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**1997 Full Year Results**

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Roy Gardner  
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Finance Director

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## Results in brief

	<u>Full year 1997</u>	<u>Full year 1996</u>
<b>Sales</b>	<b>£7,842m</b>	£8,125m
<b>Operating profit pre-exceptional</b>	<b>£175m</b>	(£57m)
<b>Earnings pre exceptional</b>	<b>£44m</b>	(£203m)
<b>Cashflow pre-exceptionals</b>	<b>£877m</b>	(£2m)
<b>Employees (FTE)</b>	<b>14,989</b>	15,369

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### Results in Brief

Overall, we have made good progress in achieving the objectives we set ourselves at the time of demerger. Operating profit was up £232m against 1996, earnings up £247m, and cashflow up substantially by £879m.

## 1997 Achievements

- Continuing improvement in customer service
- Marketing and price initiatives implemented
- 'Take or Pay' now manageable
- New product initiatives
- Cost reductions achieved
- Strong cash generation

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### **1997 Achievements**

Customer Service standards have improved to their current high level, and this is being reflected in our customer satisfaction surveys.

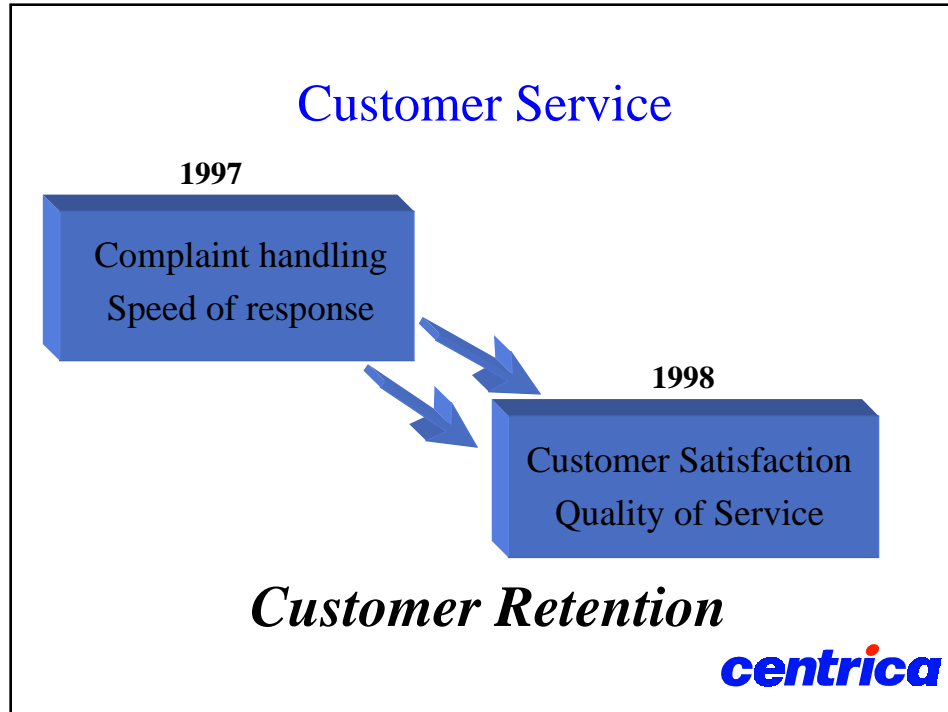
We have implemented price reductions nationally and launched a marketing campaign for gas and electricity.

Our gas portfolio is now manageable following our success in the take or pay contract renegotiations.

We've pushed ahead with developing new business activities.

Our operating costs have reduced by 13% on 1996 but clearly not at the expense of customer service.

We have achieved good financial performance in the critical area of cashflow.



## **Customer Service**

The 1997 regulated and internal targets in the key areas of telephone response and correspondence handling have been exceeded.

In 1998 we are now focused on overall customer satisfaction and concentrating on the quality of our service delivery to differentiate us from the competition and ensure greater customer retention.

