Centrica plc

Interim Results

For the Six Months Ended 30 June 2003 (unaudited)

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Performance Review

Sir Roy Gardner

Chief Executive

I. Introduction

Good morning Ladies and Gentlemen and welcome to our 2003 half-year results presentation. You've got our statement in front of you. Phil will go through the financials in more depth when I have finished. Of course there will be time for questions at the end. I will just focus on the key strategic messages.

II. Results in Brief

Overall, this is another strong set of results and I am pleased to say that our strategy continues to deliver. Turnover, excluding Accord trading, was up by 20% compared to the first half of 2002. Before exceptionals and goodwill, both operating profit and earnings are up by 11% year-on-year. As a result of that strong performance, the Board has declared an interim dividend of 1.7 pence per share – a 21% increase on 2002.

III. Centrica Strategy

I want to start by stepping back for a moment and looking at where we are on our strategic journey. In six-and-a-half years, we've come a long way. The chart shows some of the things that really mattered at each stage of our evolution, the key challenges we've addressed, and some of the decisions that we've made.

Initially, of course, our focus was on turning round British Gas performance and creating our Centrica model: building premium brand positions in scale businesses and creating value from customer relationships. We've now expanded into other products and services, we've started to export our model internationally, and we've refined our organisation around our brands and our customers. We've created considerable shareholder value and a strong business platform.

As we said in February, the focus now is primarily on delivery of value from our investments. We operate a 'managing for value' philosophy and that is built into our decision-making and also into our management remuneration. But, let me stress that we still see opportunities for profitable growth.

IV. Margin Improvement in British Gas

So, having set out the framework within which we are working, I will now turn to some specific points across the business – and first margins within British Gas. Stripping out last year's one-off NTS credit, our underlying margins have strengthened. Key drivers of margin improvement include customer numbers, churn, and pricing.

In the first six months of the year, despite our price increase in April, we gained about 170,000 energy accounts and grew our overall residential energy market share to 41%. Net gas losses have run at around 3,000 a week on average and have been more than offset by gains in electricity of around 10,000 a week. As the chart shows, churn has been trending down and we expect that trend to continue.

V. Business Transformation Programme

The business transformation programme in British Gas will further improve margins through a combination of factors: efficiency gains, enhanced customer service which supports premium price positioning, and improved cross-selling capability. It is a major programme and to manage implementation risk it is being delivered in a number of releases.

First, we have integrated our databases and now have 7,000 call centre agents who are able to see – on a single screen – details of all the relationships that a customer has with British Gas.

Second, we're building customer information and propensity models into our front-end scripting. Our agents will be prompted to make targeted product and service offers to individual customers. We are piloting this at the moment and it will start to roll out over the next month.

The third release is a replacement of our old systems, including the development of a new billing engine. This is one of the largest items of expenditure in the programme: replacing four ageing billing systems with one integrated system. This will start rolling out in the fourth quarter of this year.

The fourth release, which will be delivered next year, will give full integration of all British Gas front- and back-office processes. This will mean that we can provide more tailored billing and payment arrangements. When a customer rings in we will be able to deal, in that one call, with any query they have about any aspect of their relationship with British Gas.

Going alongside all of this is the final piece in the jigsaw: developing the people and the culture to support the new ways of working. The whole package put together will transform British Gas. To date we have spent £290 million on the programme, including £44 million this year. As we said before, we anticipate benefits of over £100 million per annum, with further potential upside from cross-selling and premium price positioning. And we're looking forward to telling you more about the programme at our British Gas presentation on 2 September.

VI. Home Services Business

The Home Services business is another important driver of growth in British Gas margins. It's a key point of differentiation for us. It's the public face of the brand and it helps us to retain energy customers through cross-sales of other products.

As you can see from the chart, we have grown our presence quite significantly. We have increased the number of customer product holdings by 15% in the last year alone, with growth across all the products. We know there is still considerable potential for us in this

market. We are confident we will be able to realise that potential and not be constrained by the availability of skilled labour. We are planning to grow the size of our engineering workforce to 10,000 by 2006 and we are putting around 500 apprentices a year through training in our Engineering Academy.

