Centrica plc

Preliminary Results 2002

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Introduction

Sir Michael Perry GBE

Chairman

I. Welcome

Good morning Ladies and Gentlemen. It is good to see you here in such large numbers for this presentation of Centrica's preliminary results for the year ending 31 December 2002. Before I invite Roy and Phil to take you through the detail of our results and our achievements, I would like to offer a few introductory observations.

II. Observations

First and foremost, 2002 was a good year for Centrica, taken as a whole, and our results were well up to market expectations. The economic backdrop for this result has in generally been more difficult than previous years and added to that, the progress of market liberalisation continues to be slower in some sectors and in some countries than we would have liked.

In our heartland of UK energy distribution, however, we performed well and we set the pace in the marketplace, which our competitors try to keep up with. The AA too is leaving its competitors standing by the roadside, if you pardon the pun. Anybody who has seen this week's edition of Marketing Magazine might enjoy the headline in that regard as much as I did – something like, 'What does the RAC have to do to catch up with the AA?'.

In North America, public confidence in the liberalisation of energy has suffered a few well-publicised shocks and state governments are being understandably more cautious. In Ontario, Canada, the liberalisation of electricity distribution ran into trouble because of supply shortage and rocketing wholesale prices and the Government there lost its nerve, hopefully only temporarily.

Here in continental Europe, liberalisation progress is still painfully slow. European Union governments have now agreed firm dates but we are still some years away from the level playing field for energy supplies which already exists in this country. We continue to press and our continent-based competitors continue to take advantage of the delay.

III. People and Governance

Now, a word or two about people and governance: you will all have noted that Mike Alexander is in the process of leaving us to run British Energy. I would like to take this opportunity to pay public tribute to Mike for his share in bringing Centrica from a standing start to where it is today. We wish him success at British Energy, but not too much.

On the non-executive team, we lose Sir Brian Shaw this year, as he reaches the normal retirement age for non-executives in our business. I would also like to pay tribute to Sir Brian for the way he brought the AA into the Centrica family and ensured it was successfully integrated. Sir Brian will continue his association with the AA as chairman of the Independent AA Motoring Trust.

On 1 January, we had the pleasure of welcoming two new non-executives: Helen Alexander, well known to you all and CEO of the Economist Group, brings a wide experience and new insights to our work. Second, Robert Tobin, possibly less well known to you because he hails from across the Atlantic, will bring deep understanding of the North America business scene to our deliberations. I once introduced Bob as the most successful American retailer after Sam Walton. 'Yes' said Bob, 'but Sam is dead'.

IV. The Higgs Report

You might expect me to make an early comment on Higgs. We find much that is good about the long list of Higgs recommendations and little to disagree with. In fact, we practice much of what he recommends already and we shall carry on looking at where to fill the gaps. My one plea on implementation is that it is not overly prescriptive. Exceptions will make good practical sense in some cases but shareholders will rightly expect that exceptions are explained and justified.

V. Integrity and Best Practice

Finally, in this immediately post-Enron period, you would be forgiven for expecting any energy-based company to make a statement about its own standards of governance and probity. Centrica prides itself on strict adherence to best-accepted practice in all these areas. It will be a hostage to fortune for any chairman to declare publicly that there are no skeletons hidden away in any cupboards but that obvious proviso having been made, I can confidently offer you the assurance that the way we present ourselves is the way we are. The Board has taken every conceivable measure to ensure that it is the case.

Overview

Sir Roy Gardner

Chief Executive

I. Introduction

Good morning Ladies and Gentleman and welcome to the presentation of our preliminary results for 2002.

II. Results in Brief

I am not going to dwell too much on this slide. Phil will go through the figures in more detail in a little while. In a challenging year for the industry, we have secured good operating profit and earnings growth and this is the fourth year in a row that pre-tax profit growth has exceeded 20%. As a result of this performance, the Board has proposed a final dividend of 2.6 pence per share, making a total dividend for the year of 4 pence per share, which is a 29% increase on 2001.

III. 2002 Overview

Now let us look at some of the highlights. Group operating profit was up by 37% and this was driven by a number of factors. For example, in our core British Gas business we improved margins in gas. We achieved growth in electricity and Home Services and we benefited from lower churn rates. We strengthened the market position of our Centrica Business Services division.

In the AA, we continued to grow the core businesses, with increasing profitability in roadside and personal finance. In Telecoms, we cut last year's losses by two thirds and we have seen encouraging progress on the development of industry processes such as carrier pre-selection and wholesale line rental. In Goldfish, we achieved growth in the credit card as a result of renewed brand building activity.

We made good strategic progress in North America, adding a leading services business and strong incumbency positions in Texas and Alberta. In Continental Europe, the Energy Directives were a significant step forward, setting out a clear timetable for full market opening. Against this background, we remain optimistic about the opportunities for growth across the Group. Hence our confidence in raising the dividend for the year by 29%.