Recent initiatives include:

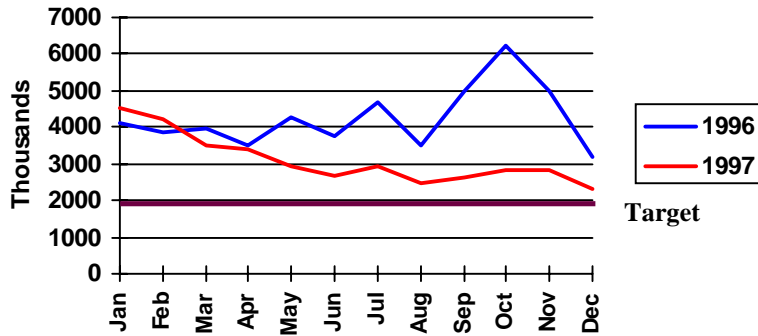
Introduction of a new simplified A4 bill to reduce customer enquiries (which has recently won a UK Utility Award).

Gaining ISO 9002 quality accreditation in a number of key functions within Services and Trading

An internal excellence award programme to motivate and reward the outstanding performance of our staff.

# Gas Consumers Council

## Category A complaints 1996/7



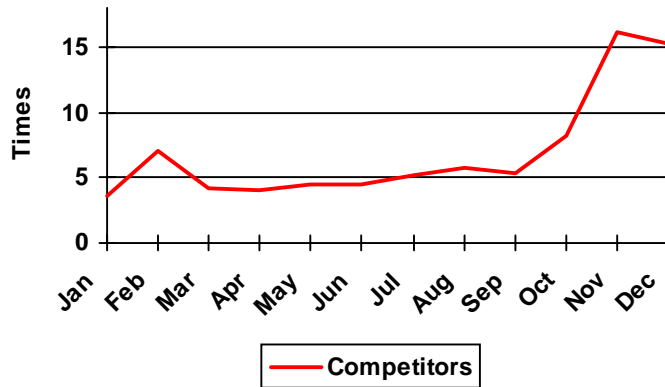
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## Gas Consumers Council

Complaint levels are now at their lowest for two years. Total complaints in 1997 were 28% below 1996 and the level is now down to just over 2,000 per month and falling. The aim is to reduce complaints to below 2,000 per month which represents approximately 0.01% of our customer base.

## Gas Consumers Council

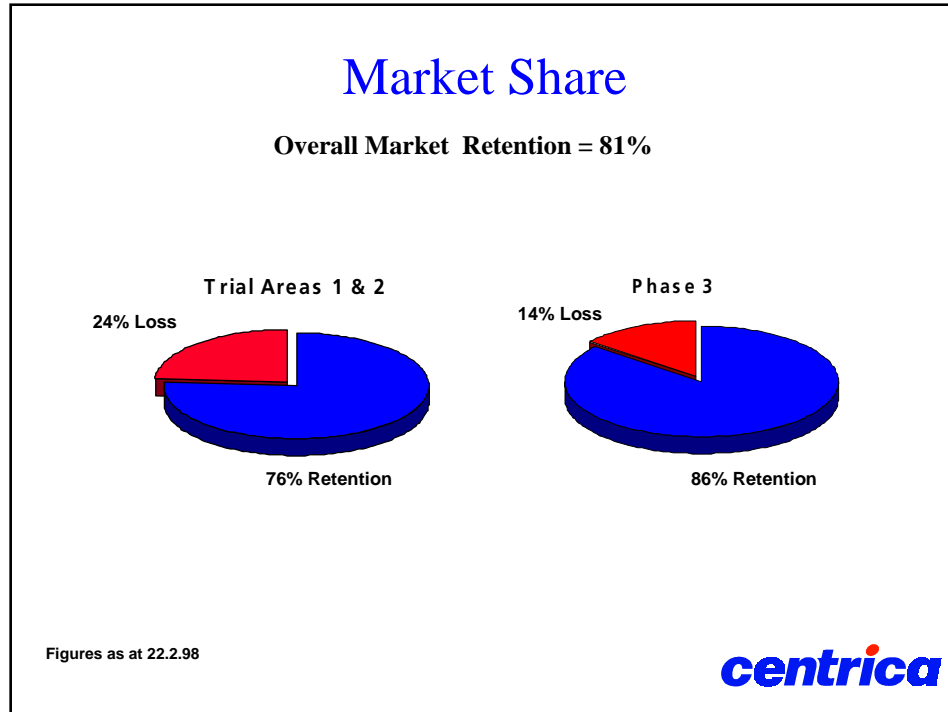
### Category A complaints of competitors relative to BGT