So, reduced churn, the business transformation programme, customer service that supports our premium price positioning, Home Services growth and they're all factors which will move us towards our target of 8% operating margins in British Gas by 2005.

VII. Centrica Energy Management Group (CEMG)

Looking now at our upstream activities, the main role of CEMG is to de-risk the downstream business by securing advantaged energy supplies. Our aim is to maintain a balanced portfolio which gives us considerable optionality in meeting our needs.

You would not expect me to share the detail of our full contractual position, but I am happy to give you a snapshot. In Gas we've already procured around 95% of our requirements for the fourth quarter next year through a combination of gas from our own equity holdings as well as fixed and floating contracts, the balance of which we will manage as it gets closer to next winter.

In Electricity, based on current load factors for our equity generation and the fixed contracts we've already got in place, we are around 90% covered in the same quarter. So, our exposure to potential rises in wholesale prices is limited.

VIII. Morecambe Bay

I also want to spend a few minutes looking at where we are with Morecambe. The chart shows our current estimates through to 2007 of the decline in production, operating profit, and cash flow compared to the 2002 actuals. On an indicative basis, we expect production and profit to decline by around 10% a year. Now, to put that into context, a 10% decline in Morecambe equates to about 3.5% of the Group's operating profits. As the chart shows, Morecambe will continue to be very cash-generative.

Of course this isn't the full story and we have been buying stakes in other gas fields to replace Morecambe's production. We expect to spend in the region of £100 million per annum to maintain our equity hedge position.

IX. Renewables

Renewables is another important issue for us, both in terms of our upstream position and also as the market leader in supply. Our strategy for renewables is absolutely consistent with the rest of our upstream strategy. It's all about building flexibility through a balanced portfolio.

For the first year, we've already met our entire obligation through the purchase of Renewable Obligation Certificates (ROCs). In terms of equity ownership of renewable assets, it's something that we have been looking at very seriously for some time, but with the pace of change in technology investing early was not necessarily the best option.

We have always said that we'd be prepared to invest when both the technology and the economics were favourable. We expect to commit up to £500 million over the next five years to build renewable capacity. Our approach will be to work in strategic partnerships to de-risk our investment and to maximise the capacity we get access to and also our returns on capital employed.

X. AA and Centrica Business Services

So, let me turn to our other businesses. The headline for both the AA and Centrica Business Services is that we are making solid progress with profits up by 8% in each business. And there are also good indications on the drivers of future value growth; for example, in the AA, successful cross-selling initiatives and driving out even more cost-efficiencies; and in Centrica Business Services, re-engineering processes and systems to drive down costs, including the full integration of Enron Direct and Electricity Direct.

XI. Telecoms Strategy

So moving on to telecoms, where we halved our losses and started to see some improvement in the regulatory environment. Carrier pre-selection is transforming the fixed-line product and growth in CPS customers has accelerated. Almost all new customers are signed up straight on to CPS and we are going through a migration process for our existing customers. We are already seeing over 30% uplift in average revenue per user (ARPU) for CPS customers and early indications suggest a 30% reduction in churn.

Wholesale line rental is a different issue. Whilst we are lobbying strongly in industry debate on the details, at the moment the financial impact looks no more than neutral. But, there's no doubt that the customer experience will be improved and in itself that will give us some upside.

We have got a breadth of competitive channels to market. Through British Gas Communications we are able to sell telecoms as part of a Home Services package and to cross-sell on inbound calls. One.Tel's positioning is more as an integrated provider for those customers who want a full telecoms product incorporating fixed, mobile, and internet services. We are also selling telephony to the small business market through Centrica Business Services.

There is still more to do in telecoms to achieve the financial performance we're looking for, but overall we have made good progress in the year to date and we are on track to get the business to breakeven by the end of 2004.

XII. Goldfish

Now, let me talk about Goldfish. There are some strong fundamentals: growth across the main products, average card acquisition costs are 20% lower than in 2002, and good performance of the loans and savings products that we launched last year. But, as you'll have seen from the results statement financial performance remains disappointing, with higher losses in the first half, due mainly to the higher operating costs of the business.

The target of cash breakeven by the end of Q4 still stands. We've identified the things we need to do to get to profitability and have plans which support that, but it's an ambitious target. And there's really no more that I can say now.