IV. British Gas Residential

Turning now to the key points across our businesses, starting with British Gas Residential. We increased gas prices to this market at the start of 2002, improving margins significantly. In September, I told you that we had deliberately slowed down our energy sales activity whilst we checked that our agents were sticking to our sales guidelines and that they were focusing on acquiring customers that added value.

We have also reviewed our sales channels and we have shut down those where the costs per acquisition were higher than the customer lifetime value. For example, we no longer use roadshows or agents on a commission-only basis for energy retail sales. Despite this and against the background of lower churn rates overall, we have continued to grow our electricity business, adding, net, some 400,000 customers last year.

Our Home Services business is a key differentiator for British Gas against its competitors and that business grew strongly, with customer relationships up by 18% and a 69% increase in operating profit. Through focusing on value in British Gas Communications, we reduced our losses by two-thirds. We cut back on sales and marketing pending progress on the industry structures and processes that we have been lobbying for.

We also improved cancellation and churn rates through better customer targeting and service improvements. Whilst we are investing into a market in a state of regulatory change, we continue to de-risk our investment plans such that losses will be further halved this year. There is still further work needed by the industry on the practical aspects of Wholesale Line Rental but once we are able to launch a fit-for-purpose product, we will be in a very good position to grow and scale-up profits in 2004. Overall there is a very good outlook for profit growth in British Gas both from continued improvements in gross margin and lower acquisition costs.

V. Residential Gas and Electricity Customers

Let us just look at one of the drivers of customer acquisition costs: churn. As we expected, our increase in residential gas prices had a short-term impact on sales and retention but over the second half of the year, we have returned largely to a position of growth in overall energy accounts. There is clear evidence over the last two years that, other than immediately following a price increase, our residential gas market share has broadly stabilised. The market as a whole is showing signs of lower switching rates in both gas and electricity.

Looking ahead, by focusing on higher value customers, we expect churn to continue to reduce or stabilise, which, together with lower acquisitions costs, will contribute to profit growth in British Gas.

VI. Customer Relationship Management

The other positive impact on profit growth is that we are coming out of the main investment phase of our CRM development and this is a key strategic investment. It underpins our ability to increase cross-selling, reduce cost to serve and enhance the lifetime value of our customers. Investment will support our virtuous circle that I talked about in September:

- Turning data into insights
- Developing relevant and personalised products and services
- Gaining higher sales per customer, which gives us more customer opportunities
- And so more data and more value

In financial terms, the investment reduced British Gas residential profits in 2002 by some £30 million. By 2005, we will be benefiting from higher customer lifetime value, driven by reduced costs to acquire and serve, as well as higher average sales per customer. We are anticipating benefits of over £100 million per annum. Later this year, we are planning to give a separate presentation on our progress and what we plan to deliver through CRM.

VII. Centrica Business Services

Turning now to the second leg of our core UK energy business: Centrica Business Services. We have made two targeted acquisitions, Enron Direct and Electricity Direct, which have contributed to margin growth and a 48% increase in operating profit. We have also built unique skills and experience in key account management and the ability to deal with more complex energy requirements.

Measured by share of supply points, we now have around 27% of the UK commercial energy market. Segmentation analysis shows that these are highly valuable customers with good net margins. Looking forward, we would expect to continue to grow our overall share in this very attractive market and to broaden our offering beyond just energy.

VIII. Energy Management

Supporting our downstream activity is our energy management group, the third leg of our core UK energy business. This group works hand in hand with our downstream businesses to meet our customers' energy needs by optimising scheduling offtakes between our own assets, our long-term contracts and the marketplace. Our aim remains to source some 25% of our energy requirements from our own supply.

Underpinning that, 2002 was a particularly busy year for energy management. We added, net, 130 billion cubic feet of equity gas and now have 2.7 TCF in our reserves. Morecambe gives us considerable production flexibility, which we are looking to replace as that field depletes. We will continue to make use of Rough although, as we have done recently, we will only use a minority of its total capacity, with the balance continuing to be sold to third parties.

In electricity, we have increased our generation interests with the acquisition of Glanford Brigg power station and the tolling agreement with Intergen for Spalding. Going forward, we may have the opportunity to purchase further generation capacity at modest prices and should wholesale prices increase, we can increase output from our existing plants.

We entered into long-term gas production deals with Statoil and Gasunie, securing over 450 billion cubic feet of gas a year for 10 years from 2005 at prices linked to the market. Last week, I was delighted to announce that we have entered into a major purchase contract with British Energy. In a market that has become increasingly illiquid, this contract alone will give us enough electricity to meet around 20% of our requirements in a combination of both baseload and peak. Over half of the power will be supplied at a fixed price and the remainder linked to the market. This is a very significant deal for us and, of course, we hedge forward to manage volatility.

IX. The AA

Moving on from our core UK energy business, let us look at the rest of the Group and we will start with the AA. Roadside and personal finance performed very strongly. Together these two activities generated over £100 million of profit in 2002. We invested in brand development, spending some £10 million on our 'Just AAsk' campaign to raise awareness of the AA's broader range of products and services.

