scheme or the British Gas Corporation Pension Scheme until 31 March 1998. From 1 April 1998 Centrica employees have been eligible to join the new Centrica Schemes. A share of the assets of the British Gas Schemes, with a market value amounting to £664 million for the Staff Pension Scheme and £375 million for the Engineers Pension Scheme, was transferred to the corresponding new Centrica Schemes. The amount transferred reflected the share of the total accrued British Gas Schemes' liabilities as at 31 March 1998 that was attributable to Centrica employees, or former employees, who elected to transfer.

26 Related party transactions continued

b) Associates and joint ventures

During 1998 the Group purchased services with a value of £50 million (1997 £71 million) from AccuRead Limited, a joint venture, and £36 million (1997 £42 million) from AG Solutions Limited, an associate. Between 1 January 1997 and 3 March 1997 the Group purchased £4 million of gas from, and sold gas to the value of £9 million to Accord Energy Limited, which was an associate during that period.

In 1998 the Group lent £9 million (1997 £17 million) to Goldbrand Development Limited. As at 31 December 1998 the outstanding balance on the loan account was £37 million (1997 £28 million).

c) Pension schemes

The administrative costs of the Centrica Staff and Engineers Pension Schemes amounting to £1 million were borne by the Group. During 1997 an appropriate share of the British Gas Staff and Corporation Pension Schemes' administrative costs, amounting to £1 million, was borne by the Group.

d) Non-Executive Director

The Group in conjunction with Privilege Insurance Company Limited ('Privilege') marketed home and contents insurance under the brand names British Gas Home Insurance and Goldfish Home Insurance during the year. Under the terms of the Agreement, both the Group and Privilege would bear an equal share of the costs and receive an equal share of the profits, if any. The Group's share of the net costs incurred under this arrangement with Privilege amounted to £2 million (1997 £nil).

Peter Wood, a Non-Executive Director of Centrica plc, was able to exercise more than 30% of the votes able to be cast at general meetings of Privilege Insurance Holdings Limited, the parent company of Privilege, until 7 October 1998 when he disposed of his interests.

27 Financial instruments

a) Foreign exchange risk

Foreign exchange risk arises from exposure to the US dollar/sterling exchange rate within long-term gas purchase contracts. The Group's policy is to hedge part of this risk by the purchase of forward rate contracts. As at 31 December 1998, losses of £16 million (1997 £9 million) have been deferred from recognition in the profit and loss account, of which £3 million are expected to be expensed in 1999. A net loss of £1 million was charged to the profit and loss account during 1998. Realised deferred losses as at 31 December 1998 of £15 million (1997 £nil) are included within prepayments on the Group balance sheet, and £1 million (1997 £9 million) of unrealised losses are off-balance sheet.

b) Fair values of financial assets and liabilities

For debtors, creditors, current asset investments, cash and debt, book values as at 31 December 1997 and 1998 approximated to fair values.

28 Post balance sheet event

On 4 March 1999, £113 million of cash was raised through the sale and leaseback of certain South Morecambe gas field operational assets. This transaction has not been reflected in these financial statements.

29 Principal undertakings

As at 31 December 1998^a

Subsidiary undertakings:

	% Group holding in ordinary shares and net assets	Principal activity
Accord Energy Limited ^b	100	Wholesale energy trading
British Gas Energy Centres Limited	100	Sale of appliances
British Gas Services Limited	100	Servicing and installation of gas heating systems
British Gas Trading Limited	100	Energy supply
Centrica Insurance Company Limited	100	Insurance services
Centrica Reinsurance Company Limited	100	Insurance services
Centrica Resources Limited ^c	100	Gas production
GB Gas Holdings Limited	100	Holding company
Goldfish Guide Limited	100	Consumer services
Hydrocarbon Resources Limited	100	Gas production from the Morecambe fields

Joint ventures:

AccuRead Limited	49	Meter reading
Goldbrand Development Limited	50	Financial services

Associates:

AG Solutions Limited ^c	40	Computer consultancy
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^a As at 31 December 1998, GB Gas Holdings Limited was a wholly owned subsidiary undertaking of the Company. GB Gas Holdings Limited held the investments in all other principal undertakings, except for Hydrocarbon Resources Limited where the investment was held by British Gas Trading Limited. All principal undertakings were incorporated and operated in the United Kingdom with the exception of Centrica Reinsurance Company Limited and Centrica Insurance Company Limited which were incorporated in and operated from the Isle of Man.