XIII. North America

1. Focus

Turning now to North America, the primary focus this year is on integrating the businesses we've acquired into the existing operations and delivering improved financial performance. I am pleased to say that so far, so good.

2. Texas

Operating profit has increased significantly, this largely reflects the contribution from our Texas acquisitions where performance has been well ahead of our expectations in this first half. And that's due to a number of factors. In March we increased prices in Texas by an average 17%, which allowed us to maintain margins against a background of higher gas and power costs. We've also been successfully working to increase the quality of our organic customer relationships. Customer numbers, consumption, churn, and credit quality are all improving.

3. Ontario

Moving beyond Texas, in Ontario, the changes to legislation which were rushed through late last year have restricted – for the moment – our ability to grow our residential electricity business. But, we've integrated our Home Services and Retail Energy businesses to drive efficiencies and to enhance our cross-selling capabilities. And we're still competing in the business market, which of course is not covered by the legislation, so we've got continued growth potential in Ontario.

The sale of the water heater assets that we acquired with Enbridge Services Inc has already created value. In April we released a further £49 million of cash by reducing our investment in the Consumers Waterheater Income fund. To date we have raised around £350 million from this sell-down, whilst fully retaining our relationship with the customers.

4. Alberta

In Alberta our acquisition of the ATCO customers is going through the regulatory processes. The necessary legislation has been passed into law and we have been granted an energy marketing licence. We will start to sign up customers by the fourth quarter and we expect the acquisition to complete by the end of the year, giving us around 80% of the gas market in Alberta and scope for cross-selling electricity and services.

Despite a backdrop of a changing regulatory and business environment, we are already getting a return in North America in excess of the Group's weighted average cost of capital.

5. Investment

Looking forward, we're still interested in acquiring customer blocks where we believe we can create value. But, it's clear that any opportunities may require us to work closely with regulators and with asset operators, of course they'll take time to find and to execute. Upstream in North America we will invest up to £350 million over the next five years on further acquisitions as we continue to make progress on hedging our gas and power requirements.

XIV. Summary and Outlook

Now, before I hand over to Phil to go through the numbers, a few words of summary. We have continued to grow the business in the first half of the year and are well-positioned to continue that trend. There are still a number of areas where we know we can achieve further cost efficiencies. With our strong brands, premium positions and customer focus, we have built a strong strategic platform. And as cash generation increases, that gives us the ability to both reward our shareholders as well as exercising choice over opportunities to grow the business in the future.

We have clear criteria for decision-making and for how we measure our success:

- Continued strong earnings growth,
- Further increasing our returns in excess of our Group Weighted Average Cost of Capital, and
- A dividend payout ratio increasing to 40%.

I believe this year's interim dividend of 1.7 pence 21% up on 2002, gives a strong signal of our commitment to rewarding shareholders and our continued confidence in our outlook. I'm going to stop there and hand over to Phil.

Financial Results

Phil Bentley

Group Finance Director

I. Introduction

Thank you Roy and good morning everyone. As usual, there is a lot to talk about in the Centrica results. I will go straight to the Group results and then give a little bit more detail about the business drivers.

II. Financial Highlights

Looking at the Group as a whole, as you can see, turnover was up 20% – 15% of that came from acquisitions and 5% from like-for-like organic growth across our existing business. Operating profit was up 11% to £694 million. Operating margins are slightly lower than last year, but as you'll remember we had the NTS credit in the 2002 operating margins. We have seen strong cash generation in the first six months, so interest cover is now covered some 31 times.

Our effective tax rate has been held at 28%, despite the 40% tax rates on upstream gas production. We expect the 30% tax rate to be held over the next three years as we utilise our deferred tax assets. Earnings in the first half at £479 million are now at record levels.

III. Operating Profit

Turning now to the operating profits of each of our Business Units which underpin the 11% improvement. Most businesses are up year-on-year, with particularly strong underlying contribution from British Gas, EMG, and North America. I will explain the main drivers in a second. The only real disappointment is Goldfish where frankly our operating cost base is still too high.

