



# Centrica

'We continued to make progress  
by concentrating on what our  
customers want.'

Sir Michael Perry, Chairman

---

Centrica's vision is to be a leading supplier of essential services in our chosen markets. Our strategy is to retain and attract customers in our core businesses with continual improvements in service and value, while at the same time developing new opportunities in the UK and internationally.

---

#### Contents

02	Centrica at a glance
04	Chairman's statement
05	Chief executive's review
07	Operating and financial review
16	Group financial review
19	Corporate responsibility
21	Board of directors
22	Directors' report
25	Remuneration report
31	Statement of directors' responsibilities
31	Auditors' report
32	Financial statements
68	Gas and liquids reserves
69	Five year summary
70	Information for shareholders
72	Index

#### Visit our websites

You can find out more about Centrica and the businesses in our group by visiting our websites.

[www.centrica.com](http://www.centrica.com) provides information about the group, including our corporate responsibility activity and shareholder services.

You can find out more about the products and services we offer by visiting our customer sites:

[www.theAA.com](http://www.theAA.com)  
[www.house.co.uk](http://www.house.co.uk)  
[www.britishgasbusiness.co.uk](http://www.britishgasbusiness.co.uk)  
[www.goldfish.com](http://www.goldfish.com)  
[www.onetel.co.uk](http://www.onetel.co.uk)  
[www.directenergy.com](http://www.directenergy.com)  
[www.energyamerica.com](http://www.energyamerica.com)  
[www.luminus.be](http://www.luminus.be)

Throughout this document references to British Gas include Scottish Gas.

# Overview of the year

Before exceptionals and goodwill amortisation including joint ventures and associates

## Earnings per share (pence)

02	15.2
01	12.1
00	10.2
99	7.9
98	4.0

## Operating profit (£m)

02	932
01	679
00	526
99	424
98	213

After exceptionals and goodwill amortisation including joint ventures and associates

## Earnings per share (pence)

02	11.4
01	8.1
00	8.4
99	4.3
98	2.1

## Operating profit (£m)

02	809
01	511
00	452
99	275
98	128

Operating profit: up 37% (58% after exceptionals and goodwill)

Earnings: up 32% (48% after exceptionals and goodwill)

British Gas residential: improved gas margins and growth in electricity and services

Centrica Business Services: profit up 48% with organic growth supported by acquisitions

AA: core business growth in roadside and personal finance

Telecoms: losses reduced by two thirds and improving sector outlook

Goldfish: credit card growth from renewed brand building

North America: acquisitions of incumbent positions but slower organic growth

Dividend: final dividend up 37%; up 29% for the year

All operating profit numbers and earnings are stated, throughout the commentary, before exceptionals and goodwill amortisation unless otherwise stated. The directors believe this measure assists with understanding the underlying performance of the group. The equivalent amounts after exceptionals and goodwill amortisation are reflected in note 3 and are reconciled at group level in the group profit and loss account on page 32, with descriptions of the exceptional items in note 5.

## Centrica at a glance

---

Every day we touch the lives of millions of people. Through our leading brands, Centrica provides warmth, comfort and peace of mind.

People know us through our brands but behind those brands lie the skill, knowledge and expertise of thousands of employees.

Centrica has unrivalled experience in providing essential services to people in their homes and on the road.

---



### British Gas

[www.house.co.uk](http://www.house.co.uk)

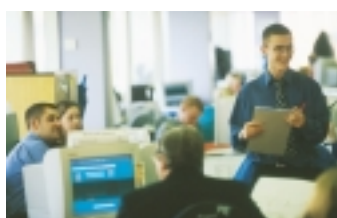
**Gas:** We supply gas to homes throughout Britain, under the British Gas and Scottish Gas brands. Against the background of a highly competitive energy market, millions of customers continue to choose us as their gas supplier.

**Electricity:** Since the residential electricity market opened to competition in 1998 we've become one of the largest suppliers of electricity in Britain.

We are committed to providing our customers with excellent service and great value for money.

**Telecommunications:** British Gas Communications was launched in September 2000, and offers customers fixed line, mobile and internet services.

**Home services:** We continue to be the largest provider of gas central heating installation and servicing in the country. We also offer our customers the reassurance of protection in other areas of the home, providing services for kitchen appliances, plumbing and drains, electrical wiring and home security systems.



### Centrica Business Services

[www.britishgasbusiness.co.uk](http://www.britishgasbusiness.co.uk)

During the year we created Centrica Business Services.

We supply gas, electricity and telecoms to industrial and commercial customers across Britain using the British Gas, Scottish Gas and One.Tel brands.

In addition to increasing our share of the energy market for small and medium sized enterprises, we are creating broader bundled offers. These build on emerging operational synergies, as well as our local and national presence.



### Centrica energy management group (CEMG)

[www.centrica.com](http://www.centrica.com)

**Gas and electricity operations:** Our equity gas production and electricity generation capabilities, along with third party supply and transportation contracts are managed to optimise value and assure reliable supply for customers.

**Energy trading:** Our trading and wholesaling business, Accord Energy, trades with all the major participants in the

wholesale UK energy market and is an active player in the emerging European markets.

---

---

We aim to enhance the service we provide to our customers and the value we give to our shareholders by continually deepening our understanding of what our customers want.

We do this by training our people, enhancing our systems and developing our brands. Centrica strives to ensure that all our experience and knowledge is shared across our businesses for the benefit of customers and shareholders alike.

---



### The AA

[www.theaa.com](http://www.theaa.com)

**Roadside services:** We provide reassurance and services to motorists in the UK and Ireland through the AA. The roadside assistance service remains at the core of our activities, with members choosing the level of cover that best suits their needs.

are a growing provider of personal loans and financial services.

**Other AA services:** AA Service Centres offer a range of maintenance and repair services to motorists across Britain.

**Personal finance:** We are the UK's number one independent insurance intermediary, and we

We are the only national driving school exclusively using fully qualified driving instructors.



### One.Tel

[www.onetel.co.uk](http://www.onetel.co.uk)

With a fresh and innovative approach, we provide a range of landline, mobile and internet services across the UK.

Our mobile service offers one of the lowest monthly line rental charges in the country.



### Goldfish Bank

[www.goldfish.com](http://www.goldfish.com)

Building on the success of the Goldfish card, we have launched the Goldfish Bank in partnership with Lloyds TSB to develop a wide range of financial services products.

New products include a savings account, personal loans and a guaranteed savings bond.



### North America and Europe

[www.directenergy.com](http://www.directenergy.com)  
[www.energyamerica.com](http://www.energyamerica.com)  
[www.luminus.be](http://www.luminus.be)

**North America:** Through Direct Energy in Canada and Energy America in the US we supply energy to homes and businesses in several provinces and states.

ventilation installation and maintenance services.

Our Direct Energy home services division provides heating and

**Europe:** Our joint venture energy business, Luminus, is an active participant in the liberalising Belgian market.







Our strong brands, enhanced customer insight and asset management expertise will continue to enable us to create value for customers and shareholders.

---

During 2002, Centrica continued to make progress towards our vision of 'taking care of the essentials' for customers in our chosen markets. We have done this by concentrating on what our customers want. This has led to top-line growth across our business units and helped drive adjusted earnings per share up 26% (before exceptional items and goodwill amortisation).

We took significant steps to ensure that British Gas remains the market leader in residential energy and continues to improve its performance in other home services. The AA had a year of solid performance as we repositioned the AA brand to increase awareness of the wide range of products and services available to motorists. Our North American business has made progress despite a challenging regulatory environment.

**Centrica remains well placed to compete in an increasingly international energy marketplace where we expect further consolidation.**

In the UK, the measures to underpin a competitive energy market enable us to continue to deliver benefits to customers. In the wider European context, good progress was made towards agreeing a framework for introducing competition to the entire energy market. In addition a number of important improvements were made to the competitive conditions in the UK telecoms market but there is still further work to be done.

#### **Dividend**

The board of directors is proposing a final dividend of 2.6 pence per share to be paid in June 2003. When combined with the interim dividend of 1.4 pence per share paid in November 2002, the total dividend for 2002 would be 4.0 pence per share. This represents an increase of 29% on the previous year and reflects our positive medium term outlook for both earnings and cash flow.

#### **The board of directors**

We announced a number of changes to the board during the year. Sir Sydney Lipworth retired at the annual general meeting in May and we are most grateful for the significant contribution he made to the development of Centrica. In September we announced the appointment of Helen Alexander and in October the appointment of Robert Tobin as non-executive directors with effect from 1 January 2003. I am delighted that Helen and Robert have joined us. Their considerable experience will further strengthen the board.