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### Gas Consumers Council – Category “A” complaints per 1,000

When compared with our competitor performance, in November and December complaints per customer were 15 times higher against our competitors than British Gas.



## Market Share

In the 2 trial areas where domestic competition has been established for some time, we have retained 76% of our customers, and our overall market retention in all competition areas as at February 1998 was 81%.

We continue to be concerned with the sometimes misleading information given by agents employed by some of our competitors, but we are pleased to note that the regulator has already taken steps to vigorously enforce the new licence condition concerning doorstep selling.

The costs of introducing competition have been high, but we are determined to make sure that competition works and ensure our customers receive a top class service.

We have seen customers return to us – either because they are not happy with the service they receive from their new supplier, or they have been incorrectly switched. Over 80,000 customers in the competition areas have already returned, or as new householders have chosen British Gas as their supplier since competition began.



## Marketing Response



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### **Marketing Response**

The new tariff, ValuePlus, was introduced into early competition areas, offering a 12% reduction on the standard tariff.

We have announced our plans to sell electricity to residential customers in 1998 at savings averaging 15% off prices prevailing in November 1997.

We have reduced our gas prices nationally from January this year.

We have increased the level and focus of our advertising campaigns. For example, “15” campaign aimed at changing customers’ perception of the price differential with competitors.

## Gas Contracts

- Renegotiation - substantially complete
- Gas Levy removed
- Continental sales secured
- Take or Pay bank reduced by 44%
- Volume / Price exposure reduced
- Revocation achieved
- Risk management

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### Gas Contracts

2/3<sup>rd</sup> of the original exposure have been removed and our volume and price exposures are now down to a manageable level.

The abolition of the Gas Levy reduced our WACOG by approximately 1p.

Additional contracts have been agreed to export gas to the continent through the Interconnector.

The Take or Pay bank reduced by 44% over the last year with an expectation that it will reduce to zero over the next few years.

Revocation of the Morecambe tax price was achieved – eliminating many of the tax inefficiencies within Centrica.

We continue to address risk to changes in market prices and escalation indices through innovative contracts e.g. recent contract with Enron utilising IPE market index.