IV. Business Units

1. British Gas

Let me start with British Gas, where our strategy continues to be to grow our top line through increased cross-selling, whilst driving out cost efficiencies. In the first six months stripping out the one-off NTS credit, British Gas's operating margins increased 180 basis points to 6% and we are confident that we will hit our 8% margin target by 2005. The price rise in mid-April generated an additional £16 million and there will be a full six-months benefit of this in the second half.

The weather in the first six months was one of the warmest since 1976, but the year-on-year impact was only £12 million, since last year was also warm. We budget assuming ten-year weather averages. This warmer weather therefore meant that we were down some £40 million against our budget due to weather.

Churn in the first half-year was down in Electricity by 10 percentage points and in Gas by percentage points, saving some £17 million. This will lead to greater savings on a full-year basis. Running dual systems and increasing energy efficiency spending led to higher operating costs, but this was more than offset by lower transportation and distribution tariffs and a slight reduction in WACOG.

Home Services delivered a £19 million year-on-year profit improvement a full £41 million of profit in the first half. Turnover was up 6% and, due to the leverage in our operating model, operating profit was up 86%. Roy highlighted the improving telecoms environment: British Gas Communications' losses fell by £16 million to just £10 million in the first half.

2. Centrica Energy Management Group (CEMG)

Centrica's upstream strategy is to build an advantaged commodity position. Our Energy Management Group had a very strong six months, increasing profit to some £373 million. The profit from our gas fields was however, £27 million lower than last year. Whilst production, as you've seen, was flat, selling prices were softer. The offset of higher taxation on our gas production was the abolition of royalties. Net of the PRT shield, this saved some £21 million in the first six months.

Our industrial and wholesale business had a very good half-year, generating profits some £32 million higher than the same time last year. We have spoken previously about the options we have to sell excess production capacity from our requirement to the wholesale market when prices are high and to lift from our 'Take or Pay' contracts. This year we have had something of a 'perfect storm', if you will excuse the pun, as the weather driving short-term volatility allowed us to sell excess gas at higher prices and to buy back our needs at lower prices. We did though, use much of our flexibility in the first six months and, with a number of profitable contracts expiring over the next 12 months, we will see lower Industrial and Wholesale profits in the second half of the year and continuing into 2004.

Rough Storage, despite a number of operational difficulties, contributed some £16 million in the first six months; in excess of our budget due to rising storage prices driven by rising summer/winter price differentials.

3. Centrica Business Services

The strategy for Centrica Business Services is to widen the range of products to a critical mass of SME customers. As with British Gas, last year's Business Services results were inflated by a £6 million NTS credit. Underlying operating margins therefore, of 7.5% are up on 2002.

The focus in the first half of this year has been on getting the cost efficiencies from the Enron Direct and Electricity Direct acquisitions. Electricity Direct contributed some £6 million profit and we were able to benefit from lower commodity costs whilst maintaining positive pricing in the face of competition. Higher opex, as we integrated our operations and commenced development of a new customer care/billing platform, more than offset lower transmission and distribution charges.

4. AA

It is a case of steady progress in the AA, where operating margins again increased and are now over 10%. We believe that the AA's premium brand positioning and leading market share, combined with new business processes, will both drive up customer sales and improve the efficiency of our cost base.

In the first six months, customer numbers in the roadside business now passed 13 million and an increased contribution from the more valuable personal members generated a £6 million year-on-year profit improvement. Offsetting this, we have been rationalising further our cost base and charges taken in the first half will lead to higher profit growth in the second half of the year.

The AA's Personal Finance business continues to grow both through insurance and lending activities, where our card and loan book now exceeds £1 billion – 43% up on last year.

There is more work to do with the Service Centre acquisition, where we are having to put in higher opex to raise quality to the AA standard. We need to see further sales growth in the second half of the year before we can say that we are turning this business around. The additional £6 million from other AA businesses reflects our withdrawal from Golf England and an improved contribution from both the Driving School and AA Ireland.

5. Goldfish

Turning now to Goldfish. Credit card contribution was lower due to a fall in net interest margin. Although interest rates funding the business have fallen, a reduced headline APR, the introduction of zero balance transfers, and lower revolve rates have all squeezed our margin. The underlying profit growth in loans and savings has been good but the banking gross contribution at £3 million is sub-scale. Our operating cost base grew some £12 million due to brand and product development and higher call centre and processing costs. These must be reduced significantly in the second half, whilst product contribution must accelerate if we are to make our year-end target.

