centrica

1998 Full Year Results

Internet version with notes

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Chief Executive

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- 1998 was a very important year in the evolution of Centrica.
- Now positioned to compete in the fast emerging energy market having laid the foundations for future growth.

Results in Brief

	Full Year 1998	Full Year 1997
Sales	**£7,481m**	£7,842m
Operating profit pre-exceptionals	**£208m**	£175m
Earnings pre-exceptionals	**£174m**	£44m
Cashflow pre-exceptionals	**£543m**	£877m
Employees (FTE)	**15,677**	14,989

•Sales at £7.5 billion were £361 million lower than '97, largely because of the impact of competition and price reductions.

•Operating profit pre-exceptionals was £33m higher than in '97 at £208m.

•Earnings before exceptionals were up very substantially on the previous year.

•Cash generation has continued to be strong, benefiting from the continued reduction of working capital levels.

1998 Achievements

- Improved financial performance
- Customer service progress continues
- Gas customer retention
- Electricity customer growth
- Services profitable
- PowerGen North Sea acquisition

•Very good progress against key objectives

•Further improvements in customer service

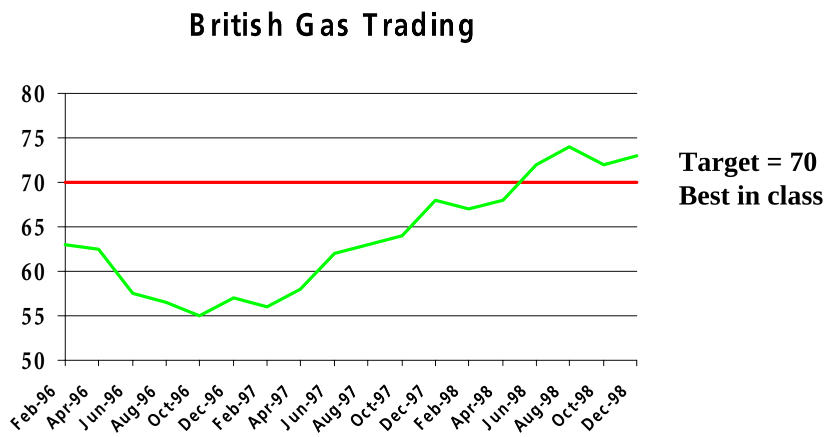
•Service & value for money major factor in customer retention

•Excellent progress in building electricity supply business

•Turnaround of Services to first time profit for year

•Acquisitions in line with strategy

Customer Satisfaction

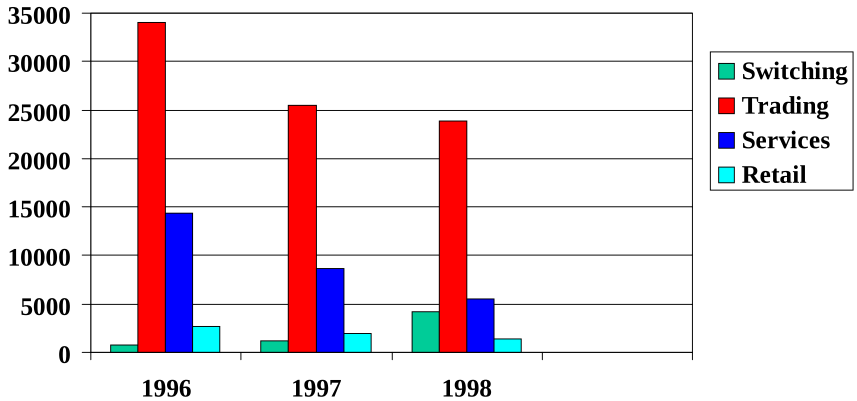


•Achieved ambition in supply business to be amongst best in class.

•Improved customer satisfaction in Services & Retail also.

•Independent research in 1998 found more than 80% of respondents were satisfied or very satisfied with the service they were receiving.