#### **Corporate responsibility**

We recognise that creating sustainable shareholder value depends on a full understanding of our impact on society and the responsible management of our business in a manner consistent with our values and principles. To this end, we established a corporate responsibility committee which sets the framework for developing and reporting our efforts in this area. Our approach was recognised by our inclusion in the FTSE4Good and Dow Jones Sustainability indices.

**We recognise that creating sustainable shareholder value depends on a full understanding of our impact on society.**

#### **The future**

Centrica remains well placed to compete in an increasingly international energy marketplace where we expect further consolidation. Our strong brands, enhanced customer insight and asset management expertise, combined with our financial and operational scale, will continue to enable us to create value for customers and shareholders alike.

The collective efforts of all Centrica employees have ensured that we have made further progress towards our vision during 2002. I would like to thank them for their commitment and I look forward to working with them to deliver the business performance, which will provide our customers with the service that they want and reward our shareholders appropriately.

**Sir Michael Perry GBE**  
Chairman

# Chief executive's review



We have a strong business with leading market positions and I am confident that our strategy will continue to deliver value for our shareholders.

In 2002 the group continued its strong overall financial performance, in particular from our leading UK energy operations, where improvement in margins and growth were accompanied by new momentum in our services to business customers and expansion of our upstream energy asset portfolio.

Our AA roadside and personal finance operations continue to deliver solid underlying profit growth. Despite slow regulatory progress in our UK telecoms and North American energy markets, we are expanding in both businesses. Goldfish brand development continues with a more focused product line. Our reinvestment in growth areas is proceeding selectively, with a constant focus on economic value creation.

Global energy markets were hit in 2002 by turbulence and the retrenchment or exit of certain market participants, and the UK was no exception. Positive underlying progress in the transparency and competitiveness of the UK wholesale electricity market resulted in financial pressure on some asset owners, and poor performance for those market participants that had not anticipated the fundamental impact on wholesale pricing.

However, the wholesale gas and electricity markets are resilient, with ample commodity supply enabling British Gas to benefit from both retail brand leadership and the hedging effect of our energy asset management. The value strategies that we are pursuing in both the upstream and downstream markets within the UK continue to afford the group a competitive advantage.

#### Turnover and profitability

Group turnover (excluding Accord trading revenue) was £10 billion in 2002, up 11% from the prior-year period. Higher sales to our business customers – through Centrica Business Services – were complemented by an increase in residential electricity sales as well as growth in North America, the AA's roadside and personal finance units, home services and One.Tel. UK gas sales volumes were lower, largely due to unusually warm weather in the first and fourth quarters of the year.

Group operating profit (including joint ventures and associates, before exceptionals and goodwill amortisation) of £932 million was up 37% from £679 million in 2001, with improved performance across most brand units, particularly British Gas. Aggregate group gross and operating margins (excluding Accord) were 30% and 9%, up from 26% and 7% respectively in 2001.

#### Customer service

We maintained our focus on improving customer service levels across all of our brands. We are now placing greater importance on qualitative and value-based measures of customer service which are built into a scorecard evaluation and reflected in the remuneration of staff at all levels.

As testament to our focus on these areas, we continue to be highly rated by external agencies. In particular, the AA won the JD Power & Associates 2002 UK Roadside Assistance Study award for customer satisfaction for the third time in five years. Further accolades include Which? magazine naming the AA as the UK's best motoring organisation, and www.house.co.uk winning the 2002 Customer Management National E-commerce Customer Service Award.

#### Outlook

Whilst the economic outlook remains uncertain, we are moving from a period of considerable investment in growth opportunities and strategic market entries, to a period of delivery from these investments, underpinned by new customer relationship management (CRM) platforms and common competencies in securing value from deeper customer relationships.

For British Gas, we expect continuing recovery in residential gas gross margins and further electricity growth to generate further profit improvement, partially offset by the higher costs of the government's Energy Efficiency Commitment and peak CRM system implementation expenses through to 2004. Annual CRM cost synergies will drive further medium term growth in British Gas operating margins.

In the UK retail energy sector competition remains tough, although we believe that the transaction prices paid recently by acquirers should result in retail pricing consistent with positive supply margins. In addition, reduced doorstep selling in the industry appears to be leading to lower churn

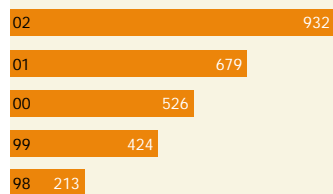
#### Operating profit by business\* (£m)

	2002	2001
British Gas residential	244	(46)
Centrica Business Services	65	44
Centrica energy management group (CEMG)	520	573
The AA	73	72
Goldfish Bank	(40)	(32)
One.Tel	2	4
Centrica North America	63	68
Other operations	5	(4)
<b>Group</b>	<b>932</b>	<b>679</b>

\*Before exceptional charges and goodwill amortisation, including joint ventures and associates.

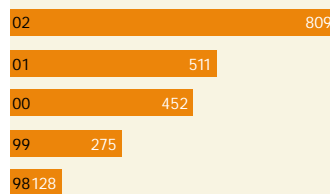
# Chief executive's review continued

## Operating profit (£m)



Before exceptionals and goodwill amortisation, including joint ventures and associates.

## Operating profit (£m)



After exceptionals and goodwill amortisation, including joint ventures and associates.

rates. While we expect the result of this reduced industry churn to be slower growth in our residential electricity customer base than we had previously anticipated, reduced customer acquisition expenses should contribute to better electricity profits.

We expect to increase market share and profitability in the UK commercial energy sector. The launch of Centrica Business Services has resulted in increased management focus and growing product portfolios in this unit.

It is anticipated that output volumes from our Morecambe Bay gas production facilities will decrease by around 10% per year, offset over time by greater output from other currently held gas assets and future acquisitions. We expect our cash petroleum revenue tax (PRT) payments to decline significantly over the next few years.

Profitability of the AA is expected to continue to improve, and expenditure in information technology will peak in 2003. For One.Tel, we expect that regulatory improvements will warrant renewed organic investment in brand and product marketing at the same time as developing our growing mobile and internet businesses. For Goldfish, significant improvement to credit card and loans contributions are expected in 2003 and with a more focused rollout of new products, breakeven will occur towards the end of the year.

North America continues to offer a significant value creation opportunity, given our focus on the marketing and service elements of deregulated energy supply. We continue to lobby regulators to maintain legal frameworks and incumbent pricing levels which

allow sufficient and stable gross margin headroom to attract new market entrants. Without this regulatory commitment to proper competitive markets, current organic growth prospects and customer renewals are being negatively affected. In this environment, we expect to focus in 2003 primarily on the integration of our existing customer bases and on profitability. We will maintain a flexible approach to customer acquisition, seeking to acquire incumbent supplier customer bases and playing a key role in markets at early stages of deregulation. Our organic growth will be focused in a few larger state and provincial markets which offer sufficient scale for successfully marketing our energy and related services. As a result of this industry environment and our strategic focus, the timing for achievement of our broader ambition in North America will depend upon the availability and pace of key acquisition opportunities.

Our strategy in continental Europe is to build a significant customer base in the medium term. Although the pace of deregulation varies across the individual markets there are now clear timetables for commercial and residential market openings. The whole of the European Union household energy market is expected to be liberalised by mid 2007. We are focusing on those countries where the speed of market opening and legal and political conditions, including unbundling and independent regulation, are more advanced.

### Employees

Our employees are central to the delivery of our strategy and we need to continue to attract and retain high quality, highly motivated people. I am pleased that we have recruited some excellent people

over the last year to complement our existing team. We are also developing programmes to ensure that we have the leadership capability to drive our strategy forward.

I am committed to making Centrica an employer of choice and the recent accreditation of our AA brand unit as 'Investors in People' is one indication that we are developing the highest standards of employment policies and practices. Increased scores in our satisfaction survey in 2002 demonstrate that our employees share our vision and are committed to delivering our strategy. I would like to join the chairman in thanking them all for their ongoing and valued commitment.

### Conclusion

To sum up, we have a strong business with leading market positions. Our core businesses are growing and are strongly cash generative and our investment in new businesses is proceeding as market opportunities emerge. I am therefore confident that our strategy will continue to deliver value for shareholders.