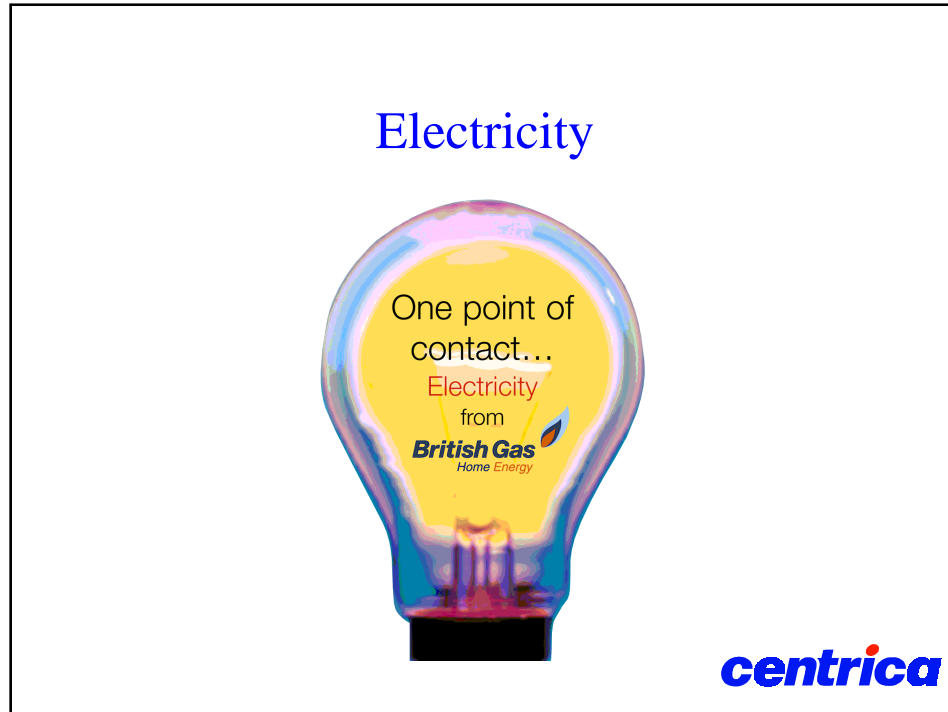
## New Business

- Electricity
- Goldfish
- Insurance
- Home Security

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### **New Business**

Our new businesses are key to providing us with revenue and earnings for the future, retaining customers, and maximising the value of our infrastructure. We aim to grow new substantial businesses in their own right.

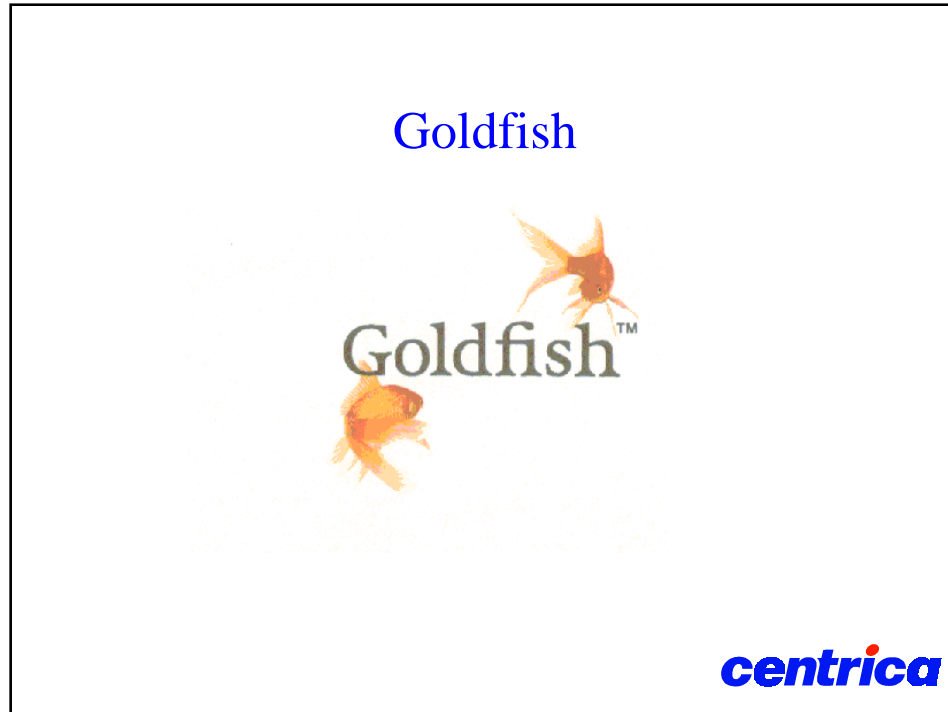


## **Electricity**

Electricity supply is the obvious extension to our product range as we already have the infrastructure in place. We are ready to become the first national supplier of gas and electricity.

As at February 1998, we have already had 3/4m registered leads and 15,000 customers have signed up, despite the extremely disappointing delay. We believe our package for dual fuel will be the best available.

Of course we need to arrange the sourcing of our electricity supplies. We are exploring a number of options with the aim to have the lowest cost source available.