Gas Consumers Council
Category A complaints



Category A complaints are those where the customer dealt with British Gas and the reply they received was not to their satisfaction

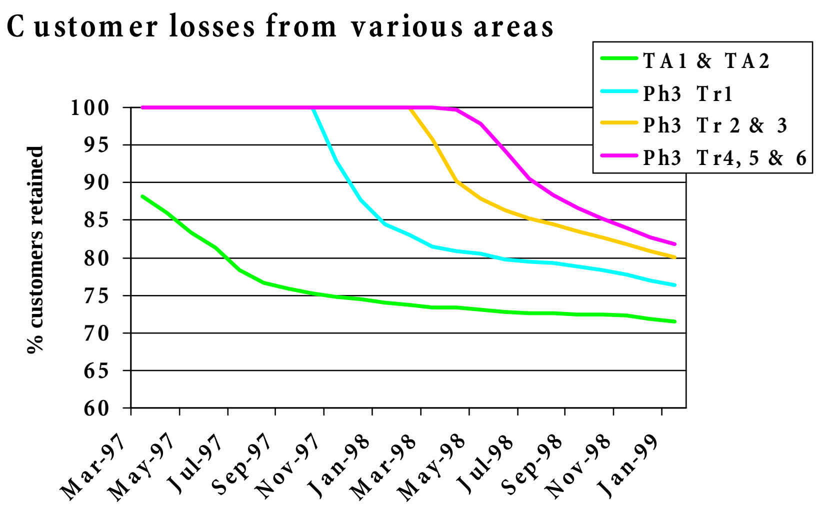
•Complaints to the GCC fell by 6% on '97 levels.

•Our competitors have around 20% of the market, and yet account for 45% of complaints to the GCC.

•Complaints relating to the complex process of switching increased due to the tight timescales for the rollout of the final 15 million customers.

•Excluding switching, complaints about British Gas Trading, fell by 6% in '98. Services reduced their complaint level by 36%, Retail complaint level down by 30%.

Customer Market Share Including Winbacks



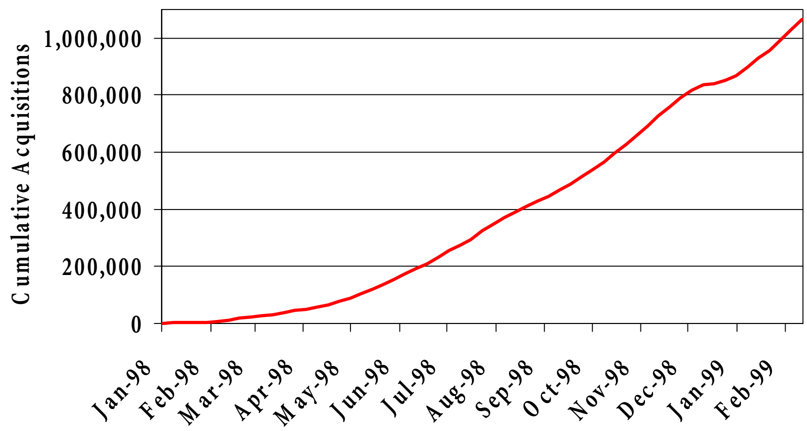
•Successful in retaining just over 80% of the residential customer base at the end of the year.

•In the two initial trial areas, which were opened to competition during '96, our overall market share has stabilised at around 70%.

•A significant number of customers who switched suppliers have now chosen to return to British Gas.

•With the focus in the UK energy market on dual fuel, we are now able to compete on price as well as service.

Electricity Sales



•By the end of 1998, 850,000 customers had signed electricity contracts with British Gas. The figure is now over 1 million and growing by around 30,000 per week.

•Our aim is to be one of the largest electricity suppliers with over 2 million customers by the end of this year.

British Gas Services

- Increased turnover
- Business profitability
- Customer service
- Business retention
- New product rollout

•1998 Turnover up by 13% and operating profit pre-exceptionals was £9m compared to an operating loss of £49m in '97 and £196m in '96.