Sir Roy Gardner  
Chief Executive



# Operating and financial review



British Gas serves millions of customers every day.

## British Gas residential Improved gas margins and growth in electricity and services

2002 has seen progression in the performance of British Gas residential, driven by improved gas margins, continuing growth in electricity and home services and reduced losses in communications. Aggregate turnover was up 2.3% in 2002, at £6 billion with operating profit at £244 million (2001: loss of £46 million), despite warmer weather. Our energy and home services operations have been integrated to reflect our vision of enhancing customer loyalty through greater understanding and to realise higher revenue and cost synergies. Our investment in the British Gas brand continues to support our leading position in the residential energy and services sectors and allows us to continue to build further multi-product customer relationships, with the aim of becoming Britain's leading home services provider. Our operations will be further supported by our investment in customer relationship management (CRM) infrastructure, enabling improved service levels, a lower cost to serve and lower costs to acquire new product relationships.

At British Gas we're making investments to enhance the quality of service we provide to millions of customers every day. We are now significantly increasing the number of engineers and developing a range of skills and expertise to sustain our competitive edge in the market. Continued investment in development of our employees so that they are able to provide ever improving service standards will lead to durable and profitable customer relationships.

British Gas strongly believes that selling practices across the energy industry must continue to be improved. It has taken a leading position driving the new code of sales practice, removing commission-only sales agents and implementing an independent compliance regime.

At 40%, British Gas's share of the aggregate residential energy customer base in Britain remained steady against the same time last

year. Net losses in gas customers were in line with 2001 but reflect a longer term trend of stabilising market share with losses occurring primarily during the few months following retail price increases. Second half losses were 186,000 compared with 426,000 in the first half. Electricity sales growth was reduced by the withdrawal of commission-only sales agents. Churn rates declined in the second half of the year, with the market showing signs of lower switching

rates overall. We believe that our premium British Gas brand, improving customer service and breadth of branded home service offerings will continue to afford us competitive advantages in our sectors.

Increases in residential energy gross profits were partially offset by the £26 million expensed investment in CRM infrastructure (2001: £9 million). We expect this will begin to improve our operating profit by reducing the costs to acquire and serve our customers from 2004. We also capitalised £154 million of CRM expenditure during the year (2001: £60 million). General and administrative expenses were higher as a result of higher manpower costs (largely to support a growing home services engineering workforce), higher debtor provisions (£20 million) and increased spending (£25 million) to meet our obligations under the government's Energy Efficiency Commitment.

Most of this spend was incorporated in our 'here to HELP' programme. This programme, created by British Gas, is the country's biggest independent initiative to tackle household poverty. In alliance with local housing providers and seven leading charities, this programme will provide help to 500,000 households over the next three years. This will take the form of energy efficiency measures, benefit checks and a range of services provided by our charity partners.

British Gas's home management website, [www.house.co.uk](http://www.house.co.uk), gives customers online access to British Gas 24 hours a day, every day of the week. Research shows that the site has averaged around 28% of all utility related web traffic in

### Key residential energy performance indicators

	2002	2001	Δ %
<b>Customer numbers (period end) (000)</b>			
Residential gas	12,839	13,451	(4.5)
Residential electricity	5,795	5,374	8
<b>Estimated market share (%)</b>			
Residential gas	64	67	(3ppts)
Residential electricity*	22	21	1ppt
<b>Average consumption</b>			
Residential gas (therms)	607	661	(8)
Residential electricity (kWh)	4,132	4,098	0.8
<b>Weighted average sales price</b>			
Residential gas (p/therm)	47.12	43.80	8
Residential electricity (p/kWh)	6.06	5.99	1.2
<b>Weighted average unit costs</b>			
Residential gas (WACOG, p/therm)	21.96	21.90	0.3
Residential electricity (WACOE, p/kWh)	2.47	2.55	(3.1)
<b>Transportation and metering charges (£m)</b>			
Residential gas	1,256	1,508	(17)
Residential electricity	444	342	30
<b>Total</b>	<b>1,700</b>	<b>1,850</b>	<b>(8)</b>
<b>Sales and marketing expenses (% of turnover)</b>	<b>4.2</b>	<b>4.3</b>	<b>(0.1ppts)</b>
<b>Average products per customer ** (period end)</b>	<b>1.53</b>	<b>1.50</b>	<b>2</b>
<b>Turnover (£m)</b>			
Residential gas	3,805	4,029	(6)
Residential electricity	1,380	1,121	23
<b>Total</b>	<b>5,185</b>	<b>5,150</b>	<b>0.7</b>
<b>Gross profit margin (%)</b>			
Residential gas	20	12	8ppts
Residential electricity	26	27	(1ppt)
<b>Total</b>	<b>22</b>	<b>15</b>	<b>7ppts</b>
<b>Operating profit (£m)</b>			
Residential energy	218	19	n/m
<b>Operating margin (%)</b>			
Residential energy	4.2	0.4	3.8ppts

\*2001 restated to reflect Ofgem market resizing during 2002.

\*\*British Gas residential brand.

Δ% has been used to express 'percentage change'.  
n/m has been used to represent 'not meaningful'.

# Operating and financial review continued



We continue to invest in the development of employees.

## British Gas residential segmental turnover (£m)

	2002	2001
Residential gas	3,805	4,029
Residential electricity	1,380	1,121
Home services	810	722
British Gas Communications	52	37
<b>Total</b>	<b>6,047</b>	<b>5,909</b>

Britain, up from around only 6% on the old British Gas site.

### Residential gas

Turnover decreased by 6% to £3.81 billion. Higher average selling prices were offset by a reduction in sales volumes, reflecting warmer UK weather (operating profit impact £42 million) and the net loss of around 600,000 customer accounts. We believe that our brand and the scale of service we provide support our average revenue per customer being above the average of the competition.

Gross margins recovered to 20% (2001: 12%). The recovery was driven by the increase in average selling prices and a reduction in transportation and metering costs of £252 million compared with 2001, due to lower volume and timing differences. A large portion of the lower costs arose in the early part of the year reflecting a reversal of the over-recovery by Transco in 2001 of National Transmission System (NTS) entry fees with a year-on-year impact of £98 million.

In 2002 we withdrew from the liquefied petroleum gas (LPG) business in line with our strategy of focusing on direct customer relationships as a large portion of the LPG business operated through third party retailers.

### Residential electricity

Turnover increased by 23% to £1.38 billion. Our weighted average retail price was slightly higher, as the full year effect of a reduction in prices in 2001 was offset by a shift in our customer mix following growth in the prepayment segment, which operates on higher tariffs given related administrative costs. Average consumption was broadly flat year on year. We believe that our average retail pricing is approximately 8% below the average of the incumbent suppliers and we estimate our market share at year end was 22% (2001: 21%).

Gross profit grew by 21% due to higher volumes, while our gross margin fell one percentage point to 26% due to increased transportation and metering

## Key home services performance indicators

	2002	2001	Δ %
<b>Customer relationships (period end) (000)</b>			
Central heating service contracts	3,482	3,314	5
Kitchen appliances care (no. of appliances)	871	562	55
Plumbing and drains care	905	743	22
Electrical care	367	143	157
Home security	28	28	-
<b>Total relationships</b>	<b>5,653</b>	<b>4,790</b>	<b>18</b>
Central heating installations	102	109	(6)
<b>Turnover (£m)</b>			
Central heating service contracts	398	371	7
Central heating installations	260	255	2
Other	152	96	58
<b>Total</b>	<b>810</b>	<b>722</b>	<b>12</b>
<b>Engineering staff employed</b>	<b>6,036</b>	<b>5,356</b>	<b>13</b>
<b>Sales and marketing expenses (% of turnover)</b>	<b>6</b>	<b>5</b>	<b>1ppt</b>
<b>Gross margin (%)</b>	<b>46</b>	<b>42</b>	<b>4ppts</b>
<b>Total operating profit (£m)</b>	<b>61</b>	<b>36</b>	<b>69</b>
<b>Operating margin (%)</b>	<b>8</b>	<b>5</b>	<b>3ppts</b>

## Key British Gas Communications performance indicators

	2002	2001	Δ %
<b>Customer numbers (fixed line) (period end) (000)</b>	<b>367</b>	<b>400</b>	<b>(8)</b>
<b>Average minutes use per month (fixed line)</b>	<b>340</b>	<b>347</b>	<b>(2)</b>
<b>ARPU (fixed line) (£)</b>	<b>10.52</b>	<b>10.87</b>	<b>(3.2)</b>
<b>Variable gross margin (%)</b>	<b>28</b>	<b>26</b>	<b>2ppts</b>
<b>Sales and marketing expenses (% of turnover)</b>	<b>7</b>	<b>22</b>	<b>(15ppts)</b>
<b>Turnover (£m)</b>	<b>52</b>	<b>37</b>	<b>41</b>
<b>Operating loss (£m)</b>	<b>(35)</b>	<b>(101)</b>	<b>65</b>

costs being only partially offset by lower commodity costs.