For the third time in five years, the AA won the JD Power award for customer satisfaction and in a survey published in November, the Consumer Association said the AA, as the Chairman said, 'Left the rest standing when it came to service levels'. Real evidence of success in customer service, brand building and cross-selling is shown by the 11% growth in turnover in AA personal finance.

We are investing £100 million in a CRM programme in the AA over the next three years. This will leverage our Group CRM skills and is an important investment underpinning delivery of our value creation targets.

X. One.Tel

Now looking at one of our newer business areas: whilst small financially, One.Tel is the largest fixed-line reseller in the UK residential market and grew its customer base by 23% in 2002. In July, we launched the One.Tel mobile and that supports the brand's positioning as a multi-product communications provider. The regulatory developments in telecoms that I have already spoken

about will change the sector. One.Tel is profitable now and has been since acquisition. With our capital investments and start-up losses behind us, we are well-positioned to grow profit as the market develops.

XI. Goldfish

Our other UK business is Goldfish. Last year, we invested £17 million in main media advertising, raising awareness of the Goldfish brand and driving a return to growth in the card base and an increase in card usage. We made progress with the launch in Q4 of other financial products, for example loans and savings. Despite the delays in getting started, we hit our overall selling target for 2002 with over 200,000 products sold.

The focus for Goldfish in 2003 is to leverage the value of our customer interface and make inroads into the cost-base of our banking platform. Increasing our credit card profits through new card options for example, and growing the savings and loan books will drive growth into profitability and we are on track to start delivering a positive cash contribution by Q4.

XII. North American Energy Supply

1. Ontario

Outside the UK, our major market is North America where, as I have already said, we have made real strategic progress. We could have grown our business more rapidly: the opportunities have been there with a number of market players wanting to get out of the retail function but we have chosen not to pursue those opportunities as they have not given us the value creation potential that we have been looking for.

In the context of slowing momentum on deregulation, our value-maximising strategy has been, and will continue to be, based on focused incumbent acquisitions and selective organic growth. In Ontario, we have maintained a 26% share of the residential gas market. We have around 15% in electricity and 50% in Home Services

Our acquisition of Enbridge Services for C$ 1 billion gave us a platform for cross-selling energy and Home Services. We have created real shareholder value from this acquisition. In December, we launched the Consumers Waterheater Income Fund, from which we realised a significant proportion of our original investment in Enbridge Services. In effect, we have retained the relationship with the customers without ownership of the assets and for nil investment. This has been a great deal.

But in Ontario, we are investing in the early cycle of deregulation and in 2002 there is no doubt that regulatory interference impacted our ability to grow organically. Two new pieces of legislation were rushed in:

- One requires customers to confirm more than once their desire to switch supplier before the transfer in made and requires equally costly procedures every time a customer renewal is sought.
- The other imposes a price cap on electricity until 2006.

We are reviewing how we can work within the new legislation to mitigate the effect on our business. One positive impact of course will be a reduction in customer churn, which will benefit our profit position through lower acquisition costs.

Last month, we relaunched our business in Ontario, introducing a new brand, Direct Energy Essential Home Services, which brings together the strength and heritage of Direct Energy and Enbridge Services. As the market leader in energy and Home Services, we are confident that our combined business in Ontario will continue to generate value.

2. Alberta

Alberta is a market at an early stage of deregulation. Subject to the appropriate legislative changes, we will take a key incumbency position there through acquiring the retail gas and electricity supply businesses of ATCO. The acquisition will give us almost one million regulated customers, equivalent to an 80% share of the residential gas market and 14% of electricity. We will use this base as a platform to expand in the deregulated market, particularly through dual fuel and Home Services.

3. Texas

Our other key market is Texas, where deregulation is well advanced. Our acquisition of the customers of Central Power and Light and West Texas Utilities, together with our existing Energy America operation, make us the third largest electricity retailer in the state. Texas has two very distinct customer groups:

- By taking an incumbency position, we have gained access to those customers in the rural areas who are typically loyal to their traditional supplier.
- In the urban areas, customers are more inclined to switch and there are good prospects for organic growth – in fact, we have seen very encouraging sign-up levels in Texas.

In other areas, including our so-called portfolio states where margins and the regulatory environment are far from stable, we are adopting an opportunistic strategy to growth. We are consciously tempering the pace of our market entry, making acquisitions and initiating sales programmes only when value can be created and we will continue to work with regulators and industry partners on the structural changes needed in the markets. This approach gives us some uncertainty on timing for growth in comparison with our previous expectations.

To date, we have created a 5.5 million customer business and we continue to see opportunity to build further. We have been investing up-front to build a material presence in North America and we firmly believe that we have achieved that in 2002. Having invested in the early cycle, we will start to get ahead of it in 2003 as we drive out returns and scale efficiencies from our acquisitions.