## **Goldfish**

The Goldfish card has been an enormous success by any standards. We have now issued over 650,000 cards, with spend and usage being much higher than average, and with an increased number of quality redemption partners.

Other Goldfish brand initiatives include the Goldfish Guide, and Goldfish Loans. The Goldfish Guide will give customers direct marketing information about products, and we believe the Goldfish Loan will offer one of the best personal loan products on the market.

**Insurance**

  
**British Gas**  
can save you  
**1/3rd** of the  
cost of your  
home  
insurance



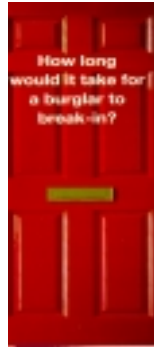
privilege

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## **Insurance**

This is a logical extension of our other home services activities aimed at retaining gas customers. The trial announced in December, offered 1/3<sup>rd</sup> off home and contents insurance which can be redeemed against the customers gas bill – on average amounting to £60-£70. The next phase of the roll-out will start in March 1998.

## Home Security



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### **Home Security**

Our move into home security provides an excellent use of our infrastructure – Call centres, Service engineers and our contracting skills. During the initial trial, we gained 9% of the market and we intend to roll-out nation-wide by this summer.

This product provides a good platform to extend into other alarm systems covering smoke detection and frozen pipes.

## Objectives for 1998

- **Customer Service**
  - Quality of delivery
  - Best in Class
- **Customer Retention**
  - Value for money
  - Excellent service
  - Unrivalled experience

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### **Objectives for 1998 (1)**

We will continue to focus on customer service – both quality of service, and speed of response. Our aim is to achieve best in class in what we do.

We are also concerned to ensure our customers are kept informed of reality in the face of competitors high-pressure techniques and the resultant confusion.

Our 1998 campaign will focus on value for money, excellent service, and unrivalled experience.



## Objectives for 1998

- **Delivery of new products**
  - Electricity
  - Financial services
  - Services to the home
- **Operational improvements**
  - Millennium
  - Service/Retail
  - Review cost base
  - Energy Management Group

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### Objectives for 1998 (2)

We will be a major player in the electricity market, offering the best value for money dual fuel service, build on the new financial services products, and continue to expand the services provided to customers in their home.

We also have a number of operational improvements we intend to make in 1998. We need to ensure our systems are ready for the year 2000, concentrate on profitability in Services and Retail, and across all units build on the cost reductions achieved in 1997.

We believe the new Energy Management Group, which combines the commercial arm of British Gas Trading with Accord and Morecambe, has the expertise necessary to better manage our transportation and gas cost base and optimise our trading activities.

## Results in brief

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## Turnover

	1997 (£m)	1996 (£m)
<b>Energy Supply (at SNT):</b>		
<b>Domestic</b>	5,906	6,192
Non Domestic	1,218	1,235
<b>Weather</b>	(391)	71
<b>Sub Total</b>	6,733	7,498
<b>Accord</b>	459	-
<b>Service</b>	467	452
<b>Retail</b>	183	175
<b>Total</b>	7,842	8,125

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### Turnover

Overall, turnover was down by £283m on 1996. The effect of weather year on year was £462m adverse. In total, domestic volumes were down 1.7bn therms to 11.4bn of which weather accounted for approximately 1.1bn and competition a further 0.2bn

The impact of competition on turnover in 1997 was estimated to be just over £100m

Commercial / Industrial volumes were down 6% to 6.1bn but this was partially offset by higher selling prices, up 5% on average.

The 1997 results include Accord from March, and the full year performance of £566m was up 40% on 1996.

Service & Retail were up £23m due to a combination of selling price increases and new product rollout.