### Home services

British Gas home services continued to report strong growth in the year. Turnover increased by 12% to £810 million. Higher central heating volumes, augmented by the impact of our Trolhurst acquisition in late 2001, were complemented by good contributions from our newer products, in particular home electrical care. We are the only major service supplier providing bundled service products under our own brand, using our own people. This integrated offering gives competitive advantage over outsourced products and services marketed by other suppliers and is a strong tool for the retention of energy customers.

A £64 million improvement in gross profit resulted from an increase in volume and average order value along with a higher gross margin due to product mix, increased productivity and the lower price of materials. This was partly offset by increased operating costs, mainly due to higher manpower and home services marketing expenses. The resulting growth of 69% in operating profit illustrated the continuing scalability of our home services business model as we increased both customer numbers and product penetration.

Our engineering staff numbers (including installation engineers)

grew by 13%. Securing access to skilled engineering staff is a key challenge and during the first half of the year we announced our intention to recruit and train approximately 5,000 engineers over the next five years: this is already well under way. To this end British Gas has set up its own engineering academy which will co-ordinate all engineering recruitment, skills training and apprentice development across the company. It will also liaise with external bodies including government and the wider industry to promote training and to reduce skills shortages.

### British Gas Communications

Turnover in 2002 was up 41% at £52 million (2001: £37 million), due primarily to a higher average number of customers over the 12 month period. Our gross margin increased to 28% (2001: 26%) as call traffic was transferred to the group's switches, managed by One.Tel. Our switches allow us to take advantage of the lowest cost routing for each individual call.

The business continues to operate at a loss, mainly due to underlying infrastructure costs and the cost of customer acquisition in an environment of continuing high churn rates. Since the implementation of enhanced carrier pre-selection (CPS) processes in July, all new customer connections are fulfilled using this method. Initial results support our expectation that the average revenue per customer



Centrica Business Services focuses on the needs of small and medium sized enterprises.

### CEMG segmental turnover (£m)

	2002	2001
Industrial sales and wholesaling	784	921
Gas production	83	80
Accord energy trading	4,304	3,570
<b>Total</b>	<b>5,171</b>	<b>4,571</b>

(ARPU) will increase and the rate of churn for customers using CPS will reduce. We are continuing to lobby for a converged process for both CPS and wholesale line rental (WLR) in order to make it simpler for customers to switch suppliers but we remain of the view that considerable work needs to be done before a fit for purpose product can be launched.

Significant reductions have been made to operating costs as synergies with One.Tel have been realised. Cancellation and churn rates have improved in the second half through better customer targeting and quality of service. Customer care and billing were transferred onto One.Tel's system in June, reducing information systems spending by approximately £1 million per month.

### Centrica Business Services Profit up 48% with organic growth supported by acquisitions

Centrica Business Services established itself as the number one supplier of energy to the commercial sector in the UK by maintaining its position in the gas market and by achieving strong organic growth in the electricity sector, supplemented by the acquisition of Electricity Direct. The organic growth accounted for almost half of the 53% growth in the electricity customer base since the beginning of the year.

Enron Direct has been successfully integrated, increasing overall business profitability, giving enhanced sales capability across the market and improving service to larger multi-site customers.

Turnover has increased by 67% to £971 million as a result of organic growth as well as a full year's results from Enron Direct and five months' contribution from Electricity Direct. Overall gross margin increased

by 3 percentage points to 17% following price rises in gas.

Centrica Business Services has increased its UK commercial energy market share to 27% (2001: 22%, measured by share of supply points), comprising 51% of the gas market and 20% of the electricity market. In gas we seek to defend our market position through focusing on customer service and a value proposition rather than acquiring market share. In electricity, due to the acquisition activity and better targeted organic growth, average consumption per customer has increased by 39%. We believe our pricing is approximately in line with other major branded suppliers.

### Key Centrica Business Services performance indicators

	2002	2001	Δ %
<b>Customer supply points (period end) (000)</b>			
Gas	383	389	(1.6)
Electricity	516	337	53
<b>Total</b>	<b>899</b>	<b>726</b>	<b>24</b>
<b>Average consumption</b>			
Gas (therms)	3,276	3,878	(16)
Electricity (kWh)	22,398	16,115	39
<b>Weighted average sales price</b>			
Gas (p/therm)	36.72	34.04	8
Electricity (p/kWh)	4.79	5.49	(13)
<b>Weighted average unit costs</b>			
Gas (WACOG, p/therm)	20.71	20.46	1.2
Electricity (WACOE, p/kWh)	2.25	2.44	(8)
<b>Transportation and metering charges (£m)</b>			
Gas	126	130	(3)
Electricity	170	40	325
<b>Total</b>	<b>296</b>	<b>170</b>	<b>74</b>
<b>Sales and marketing expenses (% of turnover)</b>	<b>2.9</b>	<b>2.1</b>	<b>0.8ppts</b>
<b>Turnover (£m)</b>			
Gas	457	460	(0.6)
Electricity	514	121	324
<b>Total</b>	<b>971</b>	<b>581</b>	<b>67</b>
<b>Gross margin (%)</b>			
Gas	16	12	4ppts
Electricity	18	22	(4ppts)
<b>Total</b>	<b>17</b>	<b>14</b>	<b>3ppts</b>
<b>Operating profit (£m)</b>			
Commercial energy	65	44	48
<b>Operating margin (%)</b>			
Commercial energy	7	8	(1ppt)

### CEMG Upstream gas assets portfolio being enhanced

The Centrica energy management group (CEMG) consists of gas production operations, the newly acquired Rough gas storage facilities, electricity generation (managed for British Gas residential and Centrica Business Services), large volume industrial and wholesale gas sales, and our energy procurement, optimisation and scheduling operations. This unit is fundamental – through its provision of competitively priced energy supplies – to the success of the customer facing operations that are at the core of Centrica's consumer marketing business.

### Gas production

Upstream gas profits were adversely affected by the reduction in wholesale prices compared with last year, reducing the average unit sales price (which is linked to market) by 5% in 2002. Production volumes, which represented 27% of our downstream demand, were 5% lower than last year due in part to warm weather in the first and last quarter. Unit production costs increased as a percentage of turnover given the higher volume taken from those fields which attract higher unit depreciation charges and the overall reduction in turnover to cover our fixed cost base.

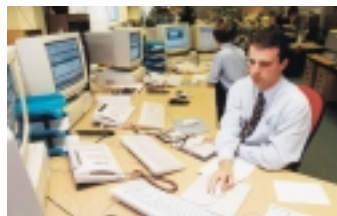
During the year, a number of upstream gas transactions were concluded in line with our strategy of increasing gas equity ownership beyond the Morecambe fields. In the first, Centrica undertook a strategic swap with Agip in which Centrica acquired uncontracted gas and equity in the large Goldeneye development, and built its equity in the Armada complex in the Central North Sea, together with other small equity parcels and cash. In return, Agip acquired Centrica's equity in the Liverpool Bay development, where the gas is not contracted to British Gas.

Subsequently, an 18% stake in the Seymour development, adjacent to Armada, was acquired from BP. This well, which was drilled late in the year and contains significant quantities of gas and liquids, should be in production in the first quarter of 2003. At the end of the year, Centrica entered into a contract to acquire the remaining 60% equity and overall operatorship in the Rose gas development in the Southern North Sea. The development is expected to deliver its first gas in 2004. Finally, agreement was reached for the sale to Talisman of the R Block

# Operating and financial review continued



We now have interests in four power stations across the country.



The energy management group sources the energy needed by our customer facing operations.



oil production interests acquired from Agip as part of the swap deal.

In total an estimated 135 billion cubic feet (bcf) (1.3 billion therms) of gas was acquired.

We have also focused on making best use of our asset infrastructure in the East Irish Sea. In November, the Centrica operated Bains field came on stream and now links into our South Morecambe infrastructure. During the year, an innovative drilling project in our South Morecambe field added a small amount of additional reserves to the portfolio. This technique is now being evaluated for future use at our other East Irish Sea assets and offers us the potential of adding reserves cost effectively.