XIII. Business Highlights

To sum up, 2002 has been about building on the themes that characterised our progress in 2001. In every part of our business the emphasis, as always, is on increasing value and not just creating scale. We have achieved profitable growth, both organically and through acquisition. We have got a strategy, which we believe is unique in the industry, of building value from customer relationships. We are making good progress, particularly in our core energy business, where we

have the leading brand and asset positions of the industry in executing the strategic imperatives that underpin this value creation.

Based on the strong profit performance in our core businesses, we have raised our dividend by 29%, a clear sign of the Board's confidence in our ability to grow our earnings and cash flow in the future, whilst making sure that we selectively invest in newly opening markets for growth. We recognise that we have entered certain markets at formative stages of development and we believe that this is the right approach.

By focusing on value, we have de-risked these investments and establishing a presence early should position us ahead of the pack as the potential for value creation becomes evident. In today's climate, I think we have shown yet again that we have a quality team managing a quality portfolio of assets and focus on delivering a value-maximising strategy for Centrica shareholders.

I am going to stop there and hand over to Phil, after which we will go straight into questions and answers.

Financial Overview

Phil Bentley

Group Finance Director

I. Introduction

Thank you, Roy, and good morning everyone. I am going to start with the key value drivers behind these results. I will then touch on our Balance Sheet and cash flow outlook and I will end with some guidance on our investment hurdles.

II. Financial Highlights

Excluding Accord, we added almost £1 billion of sales last year, with turnover now exceeding £10 billion. The principal drivers being higher energy sales to our UK business customers and our expanding electricity and services units in North America. In addition, we achieved 23% growth in residential electricity sales, 12% growth in Home Services and good contributions at One.Tel and Goldfish. Had weather in the UK been seasonally normal, our overall turnover growth would have been 13%.

Sales growth and pricing drove higher gross margins – up 4 percentage points to 30% and operating margins improved 1.8 percentage points to 9.3%. This is the third year of margin improvement, demonstrating our growth momentum and our increasing returns to scale. Given the structural investments we have put in place in North America, Telecoms and Goldfish over the last two years, we believe that margin growth is set to continue.

The proportionately larger rise in our tax charge reflects the 40% rate of taxation on offshore gas production introduced in April last year. However, our overall effective tax rate, at 28%, reflects

our recognition of some £35 million of deferred tax assets being brought through the P&L. Deferred Tax Assets on the Balance Sheet were £36 million, and unrecognised Deferred Tax Assets now standing at £163 million at the year-end. Our overall, our net earnings before exceptionals and goodwill grew by 32% to £636 million and our net margin grew by a percentage point to 6%

III. Operating Profit Analysis

What drove the improvement in our operating profit of £932 million? Clearly the largest year-on-year change was the improvement in the British Gas result, moving from a loss-making position in 2001 to a profit of £244 million in 2002. I will go into further detail on British Gas, Centrica Business Services and Energy Management in a moment, but note that together these businesses grew profit by 45%, despite lower gas production.

The strong underlying performance in both AA and North America is masked in these numbers, as I will show in a minute. Suffice to say now, that we are pleased with the core momentum in both of these two divisions.

Let me now turn to One.Tel and Goldfish. One.Tel's result was underpinned by second half sales growth of some 20% and a gross margin increase of four percentage points to 51% and our £2 million profit was after £12 million in respect of our mobile and broadband launches. In a recurring theme, note that One.Tel's systems investments are largely complete and capable of supporting a doubling of customers over the next few years.

Our Goldfish operating loss reflects the continuing infrastructure build of the banking platform, whilst at the same time there were delays in migrating the credit card and launching new products. Card income grew by 9% and our insurance and savings products have gone well. However, we need to see further volume growth to leverage this banking platform before Goldfish will make a positive contribution.

IV. British Gas Residential

I want to turn now to our top 5 businesses, turning first to British Gas. Continuing growth in electricity, with customer numbers up 8%, more than offset the 5% reduction in gas customers, thus contributing an additional £44 million in the year and higher gas prices to customers added some £182 million of gross margin. The warmer weather reduced profit by £28 million through lower consumption. On transportation, last year we recovered some £54 million of overpayments to Transco made in 2001. Thus showing us a doubled for the year on year delta.

Finally, operating costs rose in 2002. Our new CRM platform increased our cost base before depreciation by £17 million. We incurred an additional £25 million of energy efficiency commitments and an additional £20 million was incurred in respect of debtors arising from industry transfer processes.

British Gas Home Services is showing real value creation: turnover growth was 12% and, through operational leverage, this drove a 69% profit improvement to £61m. The British Gas Communications improvement of £66 million reflected our focus on customer value, not volume. All new customers are now being supplied via CPS and amongst these ARPU is up by 25% and churn is 27% lower.