## Operating Profit Analysis

	1997 (£m)	1996 (£m)
<b>Energy Supply (at SNT):</b>		
Domestic	91	77
Non Domestic	(323)	(369)
Weather	(81)	24
<b>Sub Total</b>	<b>(313)</b>	<b>(268)</b>
<b>Morecambe</b>	566	473
<b>Accord</b>	16	-
<b>Service</b>	(49)	(196)
<b>Retail</b>	(45)	(66)
<b>Total</b>	<b>175</b>	<b>(57)</b>

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### Operating Profit Analysis

Operating profit was up £232m on 1996

The impact of warmer weather was £105m adverse. At Seasonal Normal Temperature, domestic profit was up £14m due to lower operating costs of £55m, offset partially by higher gas costs and higher transportation costs. The non-domestic business loss was down by £46m with average selling prices up by 1p per therm offset partially by higher gas costs.

Morecambe profit was up £93m. PRT was £100m lower, based on new tax price, and production volumes were down 6% at 3.2bn

Accord profit for the full year was £31m. However, of this, £7m was pre acquisition and £8m was a fair value adjustment, hence the £16m operating profit.

Services were £147m better with lower operating costs of £86m and improved margins, up 77%. Productivity was up from an average of 76% in 1996 to 85% in 1997.

Retail improved by £21m but has suffered very poor last quarter performance and incurred additional logistical and installation costs. Steps have now been taken to address the operational problems, reduce costs further and strengthen the management team.

## Operating Costs

	<u>1997 (£m)</u>	<u>1996 (£m)</u>	<u>%</u>
<b>Energy supply</b>	<b>(736)</b>	(779)	-6%
<b>Services</b>	<b>(193)</b>	(279)	-31%
<b>Retail</b>	<b>(107)</b>	(128)	-16%
<b>Total</b>	<b><u>(1,036)</u></b>	<u>(1,186)</u>	<u>-13%</u>

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### Operating Costs

A substantial reduction of 13% was achieved in operating costs in 1997, mainly achieved from headcount reductions. Average full time equivalent was down 21% against 1996.

We have successfully removed significant costs in Services and Retail, whilst in energy supply incurring some additional costs for electricity and competition roll-out.

In 1998 we face additional costs for Year 2000 (£43m) and the costs of gearing up for full roll-out of gas competition.

<b>Earnings</b>		
	<b>1997 (£m)</b>	1996 (£m)
<b>Operating profit</b>	<u>175</u>	<u>(57)</u>
<b>Associates / Profit on sales</b>	(2)	15
<b>Interest received</b>	39	39
<b>Taxation</b>	<u>(168)</u>	<u>(200)</u>
<b>Underlying performance</b>	44	(203)
<b>Exceptionals</b>	<u>(835)</u>	<u>(857)</u>
	<u>(791)</u>	<u>(1,060)</u>

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## **Earnings**

Earnings, pre-exceptional, were up £247m on 1996 mainly as a result of improved operating profit. 1996 associates included a £16m contribution from Accord.

Interest received includes interest on the Transco prepayment of £36m in 1997 and amortisation of discounted provisions of £8m. 1996 also benefited from the substantial financing arrangements from BG.

The effective tax rate on ring fenced profits was 29% in 1997.

## Normalised Earnings (at SNT)

	<u>1997 (£m)</u>	<u>1996 (£m)</u>	<u>Increase (£m)</u>
Earnings	44	(203)	
PRT		69	
Weather	81	(24)	
<b>Total</b>	<b>125</b>	<b>(158)</b>	<b>£283m</b>



### Normalised Earnings

Adjusting earnings for the effect of weather and Petroleum Revenue Tax in 1996 show underlying earnings are £283m better.

This is due to the lower operating cost base in all businesses of £150m, higher selling prices for gas in the Industrial / Commercial market which account for around £70m, and higher margins in Services of around £60m.

## Exceptionals

	97 (£m)	96 (£m)
Windfall tax	192	-
Severance	35	117
Gas contracts:		
Renegotiation	573	601
Contract Losses	35	104
Total	835	822

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### Exceptionals

The windfall tax accounted for £192m of which half was paid in 1997 with the balance due in December 98.