## Storage

In November Centrica acquired the Rough gas storage facilities in the North Sea. During the period of Centrica's ownership, turnover was £9 million with an operating profit of £1 million. The Secretary of State for Trade and Industry has to decide whether to clear the acquisition, refer it to the Competition Commission for further investigation or accept undertakings in lieu of a reference.

## Industrial sales and wholesaling

Sales volumes were down by 8% against 2001 due to reduced takes under long term interruptible contracts with power stations, and the termination of one European contract. However, better gross margins, a profit of £9 million recognised in the first half of 2002 in connection with the early termination of a gas supply contract, and one-off losses on the termination of other contracts in 2001 contributed to increased profits relative to last year.

## Key CEMG performance indicators

	2002	2001	Δ %
<b>Gas production and storage</b>			
<b>Production volumes (m therms)</b>			
Morecambe	3,659	3,892	(6)
Other	397	395	1
<b>Total</b>	<b>4,056</b>	<b>4,287</b>	<b>(5)</b>
<b>Average sales price (p/therm)</b>	<b>21.5</b>	<b>22.5</b>	<b>(5)</b>
<b>Turnover* (£m)</b>	<b>932</b>	<b>1,033</b>	<b>(10)</b>
<b>Turnover (external) (£m)</b>	<b>83</b>	<b>80</b>	<b>3.8</b>
<b>Operating costs (% of turnover)</b>			
Royalties	7	7	-
Petroleum revenue tax	8	8	-
Volume related production costs	25	23	2ppts
Other production costs	12	10	2ppts
<b>Total</b>	<b>52</b>	<b>47</b>	<b>5ppts</b>
<b>Rough operating profit (£m)</b>	<b>1</b>	<b>n/a</b>	<b>n/a</b>
<b>Operating profit (£m)</b>	<b>448</b>	<b>552</b>	<b>(19)</b>
<b>Industrial and wholesaling</b>			
Sales volumes (m therms)	5,694	6,215	(8)
Average sales price (p/therm)	19.8	19.5	2
<b>Turnover (£m)</b>	<b>784</b>	<b>921</b>	<b>(15)</b>
<b>Operating profit (£m)</b>	<b>72</b>	<b>5</b>	<b>n/m</b>
<b>Accord</b>			
<b>Traded volumes (physical)</b>			
Gas (m therms)	20,399	18,512	10
Electricity (GWh)	95,329	29,446	224
<b>Turnover (£m)</b>	<b>4,304</b>	<b>3,570</b>	<b>21</b>
<b>Operating profit (£m)</b>	<b>0</b>	<b>16</b>	<b>(100)</b>
<b>CEMG operating profit (£m)</b>	<b>520</b>	<b>573</b>	<b>(9)</b>

\*91% was to group companies in 2002.

## Electricity generation

We currently have interests in four power stations with peak capacity of 1.7 GW as well as a 0.9 GW tolling agreement with Intergen for the entire output capacity of its Spalding plant, where operations are expected to commence by the end of 2004. The volume of production at our generation plants was 7,662 GWh, an increase of 160% on last year due mainly to the addition of Glanford Brigg and the full period use of the King's Lynn and Peterborough plants. Our stations provided 22% of our annual downstream demand, and 20% of peak requirements. The main value of our plants

remains in their flexible mid-merit and peak generation capacity in a less liquid market for peak supplies. However, they also provide strategic upside potential in the event of higher wholesale prices, with the option to increase generation volumes as it becomes more profitable.

## Accord Energy

Our Accord trading operations continued to support our strategic procurement requirements and take additional trading positions within strictly controlled limits based on our wholesale market outlook.

Accord broke even on the year, a drop of £16 million on 2001. After a positive first half,

we experienced gas trading losses during the unplanned shutdown of the continental European interconnector. Given Centrica's trading positions in Europe, this led to Accord having to procure gas at short notice to meet its obligations, which would have been fulfilled by exports from the UK. Accord's performance also suffered in the power markets through the highly publicised problems of TXU and British Energy, which contributed to high volatility. Accord also provided for a one-off loss of £6 million when TXU went into administration late in 2002. Physical volumes traded during 2002 were equal to 1.4 times the gas and 2.2 times the electricity volumes supplied to our downstream customers.

## The AA Core business growth in roadside and personal finance

2002 saw further progress in the development of the underlying profitability of the AA's core roadside and personal finance operations. Key to the AA's future growth is the ongoing investment in brand repositioning which was launched in May. The 'JustAAask' message focuses consumer attention on the product range offered by the AA and has increased product awareness beyond roadside assistance from 33% to 43%. Turnover grew 10% to £760 million. Operating profit increased by 1.4% to £73 million with increases in roadside services and personal finance offset by start-up losses for the AA Service Centres. This repositioning of the AA brand will support the AA's continued drive towards end-to-end motoring services to members and cross-sales of the whole product range.





The 'JustAAask' campaign launched in May has helped broaden awareness of the AA product range.



Our network of Service Centres has now been fully rebranded.

In addition, the AA is investing in a major CRM infrastructure programme over three years. In 2002, £30 million of expenditure was incurred (of which £26 million was capitalised). This investment is central to developing the AA's cross-selling potential and at the same time achieving cost efficiencies across the business.

The AA's website continues to attract new customers to buy AA products and services online. Judged to be the UK's most popular automotive related site in 2002, the website also brought the AA the award for e-business strategy of the year at the National Business Awards. TheAA.com supplied 16 million route maps in 2002 and was accessed by 21 million visitors.

The AA continues to act as the independent voice of the motorist. Highlights included February's launch of EuroRAP, a system to give a safety star rating to Europe's roads, and the Chancellor's budget commitment not to make any further fuel tax increases.

#### AA roadside services

Turnover increased by 5% to £476 million, driven primarily by membership growth, and whilst our overall share of the personal and business market marginally increased to 31%, the average price per customer fell by 0.6% due to a change in product mix.

Operating profits increased by 23% to £54 million, as higher turnover was accompanied by tight management controls and initiatives to contain the roadside breakdown costs and increase patrol utilisation.

Investment in roadside assistance continues with the provision of new vehicles, GPS route guidance and

improved management systems. The growth in roadside assistance membership has continued and with increased productivity of the 3,600 patrols, customer satisfaction has improved from 66% to 68%. The AA won the JD Power & Associates UK Roadside Assistance Study award for customer satisfaction and was named the UK's best motoring organisation in a Which? magazine survey.

Also, the first tranche of specialised all weather, portable computer systems with fault diagnostic capability were deployed to AA patrols to help maintain their ability to fix faults at the roadside. All patrols will be similarly equipped during 2003.

In the year the AA continued to train patrols and Service Centre technicians at its dedicated training college. Some 125 new patrol recruits were trained during 2002.

#### AA personal finance

Turnover in personal finance grew by 11% to £172 million. Supported by the 'JustAAask' campaign, over 70,000 car and personal loans were taken out during the year which, after renewals, left a year end portfolio of approximately 117,000 fixed term personal loans (2001: 77,000) provided through the AA joint venture. At the year end, the fixed term loan book had increased by 54% to stand at a record £661 million (2001: £428 million) with provision levels decreasing by 1% to below 3%. Continued product improvements coupled with specific advertising, emphasised the benefits of getting 'car loans from car people'.

Motor and home insurance commissions grew by 9%

#### Key AA performance indicators

	2002	2001	Δ %
<b>Roadside services</b>			
Customer numbers (period end) (000)	12,975	12,194	6
Customer renewal rate (%)	85	85	-
Average transaction value (£)	34	35	(1)
Roadside patrols employed	3,651	3,592	2
<b>Personal finance</b>			
Insurance customers (000)			
Motor	959	906	6
Home	664	618	7
Overall renewal rate (%)	78	74	4ppts
Average annual premium (£)	261	257	2
Motor and home insurance commissions (£m)	93	86	9
Loans (fixed term) book size (£m)	661	428	54
Loans (fixed term) operating profit (£m)	20	17	18
Number of fixed term personal loans (000)	117	77	52
<b>AA Service Centres</b>			
Site numbers	129	129	-
Average turnover per site (£000)	320	n/a	-
<b>Turnover (£m)</b>			
AA roadside services	476	452	5
AA personal finance	172	155	11
Other AA services	112	82	37
<b>Total</b>	<b>760</b>	<b>689</b>	<b>10</b>
<b>Sales and marketing expenses (% of turnover)</b>			
	10	9	1ppt
<b>Operating profit (£m)</b>			
AA roadside services	54	44	23
AA personal finance	47	40	17
Other AA services	(28)	(12)	(133)
<b>Total</b>	<b>73</b>	<b>72</b>	<b>1</b>
<b>Operating margin (%)</b>			
	10	10	-

on higher policy volume (up to £93 million), with customer renewal rates rising to 78% (2001: 74%). The average annual premium rose by 2% to £261, reflecting general pricing conditions in the industry.