6. North America

Our North America strategy is to build a large-scale energy business, leveraging our customer services and brand building skills with our energy procurement expertise. Overall, our profits in North America improved nearly threefold, with the acquisitions in Texas of WTU and CPL contributing some £44 million of the improvement. This business has performed better than expected, with lower customer losses and higher gross margins following our 'Price to Beat' re-filing in March. Margins in Texas are currently strong and we still hold one more price re-filing option, to be exercised before the end of the year.

In the organic markets of Texas, operating losses were higher, some £11 million more than last year. We have increased our customer numbers by 23% and that's despite forcing the churn of low value customers that we gained during our initial market entry.

Although the Ontario electricity market is closed to further growth at current wholesale prices, Ontario electricity contributed some £27 million more profit this first half-year, by virtue of the fact that we save on customer acquisition costs. Lower gas production prices reflected the expiry of some in-the-money sales contracts. At the same time, we incurred some £4 million of costs in preparation for our Alberta market entry later this year.

V. Cash Flow Drivers

Let me finish finally with cash flow, where we have seen a strong increase as we begin to generate cash from our investments and pare back our capex and acquisition requirements. Our EBITDA of £886 million was 10% higher than last year due to our higher earnings. Cash PRT paid was significantly lower than last year due to

reimbursements on account and the peak payments now having passed. In the full year, cash PRT will be about £100 million lower than in 2002.

The £212 million working capital outflow since the year-end is generally, at this time, influenced by three seasonal factors: lower customer debtors, which are more than offset by lower trade creditors, and the swing to arrears in direct debit customers in June. Much of this first half working capital outflow will unwind in the second half and we expect to end the year in line with our £100 million working capital growth guidance.

The other key drivers of free cash flow, capex and acquisitions are detailed at the back of the book, and are significantly lower than 2002. Free cash flow of £508 million compares with a £389 million outflow over the same period last year.

We expect to generate good cash flow over the next few years, raising our return on invested capital whilst at the same time allowing for both selective acquisitions and an increase in the dividend payout ratio.

VI. Summary

So, in summary, it was a good start to the year. We are building a solid platform across our key businesses, we are focused on the value drivers of our strategy, and we are confident that this strategy will deliver superior shareholder returns.

Questions and Answers

Jason Goddard, CSFB

I have a couple of questions on the investment programme going forward: the £500 million on renewables. How would that equate on a five-year view to what your ROC requirements in the retail business? On the £350 million in the US upstream, can you give us some sense of how that balances in terms of upstream generation and upstream Gas over the next five years?

Phil Bentley

The ROCs, or renewables requirements, are obviously increasing year-by-year to 10% by 2010. By that time, this investment should be covering around 50% of our needs. We will be looking to work with partners and putting our own investment in to secure 100% of the off-take. It will be something similar to the Spalding deal that we have done before.

In North America, there are obviously opportunities in Texas in terms of generation. We are growing the organic business nicely now. The AEP deal we have rolls off in about 1.5 year’s time, so we will be looking for generation there. At the same time in Alberta, our gas fields are quite shallow gas so we produce and blow down the gas quite quickly. We will be looking to replace that as we go forward.

Andrew Wright, UBS

I have two questions. On your CRM investment, you seem to be very much talking about that as a British Gas product nowadays. Has there been some element of scaling down of CRM from its original ambition of being across brands, covering the AA and other brands and services? Secondly, you have talked about renewables. Could you also give us an indication of the expected impact of the EU carbon trading scheme on your business?

Sir Roy Gardner

On CRM, clearly the focus is on British Gas and always has been, but we are also developing CRM in the AA and Centrica Business Services. So, nothing has really changed. Perhaps Jake should pick up the carbon trading question.

Jake Ulrich, Managing Director, CEMG

It is actually a much more complicated question than it sounds. There are three key periods: pre-Kyoto implementation, the five-year Kyoto implementation, and Post-Kyoto implementation. If we look at the first period out through to 2007, we are substantially hedged on our electricity requirements. As Phil indicated, the snapshot for Q4 2004 is indicative going forward. Even though wholesale prices will probably increase – from winter 2005 onwards, we expect an increase of around £4 per megawatt hour – we are pretty much covered. It will not significantly impact our profitability on the Electricity side of the business.