•Achieved a 3% increase in Domestic Heating installation market share, and maintained the level of service contracts year on year.

•The product range has been extended to offer home security systems (5,000 installed and 14,000 target in 1999), and air-conditioning beyond the current Southeast area.

•Developments are enhancing service, bringing opportunities for sales growth as we build on our established infrastructure.

Retail

- Challenging year
- Restructuring
- Reduced cost base
- Channel for Group products

•Disappointing year

•Extensive restructuring during 1998 included rationalisation of the delivery service, reorganisation of management structure, and closure of loss-making shops.

•Restructuring measures contributed to an 11% reduction in costs, and we expect a further reduction of 15% this year.

•Retail continues to provide a channel for selling other group products - such as electricity contracts, and home insurance.

Energy Management

- Gas & oil prices
- Take or pay
- Morecambe
- Interconnector
- Electricity

- Effect of lower oil prices felt through European gas prices in the UK market. Benefit to gas input costs. Take or Pay renegotiations also benefited our Q4 gas costs.
- Volume of prepaid gas reduced by about a third to 1.3bn therms - can now optimise portfolio flexibility.
- In total now renegotiated prices and volumes on nearly 50bn therms of long-term gas commitments.
- Extensive maintenance activity at Morecambe during the summer improved deliverability and reliability.
- Sales to Continental customers started on 1 October '98 through the new Interconnector pipeline.
- Continuing to explore innovative arrangements to supply electricity to enable us to deliver best value to our customers.

Financial Services

- Goldfish card
- Home insurance
- Goldfish Guide

•Over 900,000 Goldfish cards now in issue - a 3% share of the credit card market.

•Home insurance product launched nation-wide during 1998, with around 45,000 policies signed to date.

•The Goldfish Guide well received with some 70 advertisers across 19 titles now available.

•Looking at other complementary products that we can rollout to build on our initial Financial Services successes.

Regulatory - Key Agenda 1999

- Pool Reform
- Plant divestments
- Distribution & Supply separation
- Electricity Distribution Review
- Electricity & gas price control

•Gas market now fully competitive; but significant barriers to entry in electricity.

•Pool reform will bring significant price reductions to customers.

•Divestment of assets to bring more competition into electricity generation.

•Separation of supply and distribution in electricity - cross-subsidies, which are currently distorting the market, need to be removed.

•The Electricity Distribution Price Reviews will result in new controls for these monopoly network businesses from April 2000.

•Gas Supply Price Review will be running in parallel - need to ensure that the nature of any controls from April 2000 does not lead to any distortions in the converging energy markets.

Strategy

• Power Generation	-	Support downstream market entry
	-	Physical/virtual generation
• Gas Assets	-	Leverage upstream position/skills
	-	Extract portfolio synergies
• Overseas	-	Develop alliances & co-operation
	-	Exploit liberalisation opportunities

•To have a flexible range of electricity supply options, which may include virtual power stations, and the acquisition of physical assets.

•Plan to maintain current level of equity gas (approx. 20%) as Morecambe runs down. Utilise upstream skills and knowledge to acquire appraised fields.

•Seek opportunities overseas to form alliances and joint ventures to create value by exploiting energy trading and downstream supply skills.

Strategy

- Energy Supply
  - Utilise low cost channels
  - Dual fuel focus
  - Grow LPG market position
- Home Services
  - Utilise existing service infrastructure
  - Install & maintain high value items
- Financial Services
  - Build on Goldfish/British Gas brand
  - Seek out partners for new products

•Electricity is major priority, and a focus on LPG, where we have 7% of the market.

•Objective in Home Services is to install and maintain high value items in and around the home and maximise the use of infrastructure.

•In Financial Services build on Goldfish brand to deliver new banking products with partners.

Investments

- Upstream gas
  - PowerGen North Sea
  - Dana, British Borneo
- Supergas
- Repair & Care
- Organic growth
  - Electricity
  - Home & Financial Services

•Invested around £400m back into the business in the last 12 months to support the strategy for growth.