V. CEMG

Upstream, our profits were impacted by lower gas prices and by volumes, down some 5%. Increased profit from Industrial and Wholesale customers, following hedging losses in 2001, was partly offset by a lower contribution from Accord. Amidst volatile markets, Accord broke even for the year after charging £6 million on the collapse of TXU Europe and whilst Accord was affected by the Interconnector shutdown when delivering to Europe, in the UK this was offset by lower procurement costs to British Gas.

On assets, with a number of UKCS majors disposing of gas interests, we believe there are opportunities to offset the decline of Morecambe and we remain in the market for power stations. We have limited short-term exposure to both rising oil and power prices. Exposure to oil prices is limited because only 16% of our gas needs are now linked to oil prices. Even with oil above $35 per barrel, this would impact procurement costs by only £1 million in 2004, net of our own sales contracts. For power, we are fully hedged in 2003 and largely hedged in 2004 such that a £1/MWhr rise in 2004 would therefore only have a £14 million impact.

VI. Centrica Business Services

Centrica Business Services made excellent progress in 2002, illustrating the importance of channels to market, as well as scale and brand awareness. This is a substantial business and, to put it in context, turnover now exceeds that of the AA. In electricity, organic customer growth of 24% complimented strong results from our acquisitions. Some of our newer customers do have lower gross margins but as we continue to build scale and cost leverage, we should see our 2002 post-tax ROCE of 17% improve even further in 2003.

VII. AA

I mentioned that the underlying performance of the core AA business was good. Roadside profit grew by 23% to £54 million, driven by scale efficiencies. For example, the 6% growth in the membership base required only a 2% increase in our patrol force. AA Personal Finance increased its profit by 17% to £47 million. Customer growth of 6% and a four-point increase in our renewal rate – now at 78% – drove the insurance results. Our loan book grew by 54% to £661 million, with profits increasing by 18% to £20 million.

Our core AA business now makes profits in excess of £100 million and this was after increasing brand building spend by £10 million. In the AA's Other Service division, we incurred £76 million of rebranding costs at the AA Services Centre and efforts to improve uptake from existing AA members, as well as a cost reduction programme, are expected to eliminate Service Centre losses this year.

VIII. North America

Turning to North America, where we have made real strategic progress, adding some £350 million of turnover this year. This 46% growth required considerable investment in management, systems and support costs. In the last year, we opened new offices in Houston and Connecticut, as well as adding to our infrastructure in Toronto and Calgary. We now have the infrastructure to exploit our business base and to grow organically without adding materially to our costs.

Our gas business was impacted by Bill 58 in Ontario and by customer churn when prices fell sharply. However, our new electricity business, which contributed £30 million in higher gross profit, more than offset this decline. The contribution from Enbridge Services, was offset by the decline in upstream profitability, this arose on expiry of some in-the-money third party sales contracts and falling wholesale prices.

In 2003, the upward sloping gas curve should restore organic sales, accompanied by higher profits from our Texas and Enbridge acquisitions. Our Central Power & Light and West Texas Utilities acquisitions didn't impact these figures as the deal closed at the very end of the year. However, the profit resulting from these customers since 1 September, when we took the full economic interest, was approximately £21 million and this served to reduce the deferred consideration in the balance sheet.

Including our overall North American post-tax profit on an annualised basis, North America post-tax ROIC would be 9%. With the strategic investments that we have made in North America, we expect this ROIC to increase further in 2003.

IX. 2002 Cash Flow Drivers

Turning now to our 2002 cash flow drivers, EBITDA was £1.3 billion, up some £299 million on last year, reflecting our operating profit growth. To gain certain tax benefits, we accelerated Transco transportation payments of £168 million in December 2002. Cash PRT and royalties, in excess of the P&L charge, peaked in 2002 at £260 million. Given lower production volumes and wholesale prices, we expect our PRT payments to decrease by approximately £100 million in each of the next two years.

Tax cash payments rose by £83 million and working capital grew by £196 million, reflecting customer growth across the Group, particularly through acquisitions. As these new businesses bed down, we expect to release significant cash from tighter balance sheet management. Capex in 2002 was £449 million, reflecting some £180 million of CRM spend. Capex will be at a similar peak level in 2003 before falling back to pre-CRM levels.

X. Balance Sheet and Debt

Finally, I would like to address our balance sheet and investment framework. Centrica has a strong balance sheet with net assets of £2.4 billion and this continues to be a source of competitive advantage. We remain committed to our single A credit rating as a key element of our financing strategy, both for our working capital funding and for energy trading. We target a debt to debt plus equity ratio below 35%. Note that our year-end net debt of £529 million excludes £196 million of non-recourse debt raised in the sale of the Enbridge water heaters, giving a year-end gearing ratio of some 19%.

XI. Reinvestment Hurdles

We envisage acquisitions in the range of some £400 million to £800 million per annum over the next couple of years, split between upstream power and gas assets and customer acquisitions. We set differential post-tax ROIC targets for each business unit and all are expected to generate a positive spread in excess of the Group WACC.