The real issue is post-2007, much of which will depend on how the allocation scheme ultimately works out. What we are really talking about here is how vertically integrated the various players are in this market. At this stage, it is pretty difficult to say. Obviously we can run our plants at a higher load factor, which will offset some of those issues.

Sir Roy Gardner

Thank you, Jake.

Caroline Randall, JP Morgan

I have two questions. First of all, in terms of the 8% energy margin you mentioned for the UK, what price increase assumptions – if any – have you included to get to that 8% energy margin by 2005? Secondly, could Roy expand on US expansion? Is it fair to assume that you are not ruling out a vertically integrated acquisition in order to gain access to the customer base, obviously with a partner to take on the regulated assets? Thank you.

Sir Roy Gardner

Phil will deal with the second part of that question. As far as the first part is concerned, we should achieve our 8% margins without price increases. We do not assume price increases in that margin expectation. It largely comes from the benefits of our investment in the British Gas transformation.

Phil Bentley

It is a tricky question there, as it is a sort of double-negative: 'would not rule out'. What we have said here is what we have always said: we are not a manager of regulated assets; that is not our strength. If we want to free up customers, we will clearly have to work in partnership with somebody else. We will also have to work in partnership with the regulators, because these deals take quite a lot of time to pull together. The Alberta deal has been going on for well over a year now and the Texas deal took us a year. This is new law and new regulation, and it takes time. We will always say that with the right deal and the right exit strategy for the assets, we are very much interested in growing our customer presence in North America.

Simon Flowers, Merrill Lynch

I have three quick questions. Firstly, you mentioned that the WACOG had fallen in the first half of 2003. Will it increase materially in 2004? Secondly, could we have a bit of clarification on the £350 million of upstream spend in North America? The figure that came out in the press was materially different to that. I wonder if the £350 million is not perchance a per annum spend or a total figure.

My third, broader question is: the capex was very low in this half and you are talking about some organic spend, some maintenance spend, and some acquisitions. Obviously acquisitions will be opportunistic and will come along occasionally. Therefore, there may be times when you have a bit of excess cash flow in the business. What will you do with that? Are you intending to use that just to pay down debt or might it be used to reward shareholders?

Sir Roy Gardner

Phil will deal with the WACOG and capital spend, but as far as I am concerned the upstream investment in North America is £350 million over the next five years – irrespective of what the press said.

Phil Bentley

On WACOG, we are seeing firmer prices now. As you know, we are not as exposed to the higher oil prices, as we have been getting out of oil-linked contracts. One dollar per barrel of oil increase today, is less than £1 million next year on our WACOG, so that is not material, but the underlying market has been firmer. Next year you are probably looking at one penny or so per therm increase. The question will then be how much of that gets passed through to customers. That is always the next follow-on point. I think WACOG will be up, but not materially driven by the higher oil prices.

With regards to capex, as we have said before, we are over the peak of CRM investment: £290 million out of the programme we have talked about before. A lot of that is gone behind us now, so capex should start to come down. Net of the water heaters, which are non-recourse, and Goldfish, which is the wholesale funding of our credit card receivables, our debt is now less than £100 million. There is not much to pay down, if the truth is told.

That is part of the reason why we are confident about increasing the dividend rate. Shareholders will see more of that money coming back, but it is not an either/or. There is

enough cash coming out of the business and we have enough debt headroom to both invest in acquisition and increase payout to shareholders. If you look at the growth last year, 15% of the 20% came from acquisitions. That is good growth, as far as we are concerned, which is generating in excess of the cost of capital. Shareholders should be happy for us to continue to invest where we do make a spread.

Simon Edrich, Commerzbank

I have two questions, if I may. Firstly, could you please give an indication of how much of the CRM benefits of £100 million is due to the cost savings from squeezing four systems into one system? Secondly, what is the deadline for an announcement from the DTI in terms of Rough?