•Powergen North Sea assets acquired at a total cost of £257m, plus an interest in a number of fields from Dana and British Borneo.

•Acquired Supergas early in ‘98, increasing our share of the UK LPG market.

•Acquired a small electrical product servicing company in January to support electrical maintenance.

•Nearly £100m invested in organic growth - mainly on electricity. Increased investment intended in 1999 as opportunities present themselves.

Distribution to Shareholders

- Proposal
  - – £530m Special Dividend
  - – 9 for 10 share consolidation
- Board intend to pay total ordinary dividend of 2.5 pence in respect of 1999

•Proposed special dividend of 12p per share to be paid in '99, and a 9 for 10 consolidation of shares.

•Intend to pay a total ordinary dividend for 1999 of 2.5p which recognises the growth opportunities that lie ahead.

Gas Volumes, Pricing & Cost

		1998	1997
Domestic sales			
Volume	**(m therms)**	**10,922**	11,423
Price	**(p/therm)**	**45.2**	48.2
Non-domestic sales			
Volume	**(m therms)**	**6,328**	6,079
Price	**(p/therm)**	**18.6**	19.1
Equity production		**3,213**	3,199
Gas costs - full year (p/therm)		**18.4**	20.6
Gas costs - Q4 (p/therm)		**16.9**	21.7

•Domestic sales down by just over 4%. Non-domestic volumes up by just over 4%, but prices fell by 2.6% reflecting lower gas market prices.

•Average price achieved was 6% lower than in 1997.

•Overall weather effect - 800m therm reduction on SNT demand.

•Equity production, primarily from Morecambe fields was flat year on year

•Gas costs including equity gas at commercial prices, fell 2.2p or 11% due to renegotiations and the removal of the gas levy.

•Q4 gas cost reduced to below 17p, and external cost of gas to just under 16p including the cost of swing.

Turnover

	1998 (£m)	1997 (£m)
Domestic @ SNT	**5,291**	5,906
Non-domestic @ SNT	**1,211**	1,218
Weather	**(323)**	(391)
Gas (sub total)	**6,179**	6,733
Electricity	**5**	-
Accord	**600**	459
Energy Supply (sub total)	**6,784**	7,192
Services	**526**	467
Retail	**169**	183
Other	**2**	-
Total	**7,481**	7,842

•Domestic turnover down by 10% due to January price reductions and loss of market share.

•Non domestic turnover flat with higher volumes offset by lower prices.

•The impact of weather, although still substantial in 1998, was £68m better than in 1997.

•Accord sales volumes up by 1.2bn therms, turnover up 31%.

•Services turnover increased 13% against a backdrop of falling gas customer numbers and a tougher retail environment.

•Retail - disappointing year with sales down 8%, impacted by the high street slow down.

Operating Profit Analysis (pre-exceptionals)

	1998 (£m)	1997 (£m)
Domestic @ SNT	**150**	118
Non-domestic @ SNT	**(120)**	(323)
Weather	**(77)**	(81)
Gas (sub total)	**(47)**	(286)
Electricity	**(86)**	(25)
Morecambe	**344**	566
Accord	**31**	16
Energy Supply (sub total)	**242**	271
Services	**9**	(49)
Retail	**(31)**	(45)
Financial Services	**(12)**	(2)
Total	**208**	175

•Profits in the domestic gas segment up 27% as a result of lower input costs for gas and transportation. Performance in the non-domestic segment similarly affected by lower input costs.

•Investment in electricity systems, marketing and operations accelerated in line with the growth in customer numbers.

•Morecambe price revocation effect substantial - £250m impact of the transfer price fall, offset in part by related savings of PRT and Royalties.

•Prior to acquisition adjustments, Accord's profit was £33m in 1998 compared with £31m in 1997.

•Improved margins and reduced costs in Retail largely offset by falling turnover in the tougher retail climate.

•£12m investment in home insurance and the Goldfish Guide together with new development costs for other banking products.