The Group is moving from a period of considerable reinvestment in growth opportunities and strategic market entries to a period of delivery from these investments and so the strategic focus is now on running our existing businesses through stretching business performance management. For example, 50% of management's bonuses are now dependent upon economic profit improvement.

As a result, we expect to see increases in our business unit ROICs, driving up profit whilst improving capital efficiency. Finally, and in reflection of our evolution from investment to delivery, we expect to see significant increases in our free cash flow and hence dividends over the next few years.

XII. Conclusion

So, to sum up, I believe we are well poised to show real economic profit growth in the next few years. Our 2002 profit and margin delivery was strong, our core UK energy business is performing particularly well and we are clear on the paths to economic profit and ROIC growth from our other investments. This will drive improved cash flow in the future, hence our confidence in increasing our dividend today.

Questions and Answers

Bobby Chada, Morgan Stanley

I want to ask a couple of questions, firstly on working capital. At the interim results, you outlined how you expected working capital to move over the next few years. If I remember rightly, it was £600 million gross over the next three years with a net figure of roughly half of that. Is that still the case given what you have said about potential lower organic growth? Secondly, could you just give us a little bit of detail about how you have calculated the ROIC for North America?

Phil Bentley

The working capital number we gave was really indicating the peak capital requirements that we had within the year. We talked about £100 million per annum, over three years, of incremental. If you look at our working capital increase this time, it is about £364 million. £165 million of that was this acceleration of the Transco payments. That was a one-off – there were tax benefits for paying Transco early and that is what we did.

The balance, if you like, has come from North America growth and also Centrica Business Services, because they are quite high consuming customers that we have taken onboard. As I hinted in the presentation, we are looking to squeeze more cash out of our balance sheets going forward, particularly from these new acquisitions.

The second question was about ROIC. This is on an annualised basis, assuming that the profit from the AEP business in Texas is annualised on an equal basis. We said that we had economic interests of £21 million in the last four months of the year and I think it is probably fair to say that the key period in the market in Texas is actually the summer, when the air-conditioning is on.

So we would actually expect slightly more than that in a full year than simply multiplying by three. We take our net operating profit after tax and depreciation in North America and apply that over our invested capital base, which is about £850 million on an average basis. That is how you get the 9% ROIC.

Ian Turner, Deutsche Bank

Can I ask for a bit more colour on what is going on in the Industrial and Wholesale business and whether the current level of profitability is sustainable going forward?

Sir Roy Gardner

We believe it is. Prices at the moment are reasonably stable so we have got a good indication of pricing generally across the market. We are increasing our share of that business organically so clearly we are pitching our prices at about the right level. What we have to do to improve our margins further is reduce our cost base, which we are in the process of doing. Having taken onboard two new businesses, Enron Direct and Electricity Direct, we are still in the process of integrating those businesses into our new division so there is more cost to come out. We are reasonably happy.

Phil Bentley

I think that if you were talking about the Industrial and Wholesale, that was in terms of the business SME market. But Industrial and Wholesale are the big contracts that we have with, let us say, European customers and power stations here in the UK. You have to look at the 2001 numbers, where we had about £25 million of hedging losses and that is why the year-on-year Industrial and Wholesale profits looks to have gone up as much as it has. When you strip that back, we still think we have a good business there and it will continue to grow, as will the Business Services piece.

Julien Dumas-Pilhou, JP Morgan Credit Research

A quick question regarding the recovery of NTS entry fees. Do you think it will also happen in 2003?

Sir Roy Gardner

I think the simple answer is no.

Phil Bentley

It was a one-off in that they effectively overcharged us in 2001 and then we recovered it in 2002. The net benefit in 2002 was about £54 million but on a year-on-year delta, which is what you saw in the causal track, it is £180 million net. I think we are seeing further reductions in transportation costs generally. That was a particular auction that drove up prices but we are not seeing that in the same way this year.

Caroline Randall, JP Morgan

My first question is about the return on investor capital targets. What sort of timing are you expecting to achieve those targets within? My second question is on the annual acquisition spend of between £400 million to £800 million. Can you give us an idea of how much of that is likely to be on international opportunities? Within those international opportunities, can you split that between the US and whether you are looking to go into Europe?

Phil Bentley

I am not sure what you mean by the ROIC targets. We are looking to grow our businesses above the spread that I indicated in the chart there. If I take North America at 9% today, we are looking for a spread in excess of 12% and I think we are moving forward towards that with the paths to growth that we have laid out.

I think that each business unit will get there at different paces in terms of investment because with Goldfish, as I signalled, we are looking for a breakeven in the second half of the year, so obviously that will not be hitting its ROIC target just yet. In Telco, we think that we have got actually quite a good business there. One.Tel, as we have said, has £2 million after a £12 million launch. 37% of One.Tel customers now have been provisioned on CPS, which is actually driving down churn rates and increasing ARPU. We are expecting to get our returns there up above the targets that we have set but we have not given any indication to the market as to when we will absolutely hit the 12% or 15% targets.