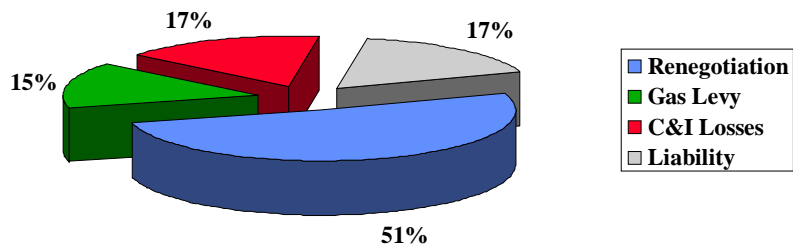
The severance payments were mainly for Services - £20m announced in the first half of 1997 covering 800 staff, and an additional £15m to cover a further 500 redundancies announced to staff in February 1998.

The £573m provided for contract renegotiations completes the current series of deals and includes Audrey (£43m) announced February 1998, Chevron announced January 1998, and the options granted to Conoco for a further 1bn therms to be negotiated in 1998.

The loss provision covers the European Interconnector contracts signed in the year.



## Estimated Gas Contract Liability Analysed



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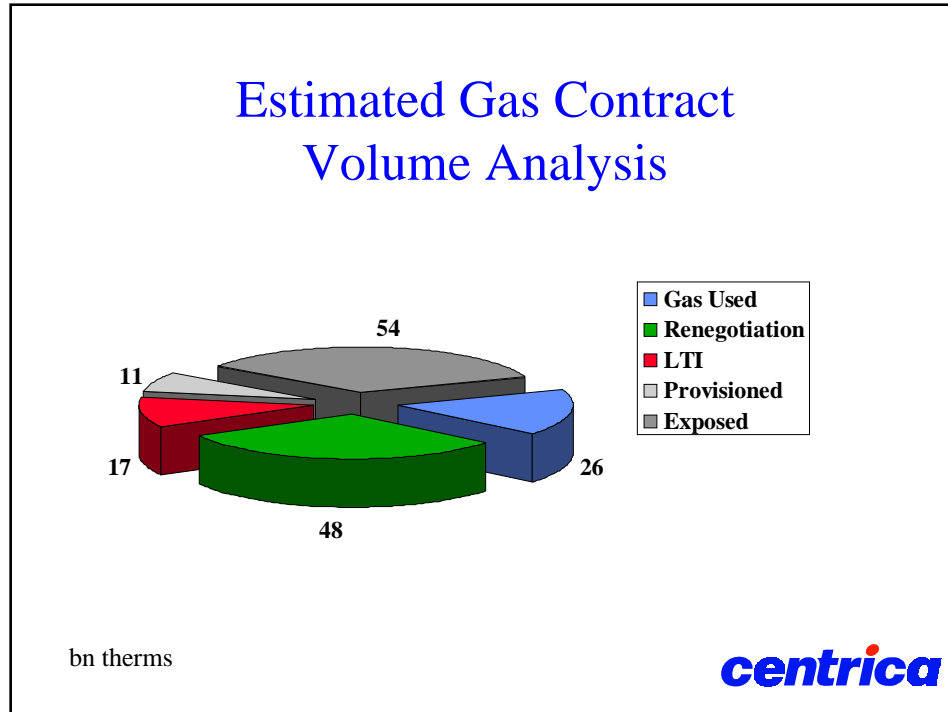
### Estimated Gas Contract Exposure – Liability analysed

Total amount charged, pre tax for re-negotiation to date is £1.2bn, bringing a reduction in volume commitments of 26bn therms, and reduced price commitments on 22bn therms.

In total we have renegotiated just over 50% of our original liability measured by net present cost, the Gas Levy removed a further 15% and Industrial / Commercial losses in last two years traded through the P+L have accounted for a further 17%.

Although a 17% liability remains, we now believe this is manageable against current long-term gas prices.