Operating profits increased by 17% to £47 million. Turnover growth of 11% was augmented by close control of support costs with increased efficiency improving the ratio of employees to insurance policy levels.

A tailored motor insurance policy specifically for AA personal members was launched in 2002 and sales

of 6,000 have been achieved in its first year. Breakdown history is one of the major factors that form part of the premiums assessment. The number of policyholders of the AA's new insurance product for parts and labour repairs grew from 3,000 in December 2001, following its launch in May to 130,000 by December 2002.

#### Other AA services

Turnover is up 37% at £112 million, including a full year of turnover from the AA's network of 129 garages acquired from Halfords in September 2001. In 2002 the business rebranded and relaunched the garages as



## Operating and financial review continued




One.Tel now offers a complete telecoms service covering landline, mobile and internet.



AA Service Centres to provide a retail presence for AA members and customers. As a further step towards providing a complete motoring service it also purchased Tyreserve and expanded its own mobile tyre replacement service, which now gives private and fleet customers access to a network of more than 3,000 AA approved fixed and mobile tyre centres.

Other AA services incurred operating losses of £28 million. £4.5 million of this came from the closure of AA workshops, with the Service Centres producing an operating loss of £15 million. £7 million of investment in infrastructure and rebranding of the Service Centres was expensed. We are carrying out various initiatives such as a cost reduction programme, advertising campaigns and offers to the current membership base to increase utilisation and rapidly reduce the ongoing loss.

The AA in the Republic of Ireland contributed a profit of nearly £2 million, an increase of over 80% on 2001, due to growth in both insurance and roadside assistance membership, thereby remaining the leading roadside assistance and personal insurance provider in the country.

Publishing, car data check, the driving school and roadside signs made positive contributions which were offset by start-up investments in Tyreserve and costs in AABuyacar and information services.

### AA exceptional item

The group has decided to reduce the operations of Golf England Limited, a subsidiary undertaking, and has recognised a £14 million provision in respect of losses on the disposal of fixed assets.

### One.Tel Improving sector outlook

Our focus for this year has been on increasing the value of the existing One.Tel customer base through enhanced product offerings and operational efficiencies. In the medium term, we believe that this positioning provides us with a sound platform to develop in the UK, assuming recent regulatory proposals are implemented quickly and fully.

In the second half of the year turnover grew by 20% over the second half of 2001 to £78 million, as a result of further growth in the customer base. Our variable gross margin increased by 5% to 52% as we took advantage of opportunities to negotiate improved transmission charges with our carriers. Our switched reseller business model relies on the use of the networks of a variety of infrastructure owners (13 as at 31 December 2002), mitigating the risks associated with network failure or carrier financial distress. Operating profit for the year was £2.1 million reflecting the investment in new products, particularly mobile and a £2 million marketing campaign undertaken in the fourth quarter to raise awareness of One.Tel's transition from

a discounted international calls provider to a full communications provider offering landline, mobile and narrow and broadband internet services. To this end, during the second half of the year we launched our first call inclusive package.

Customer acquisition costs increased to £14 million in the second half (full year: £22 million) supporting full year growth in the customer base of 23% from 2001. ARPU increased by 1% against the second half of 2001. With the implementation of the revised industry process for carrier pre-selection (CPS) in July, the level of our new landline sales using this connection method increased to 37% in December.

Mobile sales have been very encouraging with more than 35,000 contracts sold since the launch in July, supported by attractive pricing and expanded retail distribution. The migration of our broadband customers onto the One.Tel customer care and billing system is due for completion in the first quarter of 2003 enabling us to offer a complete customer experience with all our telecoms services charged on a single bill.

### Goldfish Bank Credit card growth from renewed brand building

Goldfish Bank has continued to make progress. Following a review of product strategy by the Goldfish management team, we are focusing increasingly on brand performance through a smaller range of more capital efficient products.

The credit card business was migrated to Goldfish's new infrastructure in November. This was a significant and complex process involving more than one million cards in issue and their associated loyalty points records. The new platform is operating well and customer service, through the new contact centre in Glasgow, has improved significantly. Independent research indicates that brand awareness has remained high in the credit card market and strengthened in the overall financial services business. The key objective has been to generate awareness of Goldfish as a financial services provider, rather than simply a credit card. Spontaneous awareness improved from 6% at the end of 2001 to 12% at the end of 2002, which puts Goldfish towards the top end of non traditional banking brands.

Credit card recruitment performance has strengthened throughout the year following changes to the channel mix and customer management approach. Total card net interest income was up 9% at £36 million despite lower margins prevailing within the industry and higher utilisation of interest free promotional balance transfers. Fee income rose 6% to £54 million, primarily due to higher levels of customer spend. Credit losses remained low at 3% of outstanding balances.

### Key One.Tel performance indicators

	2002	2001	Δ %
<b>Customer numbers (period end) (000)</b>			
Fixed line	746	668	12
Other services	216	117	85
<b>Total *</b>	<b>962</b>	<b>785</b>	<b>23</b>
<b>Average minutes used per month (fixed line)</b>	<b>284</b>	<b>277</b>	<b>2.5</b>
<b>ARPU (fixed line) (£)</b>	<b>16.20</b>	<b>15.85</b>	<b>2.2</b>
<b>Variable gross margin (fixed line) (%)</b>	<b>51</b>	<b>47</b>	<b>4ppts</b>
<b>Sales and marketing expenses (% of turnover)</b>	<b>14</b>	<b>8</b>	<b>6ppts</b>
<b>Turnover ** (£m)</b>	<b>153</b>	<b>65</b>	<b>135</b>
<b>Operating profit (£m)</b>	<b>2.1</b>	<b>4</b>	<b>(48)</b>
<b>Operating margin (%)</b>	<b>1.4</b>	<b>6</b>	<b>(4.6ppts)</b>

\*30 day tolling

\*\*2001 turnover is from date of acquisition (3 July 2001)



A new internet based savings account was launched during the year.



### Key Goldfish Bank performance indicators

	2002	2001	Δ %
<b>Credit cards in force (000)</b>	<b>1,082</b>	<b>1,025</b>	<b>6</b>
<b>Average monthly spend per active card (£)</b>	<b>541</b>	<b>476</b>	<b>14</b>
<b>Gross card receivables</b>	<b>773</b>	<b>677</b>	<b>14</b>
<b>Net interest margin (%)</b>	<b>5.2</b>	<b>5.1</b>	<b>0.1ppts</b>
<b>Credit card income (£m)</b>			
Net interest income	36	33	9
Fee revenue and other income	54	51	6
Total (before deduction of loyalty costs)	90	84	7
<b>Loyalty scheme costs (% of income)</b>	<b>33</b>	<b>31</b>	<b>2ppts</b>
<b>Credit losses (% of receivables)</b>	<b>3</b>	<b>3.2</b>	<b>(0.2ppts)</b>
<b>Credit card profit contribution (£m)</b>	<b>9</b>	<b>12</b>	<b>(25)</b>
<b>Goldfish non-credit card product contribution (£m)</b>	<b>(2.4)</b>	<b>n/a</b>	<b>n/a</b>
<b>Sales and marketing expenses (% of income)</b>	<b>6</b>	<b>5</b>	<b>1ppt</b>
<b>Goldfish operating loss before minority interest (£m)</b>	<b>(40)</b>	<b>(32)</b>	<b>(25)</b>

The number of cards in force has increased by 6% to 1.08 million (2001: 1.02 million). During the year 77,000 new accounts were opened (2001: 27,600), with attrition low at 4.5%. The average monthly spend on the Goldfish card increased by 14% against 2001, making it among the highest in the UK market. The credit card profit contribution of £9 million was £3 million lower than 2001 due to a £4.5 million increase in customer acquisition costs and a £3 million cost relating to the migration to Goldfish's new infrastructure in November.