On the question about annual spend, it is hard to say really. It will depend on opportunities. We think there are good opportunities here in the UK and North America for Gas and Power assets. To put it in context, you will get change from £100 million for a 500 million megawatt power station, so that scales that piece of it. If we are acquiring customers, it is going to be in North America and in Europe and that is where we will target that investment.

Andrew Wright, UBS Warburg

Two questions: one regarding Upstream investments in electricity in the UK and in North America. You reiterated your view that 20% of your requirements should come from your own physical assets – are you likely to change that view because of the reduced liquidity and reduced number of counter-parties in the market, and also because of the reduced cost of buying Upstream assets?

The second question is going back to those ROIC targets. How do we interpret that with regard to your incumbent businesses where the book value of investor capital bears only a limited relationship to the value of those businesses? Also, are you including revenue expense gross-related investment in your invested capital?

Sir Roy Gardner

If I could just make a comment on the first piece, we are currently going through the process of reviewing exactly how much, in terms of gas reserves and power generation, we might need in North America. We are not there yet. The initial indication is that is should not be too far adrift from the stance we are taking in the UK.

Phil Bentley

To finish that point about Upstream electricity, we have about 17% cover now in electricity and now the British Energy deal gives us another 20%, so we are getting to a position where we will be fully hedged in 2003 and over 80% in 2004. We may add a couple more power stations but we are not desperate to do so.

The way we would calculate the ROIC is that the revenue expense is effectively deducted in the NOPAT. If you assume what the capital invested would have been if we had bought Centrica two years ago, which is the point that you are making there, our balance sheet is much lower than the current value today. You have only got to see that in terms of the prices customers are being traded for versus the valuation in our balance sheet. Had we bought this whole business at market prices a couple of years ago, our ROIC at the moment is about 11%, so we are above our WACC, clearly creating value. Our ROCE for the Group is about 18%. That reflects the point you are making.

Simon Flowers, Merrill Lynch

This question is about Upstream. You said that you are looking to replace Morecambe reserves as the field declines and you also mentioned Morecambe's flexibility. I was interested to know if the acquisition of Rough and the combination of new reserves gives you similar flexibility and a proxy for Morecambe in the future. Also, do you think that with that combination you can maintain broadly the levels of profit you are getting in CEMG in the future?

Jake Ulrich, CEMG

I will clarify the assumption that Rough adds to the flexibility we are currently used to with Morecambe and some of the other Upstream properties. That is not really the case. Rough is a long-term storage piece and currently we are using it at between 25% and 35% of the total capacity and I do not see any regulatory environment that would allow us to use more than that. That really does not change the way that we are doing our business.

We bought Rough for different reasons – there was a lot of uncertainty with the past owners and there was some uncertainty with us concerning their credit situation and their ability to do the investment required to maintain the deliverability going forward. So forget any tie of Morecambe and Rough.

What we are trying to do is replace the flexibility we have at Morecambe with other Upstream properties. It is very much dependent on changes in the marketplace. It is a very dynamic market as we all know, so as the number of counter-parties change and the credit ratings of these parties change, the market traded depth has decreased recently. We have to review how much flexibility that requires. We will be looking at some investment to maintain or increase that 20% level.

Phil Bentley

Morecambe Bay is more profitable than any other field that we would now be having to buy for market price. Whilst we look to maintain our asset hedge over that period, profits are going to decline and we are quite clear about that. We would like to think that we look through the whole of UK energy, both the Upstream and the Downstream together, and we are getting good growth out of our downstream business, certainly more than adequately offsetting any of that financial decline in the Upstream.

Bobby Chada, Morgan Stanley

Sorry to labour this ROIC point, but maybe you could talk philosophically about what lead time you allow in your projections until you hit the ROIC target when you approach a new project. Obviously that will change project by project, but if you could give some guidance. Second, on the CRM benefits that you talked about, you have given us a spread on the chart that looks roughly £100 million to £150 million of upside. Could you just clarify whether that is costs benefits or whether you are now starting to think about revenue synergies?

Phil Bentley

Those investment hurdles that we have set there are the equivalent of our internal rates of return. So that is what we would be discounting our businesses cases at. Any investment in North America, for example, is expected to make a 15% IRR. In terms of how quickly do you get there, the answer is that it depends. If I look at the AEP deal, it will pay back within three years, so it has a particular feature that is very profitable whilst we remain setting the price to beat tariffs that gives us a gross margin of just under 20%. On the other hand, it is fair to say that it can take a little bit longer in Europe. We as a Board are looking at economic profit generation, pay back period and we have got to get the right balance. If you target it too short, you may miss some of those longer-term investments that are actually significant growth drivers of the future.

Sir Roy Gardner

In terms of CRM, there is certainly a range there but being naturally conservative, we have talked about £100 million of benefits. It could be significantly higher and the range above £100 million will mainly come from increased cross-selling. Within the £100 million, you can assume it is roughly half-and-half reduced costs and cross-selling.