Sir Roy Gardner

This is a chance to bring in Mark to talk about CRM, bearing in mind that you will hear a lot more about it in September. Let me deal with Rough. The Competition Commission has submitted their recommendations to the Secretary of State, as you know, and based on the normal timescale we would expect an announcement imminently. It will surely be within the next week.

Mark Clare, Managing Director, British Gas

There are clearly a number of benefits of CRM. We are talking about the transformation of the whole business, so there are a number of elements to that. If you look at the cost savings associated with just the systems, they are fairly modest. Most of the cost savings come from lowering the cost of services to our customers. All of the processes which we currently use will be improved as part of the process: acquisition costs will be much lower, churn rates will be lower, and we will be delivering greater customer service. From all of that we will have a much stronger position, a very different customer experience, and we would expect to increase cross-sales as well. There are a number of things that go into that equation.

Sir Roy Gardner

Thank you, Mark.

Andrew Mead, Goldman Sachs

On the dividend, you have given a greater commitment in the statement today about paying the dividend going forward, but actual increase is less than you paid out at the full-year. I want to understand a bit better how do you get to the 40% payout ratio versus your earnings progression over the next few years and whether or not the first half increase you have declared is much of an indication for the full-year. Also, is the overall CRM capex budget still £350 million?

Phil Bentley

If you look back, we have tended to pay out more as a total dividend increase than in the first half. What we tend to do is distribute it broadly one-third and two-thirds. For example, last year we raised our total dividend by 37%, so we increased it more. When you are growing earnings, it is difficult to keep the payout ratio increasing. We had a 26% payout ratio last year and the market is around 29-30% for the end of this year. If you are modelling 3-4% per year, you see how you get up there. That is how we look at it internally. You should expect to see a higher increase in the second half of the year, as we have done historically.

We are on track with the CRM programme. Nothing has slipped and we are on time with the releases. The contractual terms with Accenture are still on track and we are looking forward to showing you some of that in early September, when you will see operators using the system (7500 operators currently use this), with the dynamic scripting for high value and low value customers. You will hopefully see that and more.

Andrew Mead, Goldman Sachs

Is the capex budget still going to be about £350 million by the end of 2004?

Phil Bentley

Yes.

Martin Brough, Dresdner Kleinwort Wasserstein

Could you give us an idea of the weather benefit for the North American gas business in the first half, if you saw one? There was obviously a big increase in the turnover on the volumes. What is the outlook for customers there? Also, could you explain a bit more about the Energy America provision?

Deryk King, President & CEO, Centrica North America

We had two positive weather benefits in the first half of the year. In Texas, the average temperature was slightly higher than the long-term average in May and June, and slightly lower in July, with a small net benefit. On Gas, we had a very long, cold winter – as those of us who live in Ontario can attest to – which extended throughout Eastern Canada and the Northeast US and Midwest. We saw quite a significant increase in unit demand across that Gas territory, which was offset in our results by a small shrinkage in our gross margins due to the extremely high volatility in gas prices over the last year that has made hedging a challenge.

Phil Bentley

On the provision, we have withdrawn from Maryland, where we could not see getting a positive margin, and returned those customers back to the supplier of last resort. We are looking at another state at the moment where potentially the options include that. It is not Texas or one of our growing states. Frankly, we are in a discussion there at the moment that says: if we cannot see a way of improving the rules of engagement here, we will

return those customers. There is a right way to do that, signalling in the discussion, and a wrong way.

The accounting treatment is that we have taken the provision immediately. We have taken that £12 million. If we find a way forward such that we can get margin back into that market, then we have been overly prudent, but we generally tend to take a fairly prudent line on these things.

David Stedman, Daiwa Institute of Research Europe

I notice in the results that you changed the assumptions you use to calculate your pension. There is quite a significant increase to £783 million at June 2003. Earlier this week BP chose to use some of its substantial cash flow to pay down its deficit. I was wondering what your thoughts were about this, given your emphasis on cash flow in the next couple of years.

Phil Bentley

The analysis is in Note 14. We have lowered the discount rate, which has largely been driven by the market. What you have to remember about the Centrica liability book is that it has a duration of 24 years. You are looking for 24-year AA bonds to use for your discount. When you compare other companies that are using a 5.25% or a 5%, i.e. a lower discount rate, they generally have a much shorter duration on that liability book. There are only three companies that we know of in the FTSE which have a longer duration than Centrica.

