

Centrica plc AGM – 10 May 2004

Address by Sir Michael Perry GBE, Chairman

I would now like to spend a few minutes reviewing your company's performance during 2003. This is the last meeting that I will have the pleasure of addressing as Chairman, so I also want to reflect a little on the longer-term performance of Centrica since its founding as the product of the demerger from the old British Gas plc, over seven years ago now. I will finish my remarks with a brief comment on what the future might hold for my successor.

But first, how we fared in 2003. In my letter to you all inviting you to attend this meeting, I referred to our steady performance in the face of economic uncertainty. Since then you will have had the opportunity to read our annual review, and you will have noted that our operating profit in 2003 passed the one billion pounds mark for the first time. A very pleasing result, I am sure you will agree.

As is customary, our detailed results were announced to the markets and to the press some three months ago. Let me just refer you to the headline figures, as compared with the previous year.

As I am sure you are aware, these results were very well received by the markets. As a result, and if I take the twelve months since the last AGM, the value of your shares has increased by 30%, yet again outperforming the market as a whole.

The analysts who follow our business closely were particularly pleased to observe that we are now in a position to propose paying a dividend of more than 30% of our earnings. You will be asked to vote on this issue later in the meeting. The directors are proposing a final dividend of 3.7 pence per share to be paid in June 2004. When combined with the interim of 1.7 pence paid last November, this will take the total dividend to 5.4 pence per share, which is an increase of over a third compared with last year.

But back to my review of 2003. As ever we faced some challenging issues. Not least was the unusual combination of a warmer than average year, which reduced demand for energy. Paradoxically, lower demand was coupled with rising wholesale gas and electricity costs, as well as increased charges for using the pipes through which we deliver our gas. We had no alternative but to pass these higher costs on to our customers. However, British Gas continues to offer extremely good value in a highly competitive market, as is evidenced by the strength and resilience of our market share. In addition, the growth in our home services business demonstrates that customers are trusting us to provide an even wider range of essential products and services in their homes. This is helping to ensure that they stay with us in the face of strong competition.

Our telecommunications business is making progress but we fight a continuing battle to try and get a level playing field in the UK market. We welcomed the recent announcement from the telecoms regulator – Ofcom – about the first phase of their review of the telecommunications market. It identifies the questions that need to be asked. However, the regulator now needs to build momentum and move rapidly from asking questions to providing answers. Competition in the telecoms industry has already suffered from too many delays in the regulatory process. We are confident that Ofcom’s findings will conclude there are underlying problems in the structure of the industry. It is common ground that a well-functioning telecommunications market depends on effective and sustainable competition, which we do not yet have in the UK. Regulatory intervention is needed to restrain the entrenched power of the incumbent.

2003 was marked by a very strong performance from the AA, which is now making returns in excess of our cost of capital. Membership is growing, and the ability of our patrols to solve motorists’ problems at the roadside is enhanced by investment in ever more sophisticated technology.

Our businesses in North America had a very good year with profit more than doubling. The growth of Direct Energy in Ontario, Canada, was constrained by government efforts to contain energy prices for consumers, but our operation in Texas demonstrated how well we can perform as an incumbent supplier in a liberalizing market. Texas is a model we shall seek to repeat.

In Europe, our Luminus joint venture in Belgium continues to establish itself in difficult competitive conditions, and in Spain we have made a small start in the SME sector. A modest beginning, but an important toehold as continental Europe liberalizes its energy markets. More on that topic in a moment.

There has been much speculation in the UK media about the future of energy supplies, and it is important that I spend a few moments explaining the Centrica position. First and foremost, Centrica is totally committed to ensuring a safe and secure supply of gas and electricity for our customers. To help us do this we acquired some more power stations in the UK during the course of 2003. As you will have read, we have bought more since. We also announced a major investment in renewable energy, which will help us meet the obligation imposed by the government to supply over 15% of our electricity from renewable sources by 2015.

At this point I thought it would be worth taking a closer look at how we are managing the risks of supplying energy for our customers. Here is a short film, introduced by the Managing Director of Centrica Energy, Jake Ulrich.

[Film]

So as you can see, we are making major efforts to keep our customers supplied with energy wherever we operate.

And of course there is also our gas storage business, Centrica Storage Limited. In December the Secretary of State for Trade and Industry gave final clearance for our purchase of the UK's largest gas storage facility, which provides storage services for a wide range of customers using a depleted gas field called Rough. 2003 was the first full year of our ownership of Rough and it has proved to be a valuable acquisition, and one which is already making exceptional returns.

As you will be aware, your Board has concluded that, subject to his re-election today as a director, Roger Carr will be taking over the reins as your chairman at the end of this meeting. That being so, and in part to prepare him for the task ahead, I thought it would be opportune to spend a few moments taking stock of what we have achieved in the last seven years – a sort of report card, as it were – and reflect on some of the major issues that he will encounter as he leads your Company into its next phase of growth.

Many of you will remember that our shares were worth 64 pence at the time of demerger back in 1997. For those of you who have held shares since then, at the current price of well over two pounds, the appreciation in your capital invested, together with the dividends paid out since then, all add up to a total return which is as good, if not better, than any you could have received from an investment in a FTSE company over that period.