Phil Bentley

Just to give some colour to that again, we are going to spend some time with British Gas explaining what is driving that value creation in CRM and that is something we are down to talk to you about. Just to throw some statistics out: we expect core volumes to be down by about 30%, duration down by about 30%, call waiting time down by 17% and we will have significant savings in terms of debt management and back office correspondence, not sending out separate bills all the time. On the cross-selling, you see that through really focusing on the top-quality customers. Frankly, if we could lose the bottom 20%, the bottom two deciles, of our customer base, we would create a significant amount of value.

We believe the new CRM programmes will significantly drive improvements in retention. We have already started to see some good moving average totals for retention improvement and we think that will really be accelerated by the CRM investment and then targeting acquisitions on those customers that it really makes sense to do so. We would like to think that there is more than the simple £100 million. We will try to show you pass through to that in a bit more detail.

Peter Atherton, Salomon Smith Barney

Sir Roy, in your final concluding remarks, you said a focus on value de-risks new investments. Perhaps you could give us some flavour of what you actually meant by that. I picked up from the

statement that there was a new emphasis from you about focusing on driving your existing businesses harder and you do not actually seem to have changed any of your growth targets.

Sir Roy Gardner

That has always been our policy to create shareholder value. Ever since Centrica was formed, we had a vision of where we were taking the company and the value that we were likely to create in so doing. Nothing has really changed – we are just trying to ensure that you all understand that this is our policy. By clearly looking for the value within each investment, there is obviously a degree of certainty about the returns we are likely to make from an investment.

Therefore, we are saying that we are de-risking the investments we are making. All of our targets now are based on economic profit growth rather than just pure profit. Everybody in the company recognises that this is what we are driving for and we have trained a great deal of our managers in the process of understanding economic profit to make sure they understand that this is the way we are driving this business.

Austin Earl, Newman Ragazzi & Company Limited

I would just like to add some clarification questions on the cash flow. First, on working capital, you mentioned in the slide £196 million, but in the table in the results it is £364 million. Is the different between those two numbers the £165 million that you said was the one-off advance payment to Transco?

Phil Bentley

Yes.

Austin Earl

So when you are talking about what you guide at the half year, the £600 million outflow over three years, shall we view it that we have already had £200 million of that and therefore there is another £400 million over the next two years?

Phil Bentley

That £600 million was the maximum peak funding in any one period. That was never intended to be incremental funding. You should be modelling about £100 million a year incremental working capital funding. We have added a fair amount of acquisitions this year and some fairly heavy-up turnover and so that has driven growth in debtors probably more than normal. You have had slightly more than that £100 million last year, but we expect to get some of that cash back in 2003.

Austin Earl

You are confusing me. If there is going to be this £100 million outflow a year or so, why are you talking about cash coming out?

Phil Bentley

It is driven by two features: the amount at which we acquire new business, and therefore the working capital tied up in new businesses going forward, versus the cash that we get out of businesses that we acquired a couple of years ago.

Austin Earl

I am looking at what is going on with the existing businesses rather than the businesses you acquire. You acquire that working capital organically. You seem to be implying that there will be cash coming out but in terms of the actual balance sheet working capital, you are saying that is going to go up because you will be acquiring working capital.

Sir Roy Gardner

Can we take that offline?

Austin Earl

Can I just finish on the cash flow? On the capex, you said similar in 2003 to 2002 and then returning back to a lower level which is what?

Phil Bentley

We spent £180 million on CRM out of that £449 million so you can take that off pretty sharpish. I would hope that we would spend less on IT going forward when we have the state of the art system.

Richard Gray, UBS Warburg

Perhaps you could just qualify for us, because there seems to be some confusion arising out of comments reported on Reuters in your statement. Is the 10 million customer target dead for North America? If not, do you foresee that it will be reached this year and were you correctly quoted as saying that the company, as far as North America is concerned, has moved away from organic growth to acquired growth? It is really just a strategic recap on your thoughts on North America and customer target numbers.

Sir Roy Gardner

Thank you for asking that question because I want to tell you that we are not abandoning our targets. There have always been opportunities to achieve 10 million customers in North America and there still are, and at the same time creating value from those customers. We have walked away from a number of opportunities to get very close to that target already. We chose not to because it did not provide the value that we believed we needed.

You never see the deal that we do not conclude, but there are examples of us walking away that you have – New Power for example. We walked away from that deal twice and came back and got it for a very reasonable price and that is what we will continue to do. There are still opportunities

to acquire significant customer blocks in North America for value and that is what we are doing. I am not going to be bound by a timeline purely for the sake of acquiring scale. That would be silly.

I am afraid we have run out of time. I will just hand back to the Chairman.

Sir Michael Perry

Thank you all very much indeed for your attention and for being here in such large numbers. I suspect the eyes of the world are going to be more on the UN building over the next few days than the London Stock Exchange but I wish you all the best of luck.

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