## Estimated Gas Contract Volume Analysis

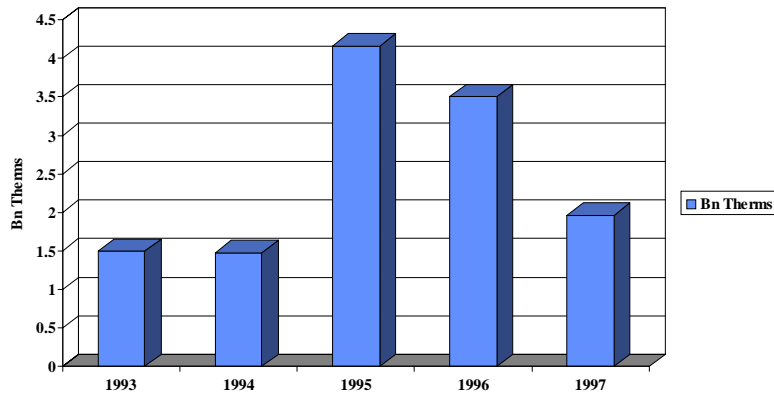


### Estimated Gas Contract Exposure – Volume Analysis

Against the total volume pre renegotiation of 156bn, our P&L exposure is now 54bn. Domestic market pre-competition will use 26bn, we have commitments to deliver 17bn therms to our Long Term Interruptible customers, we have provided against 11bn therms for long-term gas sales and the Take or Pay bank, and have renegotiated a total of 48bn therms covering both volume and price.

External WACOG projections for Q4 1998, post removal of the Gas Levy and renegotiations, are around 17.5p/therm for 1998, against 19.0p on average in 1997.

## Prepaid Take or Pay Volumes as at 31/12/97



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### Pre paid Take or Pay Volumes

Our Take or Pay bank reduced by 1.5bn therms – despite the warmer weather, and the plan in 1998 is to reduce it further to unlock the prepayment - subject to weather constraints.

## Cashflow

	1997 (£m)	1996 (£m)
Energy Supply	509	547
Services	(16)	(178)
Retail	(40)	(62)
Operating cashflow	453	307
Working Capital	575	(264)
Sub Total	1,028	43
Capex	(84)	(91)
Taxation and Interest	(67)	46
Sub Total	877	(2)
Exceptionals	(653)	(905)
Total	224	(907)



### Cashflow

Cashflow before exceptionals was up £879m over 1996.

Operating cashflow was up £146m as a result of the improved business performance.

The improvement of £839m in working capital includes the use of the Take or Pay bank (£242m in 1997 v £95m in 1996), the benefit of a cold last quarter in 1996 and warm 1997, estimated at £150m, the recovery of billing problems and backlog from 1996 and the benefit of improved cash management process.

Tax paid includes corporation tax on Morecambe for the second half of 1996.

## Outlook for 1998

### Earnings

- Reduced transportation costs
- Gas costs down
- Lower selling prices
- Millennium costs
- Substantial tax changes
- Service and Retail improvements

### Cashflow

- Weather effect reverses
- Windfall tax
- Exceptionals spend
- Full year tax on Morecambe

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### **Outlook for 1998**

#### **On Earnings,**

- Reductions in Transportation costs announced in 1997 will give a full year effect in 1998.
- Gas costs will be down in 1998 as a result of the levy reduction and the renegotiation effects from October.
- Prices to 2/3 of our gas customers have been reduced by 8-9%.
- Millennium costs of £61m in total are forecast of which £43m is anticipated in 1998.
- The tax position will change due to revocation of South Morecambe tax prices. The South Morecambe price will drop to market prices plus swing from January 1998, royalties paid will reduce accordingly, the Petroleum Revenue Tax benefit has already been seen in 1997, and corporation tax will reduce on lower ring fenced profits.
- Work continues to reduce Service and Retail losses substantially in 1998.

#### **On cashflow:**

- A large proportion of the estimated £150m benefit from weather is likely to reverse in 1998.
- The second instalment of the windfall tax is due, in addition to exceptionals provided for in 1997 not paid, amounting to around £200m.
- A full year's Corporation Tax on Morecambe, estimated at £240m, will be payable.
- We will not have the benefit of prior year billing backlogs reversing.