You cannot say that Centrica is not being prudent enough. If you take the bond rate, we actually overview it down for prudence. As you know, it is quite difficult to get a good AA measure for 24-year bond yields. We have been doing certain things to stop ‘filling the hopper’, as it were. We have raised the contribution from our employees. We are going to put in a little bit more going forward, but what we put in is not of the same scale as what BP puts in. We only put in £130 million, probably 10% more at these levels, so it is not a material drain on cash flow because of the long duration of the book.

Simon Edrich, Commerzbank

There was some organic growth in North America that led to a bit of a reduction in the half-year operating profit. Presumably that is just due to the acquisition costs of customers. Could you give some colour as to how you expect that to evolve over the year?

Sir Roy Gardner

It follows the normal pattern. It is very similar to the acquisition cost being written off in advance of the income stream.

Perhaps Deryk can pick it up.

Deryk King

Perhaps I could just comment on organic growth. We are gearing up our organic growth in Texas and radically improving the quality of the customer base, which was frankly poor in terms of the initial customers we acquired. I would expect to see organic growth continuing to develop in Texas.

On the Gas side, it has been more difficult. We have lost around 87,000 customers since the end of the year, of which around two-thirds were in Ontario and one-third in North America. In Ontario, I think you are all aware that we were significantly affected by changes in legislation: the so-called Bill 58 last year, which made not only new customers more difficult to attract, but also made renewals more difficult. We have successfully persuaded the government in Ontario to change both the legislation and the regulations to be more favourable and I would expect to see the losses due to those regulations reduce significantly going forward.

Iain Turner, Deutsche Bank

Could you give us an update on customer numbers and volumes in Texas and where you are in terms of retail clawback?

Deryk King

As Roy or Phil said, we grew our organic customer base by 23% in the first half. I would expect to see that continue. We lost 38,000 customers in our 'franchise' territories in WPU and CPL, which was just under 5% of the total customer base – exactly in line with expectations. I would expect to see the net increase in customers in Texas starting to grow.

In terms of clawback, you have to segment that into two categories of customer. In the commercial customer segment, the attrition rates in terms of megawatt hour load is about to reach the 40% threshold level, so we do not expect to have to pay any clawback on the commercial customer segment. In the residential customer segment, losses have only been about 5%. There is no chance of that hitting 40% by the end of the year, so we would expect to pay clawback at the end of this year and we have been providing for that month-by-month in full and in our results.

Andrew Wright, UBS

You mentioned in your statement that the competition opened in Belgium on 1 July. Have you had any early experiences of the impact of that?

Sir Roy Gardner

Yes, we have. We lost a small number of customers, but they happened to all be employees of Electrabel.

Caroline Randall, JP Morgan

I just wanted to clarify something on the capex. Phil indicated that capex spend should come down from this point on, but I was looking at the numbers that you have been talking about today. If you are looking at about £100 million per annum to replace Morecambe over the next few years, plus £500 million over the next five years for renewables, plus £350 million over the next five years for upstream North America, plus maintenance stuff as well; over the next few years that takes me up to at least £400 million, or perhaps slightly more. I know that last year was £400 million as well. Are you classifying some of that as acquisition spend?

Phil Bentley

Acquisitions are acquisitions and capex is capex. When I say capex, I am talking about capital expenditure. If we take our existing assets, such as Rough, that is not a capital expenditure. The £304 million is an acquisition. If we then start to do some maintenance on Rough, that is capex. We are quite clear about when we are talking about capex and when we are talking about acquisitions.

Robert Marshall-Lee, Newton Investment Management

Following up on the clawback question, could you give us a feel for the cash payment as opposed to the accounting provided?

Phil Bentley

You are getting into some quite technical areas now, which is around the earnings sharing mechanism that we have with AEP. As you may recall, beyond a certain level of profitability AEP takes 80% of the incremental earnings and then it kicks in again to 50%. We are into the realm of most of this clawback actually being paid by AEP. It is not a big lump of cash that must be paid from our coffers.

Sir Roy Gardner

Thank you very much indeed.