In the autumn Goldfish entered the personal loan market, focusing initially on generating a high quality applicant pool. The product proposition was based on flexibility featuring no redemption penalties for early settlement. At the year end approximately 1,800 personal loans had been drawn down with total outstanding balances of £14 million. Increased awareness, response and take-up rates will be sought in 2003. Goldfish customers purchased 104,000 additional Goldfish branded products including travel insurance, home

insurance and personal accident insurance. This is 69% up on 2001 and is an encouraging indicator of future cross-sales potential. The profit contribution from all non-credit card products was negative: a net loss of £2 million due to the investment of £5 million in customer acquisition during the period.

Goldfish successfully launched its internet based savings account and began active marketing in the autumn. This has proved to have strong appeal with £286 million in deposits and over 11,000 accounts opened of which approximately 50% were customers new to Goldfish. Savings will continue to form part of a diversified funding strategy.

The overall operating loss was £40 million with operating expenses at Goldfish, consisting of brand marketing, banking systems and product development, up 7% at £47 million. A further £46 million investment was capitalised in the development of the IT systems platform. As this nears completion, we expect significantly lower investment in 2003.

### Centrica North America Acquisitions of incumbent positions but slower organic growth

Total North American turnover was £1,118 million in 2002, an increase of 46% over 2001 driven largely by our entry into the Ontario and Texas electricity markets, our entry into the Ontario services market through the acquisition of Enbridge Services Inc and the addition of over 300,000 gas customers through the acquisitions of Enbridge Services Inc and parts of NewPower Company's customer base.

Operating profit fell by 7%, as profits from our home services businesses (£23 million) and reduced losses in our electricity business (by £5 million) were offset by lower profits (by £4 million) in our gas business. Included within the retail energy results are the increase in the cost base (£10 million) due to the development of the infrastructure to support future growth and £21 million of expensed costs incurred in acquiring customers organically. Upstream profits were lower as wholesale prices fell and favourable forward contract prices expired. These results include the adverse currency movements (£4 million), with a 6% decline in the average Canadian dollar exchange rate during the year.

The pace of organic growth slowed in 2002 owing to a combination of slow emergence of competitive markets, restrictive legislative and political developments affecting sales activities, and large fluctuations in wholesale natural gas prices. We are continuing our efforts with governments and regulators at state, provincial and federal levels in support of market

liberalisation. We remain of the view that momentum will be regained in the regions that are important to our future, but the timing remains uncertain.

### Retail energy

Turnover for the residential gas supply business increased by 12%, driven primarily by higher selling prices and acquisitions. Our Ontario residential gas market share was approximately 26% at year end. In our US gas markets, slower growth caused by high rates of customer churn was offset by the acquisition in August of 212,000 customers in Michigan, Ohio and Pennsylvania from the NewPower Company. We continue to manage our portfolio of US gas customers closely, and will focus our efforts on maximising the value from our current position.

In our first year of operating in the electricity business in Ontario (from May) and Texas, turnover was £189 million with an operating loss of £10 million. Based on operating experience this year, we estimate that average annual consumption for our residential electricity customers would be 11,000 kWh, broadly in line with our expectations and more than twice our UK customer average. The Texas residential electricity market continues to support a positive competitive environment, with the presence of a pricing regime that affords reasonable, sustainable gross margin prospects to both incumbents and new market entrants. Following our entry into this market in January, we served 890,000 retail energy customers by the year end, consisting of both acquired positions (810,000 customers) in southern and western Texas (for which our transaction closed in late December 2002) and organic programmes mainly in the Houston and Dallas/Fort Worth regions.

# Operating and financial review continued



The integration of Enbridge Services Inc has allowed us to broaden the range of products we offer.

Our retail energy supply gross profit grew by 14% to £95 million. Our gross margin decreased to 14%. Our current gross margins (other than for our acquired incumbent positions) are largely driven by our historic hedging activities in each local market, through which we have procured the energy commodity at a fixed forward cost, achieving a margin on the quantities supplied to our fixed price retail customers over a contracted period. There are risks to these margins from the complexities involved in accurately forecasting total commodity requirement, linked to rates of consumption, customer acquisition and retention. We are now the third largest electricity retailer in Texas.

Volatility in wholesale gas spot prices remained high, as benchmark gas contract prices moved between US\$10/mmbtu and US\$2/mmbtu. In markets where we compete against utilities flowing through gas or electricity to customers at wholesale spot cost, this made winning new forward curve-based business extremely challenging and also led to high levels of churn among customers signed up to what became relatively high priced programmes. This cyclical pattern will continue to be a feature of our organic growth. In the latter part of the year, prices returned to levels that we believe are more sustainable in the long term (US\$4-5/mmbtu) and conducive to the development of our customer base.

Gross margins for our recently acquired customers in Texas are based upon prices approved by the Texas Public Utility Commission under the 'Price To Beat' structure, which we can apply to have modified twice in any year to reflect changes in gas feedstock costs. Under the acquisition

## Key North America performance indicators

	2002	2001	Δ %
<b>Customer numbers (period end)</b>			
Residential and small commercial gas (000)	1,339	1,230	9
Residential and small commercial electricity (000)	1,416	n/a	n/a
Home and business services (000)	1,627	n/a	n/a
Industrial and commercial energy (sites served)	61	49	24
<b>Average consumption</b>			
Residential and small commercial gas (therms)	1,138	1,154	(1)
Residential and small commercial electricity (kWh)	10,666	n/a	n/a
Industrial and commercial energy (m therms)	19	23	(18)
<b>Gas production and energy trading</b>			
Gas production volumes (m therms)	356	344	3
Average sales price (p/therm)	21.4	27.9	(23)
<b>Turnover (£m)</b>			
Residential and small commercial gas	486	433	12
Residential and small commercial electricity	189	n/a	n/a
Home and business services	159	n/a	n/a
Gas production and energy trading	124	105	18
Industrial and commercial energy	160	230	(30)
Total	1,118	768	46
<b>Sales and marketing expenses (% of turnover)</b>			
	1.7	3.7	(2ppts)
<b>Gross margin (%)</b>			
Residential and small commercial gas	13	19	(6ppts)
Residential and small commercial electricity	16	n/a	n/a
<b>Operating profit (£m)</b>			
Residential and small commercial gas	16	20	(20)
Residential and small commercial electricity	(10)	(15)	33
Home and business services	23	-	n/a
Gas production and energy trading	33	62	(47)
Industrial and commercial energy	1	1	-
Total	63	68	(7)
<b>Operating margin (%)</b>			
	6	9	(3ppts)

arrangement, Centrica has an economic interest in the profitability of these businesses with effect from 1 September 2002 through to completion on 24 December 2002. These amounts will be credited against amounts payable, under the acquisition agreement, in respect of the sharing of earnings over the next four years. All such payments will be treated as deferred purchase consideration. With effect from 24 December 2002 the full profits have been recognised in the accounts.

Market entry costs this year for Ontario and Texas of £20 million have been expensed. Organic

customer acquisition costs were lower, following high levels of Ontario electricity customer acquisition in 2001 and due to slower organic growth in the US market. This, along with the growth in turnover meant that sales and marketing costs as a percentage of turnover reduced by 2 percentage points.

We entered the Ontario electricity market when it opened in May, and successfully converted over 500,000 contracts signed pre-opening to flowing customers. We now have 15% of the residential electricity market. On 11 November, the Ontario government announced that it would cap residential and

small business electricity prices at below market rates, to be subsidised by government, effectively suspending competition until 2006. Under this legislation, Centrica remains entitled to receive the market pricing mitigation agreement payment, amounting to £16 million relating to 2002. Margins on residential retail contracts already written are protected, at least to 2006. The regulations regarding business customers are still formative. This electricity customer base of over 500,000 will continue to retain value and be used for cross-selling gas and home services products, but further organic electricity growth is unlikely to be possible until this new legislation expires in 2006.

We continue to seek opportunities to acquire incumbent customer positions from utilities seeking to exit the retail function. Our agreement in December, which is subject to legislative changes and regulatory consents, to purchase the incumbent retail energy business of ATCO Group in Alberta – which currently consists of approximately 820,000 gas and 160,000 electricity customers – will give us an 80% share of the gas market and 14% of the electricity market. We will maintain growth momentum into 2003 as we migrate customers to unregulated energy and services packages.