^b During 1997 the Group agreed with NGC Corporation (NGC) of Houston, Texas, to a reorganisation of the share structure of Accord Energy Limited (Accord). NGC's ordinary shareholding was converted into a 25% holding of preference shares in Accord and the Group has an option, which it is likely to exercise, to acquire those preference shares on or after 1 July 2000. The Group currently holds 75% of the preference shares in Accord. The change of control was accounted for as an acquisition for deferred consideration. Third party preference dividend payments and the capital payment anticipated on exercise of the Group's option are being/will be set against the deferred consideration of £98 million established upon change of control.

^c Centrica Resources Limited and AG Solutions Limited have accounting reference dates of 31 March.

Shareholder information

Analysis of shareholders as at 31 December 1998

Distribution of shares by type of shareholder	Holdings	Shares
Nominees	7 127	3 569 434 173
Limited companies	1 051	45 334 426
Banks	41	211 051
Insurance companies	37	72 413 896
Pension funds	48	27 803 541
Other corporate bodies	812	37 569 350
Individuals	1 285 355	685 681 632
Total	1 294 471	4 438 448 069

Size of shareholding	Number of shareholders	Number of shares held
1 – 500	840 868	218 275 582
501 – 1 000	315 090	207 470 060
1 001 – 5 000	129 773	214 313 779
5 001 – 10 000	5 638	38 982 293
10 001 – 50 000	1 660	30 122 364
50 001 – 100 000	215	16 159 129
100 001 – 1 000 000	794	304 098 399
1 000 001 and above	433	3 409 026 463
Total	1 294 471	4 438 448 069

Registrar

Administration enquiries about the holding of Centrica shares (other than ADRs – see below) should be directed to the Company's Registrar. Changes of address and name should be communicated to the Registrar promptly. The Registrar can be contacted as follows:

Lloyds TSB Registrars
54 Pershore Road South
Birmingham B22 1AD
Telephone: 0121 433 4344

Amalgamation of accounts

Shareholders receiving duplicate sets of company mailings due to multiple accounts in their name should write to Lloyds TSB Registrars to have their accounts amalgamated.

American Depository Receipts

On 11 February 1998 Centrica introduced an American Depository Receipt (ADR) programme. The ADRs, each of which is equivalent to 10 ordinary shares, are issued by The Bank of New York. For enquiries about the ADR service, please contact our representatives at The Bank of New York by dialling 1 888 BNY ADRS inside the US and 001 212 815 5204 outside the US or by writing to The Bank of New York, Shareholder Relations, PO Box 11258, Church Street Station, New York, NY 10286-1258.

Share apportionment and capital gains tax base cost of shares at demerger

Shares were acquired in Centrica plc at demerger from BG plc on the basis of one Centrica share for every BG share held at demerger. Shares in Centrica plc acquired on demerger from BG plc will

be treated as having a base cost for Capital Gains Tax purposes ascertained by reference to the values of Centrica and BG shares on 17 February 1997, calculated in accordance with the provisions of Section 272 of the Taxation of Chargeable Gains Act 1992. The base cost of any holding of BG shares on that date will be adjusted on the same basis. The relevant prices on the London Stock Exchange on 17 February 1997 were: Centrica 64.25 pence; BG 173.25 pence. The base cost of the pre-demerger British Gas plc shares will be split between the post demerger Centrica and BG shares in the proportion Centrica 27.053% and BG 72.947%.

Share capital consolidation

A resolution will be put to an Extraordinary General Meeting on 10 May 1999 that the ordinary shares of the Company should be consolidated on the basis of nine new ordinary shares for every ten existing shares. This proposed consolidation is linked to the recommended payment of a special dividend of 12 pence per ordinary share which will be considered at the Extraordinary General Meeting.

Share price

Details of the Centrica share price can be found on Ceefax and in the London Share Service pages 'Gas Distribution' section in the Financial Times.

Centrica website

Extracts of this report and further information about the Centrica Group can be found on the Centrica home page at www.centrica.co.uk. Other information on Group businesses can be found at www.gas.co.uk and www.goldfish.com.

Financial calendar

Record Date for the proposed special dividend and share capital consolidation 7 May 1999

Annual General Meeting and Extraordinary General Meeting 10 May 1999

Whittle & Fleming Rooms
The Queen Elizabeth II Conference Centre
Broad Sanctuary
Whitehall
London SW1P 3EE

Shares ex special dividend 11 May 1999
Special dividend payment 23 June 1999
1999 Interim results 9 September 1999

Product information

Shareholders who wish to find out more about any of our products and services should telephone:

0845 600 1 900
Open Monday to Friday, 8am – 8pm;
Saturday, 8am – 6pm.

Centrica plc: Registered Number: 3033654
Charter Court, 50 Windsor Road, Slough, Berkshire SL1 2HA
Telephone: 01753 758000 Facsimile: 01753 758011

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