We've moved from a position in the bottom half of the FTSE 100 to the top 30. Our market capitalization has grown from £2.9bn in 1997 to £9.5bn at the closing share price last Friday. An increase of more than 300%. In Britain we have expanded our business from gas into electricity, telecommunications, roadside services and a whole range of home services. We have established a firm foothold in North America and have made a start on Continental Europe.

None of this would have been possible without attracting and retaining outstanding management. I can assert, without fear of contradiction, that over the past seven years we have built one of the strongest executive teams in the country, under the excellent leadership of Sir Roy Gardner. To support them, we have seen the creation of a strong, cohesive Board of Directors, with an appropriate balance of experience across both the non-executive and executive members.

We have developed governance processes and practices, which I believe are exemplary, and in which all our stakeholders can have full confidence.

And finally we have embraced the challenge of corporate responsibility. We are committed to ensuring that we fully understand, manage and report on the social, economic and environmental impact of our business activities.

So what of the future? As I hand over to Roger I believe that Centrica is in a very good position to continue to grow. We have established a solid platform and we have delivered steady progress over successive years.

However, there is a backdrop of continuing global economic uncertainty, which brings with it an uncertain outlook for energy prices. This makes it all the more important for us to continue to focus on the three pillars of our strategy – developing relationships with our customers, successfully managing risk in energy markets and sharing knowledge and best practice. The second pillar is particularly important in this environment, and you heard about our current energy management activities in the film.

We believe that the best guarantee for sourcing a safe, diverse and reliable supply of energy into the future is a legal and regulatory framework providing markets which are fully competitive and transparent. The UK leads the way on this, and over the last seven years British energy suppliers have demonstrated the proof.

In Continental Europe progress is much slower, but we have taken encouragement from the introduction of the new energy directives by the European Commission, and we trust that deregulation will now actually happen in the member states. The commercial markets for energy are due to be fully open this summer and the residential markets by 2007.

However, the key to proper implementation of the directives is to allow effective competition to develop. For that we need to see real progress in the key markets. Specifically we need to see evidence that the new regulatory regime in Germany is effective, and we need signs that the French market will be opened up effectively and on time.

In North America the regulatory and political environment continues to be varied. Some states, such as Texas, are moving forward apace, while others are more hesitant. Our task is to demonstrate, wherever we can, that the model of market liberalization works, to the benefit of customers and society as a whole.

Our own commitment to working within the framework of competitive markets remains firm. If Governments who have agreed to the principle remain equally firm in their commitment to turning the principle into a practical reality, there is every reason for confidence that the long-term outlook for security of supply in both gas and electricity is secure. There is evidence that the international community sees the sense of this, and that continuing economic liberalisation in various ways, such as the Lisbon agenda, which has been adopted by the EU, will be facilitated.

Meanwhile Centrica will continue to make the necessary investments to ensure that we secure supplies for our customers in the coming decades. This will see gas coming from Norway and Holland through pipelines connecting the UK to mainland Europe, and shipments from further afield in the form of liquefied natural gas (LNG). In the process we will see the market for gas becoming more and more international, with sources of supply increasingly diverse.

Another key feature of the energy landscape over the next few years will be the series of measures designed to deliver a low carbon economy. We have already seen the UK government extend the obligation on suppliers to source electricity from renewable supplies such as wind power to over 15% by 2015. In addition an EU-wide scheme to reduce emissions of greenhouse gases will come into force from next year. All these measures, however desirable in their own right, will inevitably create upward pressure on energy prices. As a consumer-led organisation in a competitive market we are obliged to do all we can to minimize the effect of these impacts on prices to our customers, and we will continue to seek new ways to offer our customers good service and value for money. That is precisely why competition is good for prices and for customers.

To this end Centrica has worked closely with the UK Government to ensure that the emissions trading scheme is designed in a manner which minimises the impact on consumers by ensuring that there is a proper market for carbon. We are making significant investments in offshore wind capacity to meet our obligation to provide our share of the renewable obligation.

As well as managing the risk of providing energy we will remain focused on staying well ahead of our competitors by providing innovative products and services that our customers both want and prefer, supported by the third pillar of our strategy, enhanced knowledge and shared best practice. By so doing, I believe we are well placed to remain a leading provider of essential services for many years to come, both at home and ever further afield.

Before I close, I just want to express my thanks to all my colleagues on the Board, and through Roy Gardner to the full Executive team, for making the past seven years an exhilarating and rewarding experience for me personally. It is their professionalism and leadership, and not I, who have caused the company to grow and prosper, and I am deeply grateful to them.

I also want to thank you our shareholders for your support in continuing to invest in Centrica. The early years were not easy, but as we have begun to deliver our strategy and reward you in both capital appreciation and dividends, I trust you feel that your patience has been vindicated.

Last but not least I want to pay tribute to our employees. Success never happens without a great deal of change and change isn't always easy. The commitment and dedication of all our employees is what has made the whole enterprise possible.

Thank you for your attention. I would now like to invite our chief executive, Sir Roy Gardner to give you an update on our progress during 2004 and his outlook for the rest of the year.

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