Operating Costs

	1998 (£m)	1997 (£m)
Energy Supply		
Gas	**663**	709
Electricity	**85**	25
Services	**200**	193
Retail	**95**	107
Financial Services	**12**	2
Total	**1,055**	1,036

•Overall operating costs rose slightly in absolute terms, however excluding new product investment, the cost base reduced overall by 5%.

•Gas supply costs fell by 6%, Retail cost base reduced by 11%, and Services cost base increased by 4% against a turnover increase of 13%.

Earnings

	1998 (£m)	1997 (£m)
Operating profit	**208**	175
Associates/joint ventures	**(1)**	(1)
Interest receivable	**42**	38
Taxation	**(75)**	(168)
Underlying performance	**174**	44
Exceptionals	**(85)**	(835)
Earnings/(loss)	**89**	(791)

•Pre-exceptional earnings increased by £130m during 1998.

•Interest receivable increased and the Morecambe tax price revocation reduced the tax bill by around £76m.

Exceptionals

	1998 (£m)	1997 (£m)
Windfall Tax	**-**	192
Restructuring costs	**3**	35
Gas contracts:		
Renegotiations	**63**	573
Contract Losses	**-**	35
Year 2000 costs	**19**	-
Total	**85**	835

•Renegotiations covered by the charge in 1998 include Victor at £50m and Dana at £11m, but exclude the internal price write-downs carried out on PGNS assets purchased.

•Year 2000 costs of £19m compare to £3m incurred in 1997, which were not categorised as exceptional. Overall the programme is on track and is now estimated to cost around £40m compared to the original estimate of £61m.

Cash Flow before Financing

	1998 (£m)	1997 (£m)
Energy Supply	457	511
Services	40	(16)
Retail	(25)	(40)
Financial Services	(10)	(2)
Operating cash flow	462	453
Working capital	408	575
Sub total	870	1,028
Cap expenditure	(70)	(87)
Acquisitions	(101)	3
Taxation & interest	(156)	(67)
Sub total	543	877
Exceptionals	(211)	(653)
Total	332	224

•Strong cash flow performance - £870m inflow from operating activities against £1028m last year.

•Overall cashflow at £332m is struck after the cash impact of the PowerGen North Sea acquisition of £87m but before the debt impact of £134m.

•Working capital reduction includes the fall in our Take or Pay bank.

•Reversal of the transportation prepayment in 1999 will reduce working capital.

•Further reductions in the level of our Take or Pay bank anticipated beyond 1999.

•1998 tax payment of £215m reflects a full year cost at the pre-revocation Morecambe transfer prices and compares to £112 in 1997 (covering the last six months of 1996).

•Future tax payments will reduce in line with our new Morecambe arrangements.

Cash Flow Movement

	1998 (£m)	1997 (£m)
Opening net cash/debt	**41**	(178)
Cash flow before financing	**332**	224
Debt taken on acquisition	**(145)**	-
Other	**(5)**	(5)
Closing cash	**223**	41

•This takes into account the debt acquired on with the PGNS and Supergas acquisitions.

•£1.5bn generated since demerger, before the impact of £864m on exceptional payments and £267m on acquisitions.

Outlook for 1999

- Gas portfolio
- Electricity investment
- Cost reductions
- Services & Retail improvement
- Transco pre-payment reversal
- Distribution
- Investment opportunities

•Gas costs reduced through renegotiation and falling oil prices. Softening gas market prices will impact turnaround of commercial business although improvement expected

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•In domestic market, no effect on end customer selling prices foreseen.

•Morecambe operating fully in 1999, will arrest reduction of Take or Pay bank.

•Acceleration of electricity programme.

•Reduce cost base in gas supply and retail.

•Further sales and profit growth in Services.

•Retail to reduce costs and maximise turnover, but losses anticipated.

•Option to reverse Transco pre-payment £450m.

•Proposed Distributions, if approved, will reduce 1999 cashflow significantly.

•Many divestment opportunities to pursue.