## Home and business services

As part of our strategy to gain competitive advantage and operating leverage from an energy and home services cross-selling platform, the acquisition of Enbridge Services Inc for C\$1 billion (£438 million) was completed in May 2002. Enbridge Services Inc made an operating profit of £23 million during the year. We subsequently



A major advertising campaign launched Luminus in Belgium.

raised some C\$744 million (£303 million) through selling down 58% of our interest in the waterheater assets acquired as part of the transaction by way of the launch of The Consumers' Waterheater Income Fund. Our remaining 42% retained interest had a value of C\$218 million (£89 million) at 31 December, which we intend to continue to sell down in 2003. Centrica remains the exclusive installer and provider of maintenance and repair services for our customers' waterheaters and, accordingly, without legal ownership of these assets, retains relationships with approximately 1.3 million households.

In the group's balance sheet the waterheaters are included in fixed assets and the debt financing raised (C\$500 million), for which there is no recourse to Centrica, is included in loans, net of expenses. The profit and loss account includes the entire rental income and related costs, including depreciation and interest on the income fund's debt financing from the date of launch of the fund in December. The income fund unit holders' share of profit is reflected in a non-equity minority interest in the profit and loss account. The balance sheet non-equity minority interest includes amounts raised from the sale of units.

The value of the retained businesses together with the cash receipts for the divested assets has created major value for Centrica shareholders. We also remain a leading installer of heating, ventilation and air-conditioning (HVAC) equipment in Ontario, which has a profitable associated financing business

and, in addition, some 330,000 of households have contracted with us for HVAC maintenance and protection plans. We now have around 50% share of this home services market and increasing this share is a key objective of 2003. Beginning in 2003 we intend to manage services for our business customers separately.

#### Upstream gas

Development of our gas fields in Alberta continues. We drilled, completed and began production at 218 wells during 2002, compared with 307 in 2001. Production volumes were up slightly at 356 million therms, representing 24% of our North American downstream gas sales. Operating profit fell by 47%, primarily as a result of a lower wholesale market which led to a 23% decline in our average sales price and the expiry of higher priced forward sales contracts.

#### Europe

In developing our strategy for Europe, we are focusing on those countries where the speed of market opening and legal and political conditions, including unbundling and independent regulation, are more advanced.

Through Luminus, our joint venture in Belgium, we now have approximately 18% of the electricity market above 1 GWh in Flanders which opened in January 2002. The broader commercial energy market opening in early 2003 will be followed closely by the residential market opening in July 2003 for both electricity and gas. Luminus is positioned as the number two player in the Flemish market. When the

residential market opens the business expects to have over 600,000 residential electricity customers and nearly 200,000 residential gas customers.

Our second move in Europe is in Spain, where our initial aim is to enter the small and medium sized business sector of the market and to build a business organically which utilises the skills we have developed in other markets. We are currently testing our proposition with a view to opening for business in the second quarter of 2003.

The operating loss in 2002 was £7 million, reflecting start-up costs in Belgium and Spain.

Note: All current financial results listed are for the year ended 31 December 2002. All references to 'the prior-year period', '2001' and 'last year' mean year ended 31 December 2001 unless otherwise specified.





We aim to grow our earnings and cash flow within a prudent risk management framework. During the year our share price out performed the FTSE 100 by 3.1% and since demerger in February 1997 to the end of 2002 we out performed the index by 187%.

Centrica's aim is to achieve a total shareholder return (TSR) ranking in the first quartile of UK FTSE 100 companies, taking account of share price growth and dividends received and reinvested over a sustained period. Centrica promotes continuing growth in earnings and cash flow and seeks to maximise the return on capital it achieves within a prudent risk management framework. The remuneration report on pages 25 to 30 summarises our TSR performance over recent years against our FTSE 100 comparator group.

The company's closing share price on 31 December 2002 was 171 pence (31 December 2001: 222 pence), resulting in a market capitalisation of £7.3 billion (2001: £8.9 billion). World stock markets continued to fall in 2002, the FTSE 100 index dropping by 24.5%. The company's share price still out performed the FTSE 100 by 3.1% (2001: 2.1%) and since demerger to the end of 2002 we out performed the index by 187%.

### Earnings

Earnings increased by £155 million to £478 million in 2002. This reflected improved operating profits\* up £253 million and lower exceptional charges offset by taxation up from £155 million to £250 million and higher goodwill amortisation, up by £35 million to £123 million.

Earnings before exceptional charges and goodwill amortisation were up 32% to £636 million. This represents a return on capital employed over the year of 32% or 7.9% on our average market capitalisation.

### Operating profit

Operating profit\* was £932 million (2001: £679 million). Most of the

improvement came from our UK residential gas supply business, and growth in our business services and home services operations.

### Exceptional charges and goodwill amortisation

During the year, non-operating exceptional charges arose of £26 million net of tax (2001: £71 million operating exceptionals net of tax). These related to changes in our Golf England operation and disposal of our LPG cylinder business. In addition, a £9 million (2001: £ nil) exceptional tax charge arose (see Taxation below). The goodwill amortisation charge for the year was £123 million (2001: £88 million), in line with our programme of continuing acquisitions.

### Net interest

Net interest charged to the profit and loss account was £62 million compared with £43 million in 2001 and was covered 15 times by operating profit\* compared with 16 times a year earlier. The increase in interest payable was due to higher average indebtedness mainly as a result of acquisitions, offset by lower interest rates and the net proceeds of the share placement during the year.

### Taxation

The ongoing taxation charge of £243 million for 2002 represents a 28% rate on profits adjusted for goodwill amortisation and exceptionals (2001 comparative rate: 26%). The increase in the effective rate is principally due to the introduction of a 10% corporation tax surcharge on UK offshore gas production, with effect from 17 April 2002. This surcharge increased the tax charge for the year by £12 million and resulted in a restatement of the deferred tax liability of £9 million, which

has been treated as exceptional. The overall charge is still less than the UK 30% statutory rate, primarily because previously unrecognised deferred tax assets of £35 million have been utilised during 2002.

### Earnings per share and dividends

Basic earnings per share grew from 8.1 pence to 11.4 pence and adjusted earnings per share from 12.1 pence to 15.2 pence. Over the last three years the adjusted performance measure has grown by an average compound growth rate of 24% and facilitated a progressive dividend policy. We are proposing a final dividend of 2.6 pence giving a total of 4.0 pence (2001: 3.1 pence), an increase of 29%.

### Cash flow

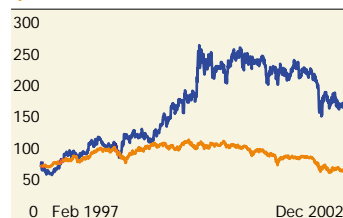
Group operating cash flow (including dividends from joint ventures and associates, from continuing operations before exceptional payments) was £790 million for 2002, compared with £885 million in 2001. An increase of £299 million in operating profit\* before depreciation and amortisation of investments was more than offset by changes in working capital, including growth in trade debtors, the timing of gas transportation payments, petroleum revenue tax (PRT) and gas production royalty payments.

Total capital expenditure was £449 million this year, up from £312 million in 2001. This includes £180 million of costs capitalised for information systems investments associated with our new customer relationship management (CRM) infrastructure. Acquisition expenditures (net of cash and overdrafts acquired) were £989 million in 2002 (2001: £1,204 million), consisting primarily of our purchases of the Brigg power plant and Rough

\*Before exceptional charges and goodwill amortisation, including joint ventures and associates.



### Centrica share performance (pence)



Smoothed 5 day average  
 ■ Centrica plc  
 ■ FTSE 100 relative

### Group operating cash flow (£m)

02	790
01	885
00	1,149
99	1,464
98	871

Including dividends from joint ventures and associates before exceptional payments.

### Group operating cash flow (£m)

02	717
01	825
00	1,063
99	1,318
98	659

Excluding dividends from joint ventures and associates after exceptional payments.

gas storage facilities in the UK, Enbridge Services Inc in Canada and WTU Retail Energy LP and CPL Retail Energy LP in the US. The group's net cash outflow before liquid resources and financing was, as a result, £918 million, against a net outflow of £342 million in 2001.

#### Balance sheet

The net assets of the group increased during the year from £1,536 million to £2,402 million.

#### Fixed assets

Net intangible fixed assets of £1,813 million (2001: £1,524 million) represented goodwill, which has arisen on acquisitions. During the year, £466 million (2001: £314 million) was added, including £193 million for the acquisition of Enbridge Services Inc, £167 million for WTU Retail Energy LP and £80 million for Electricity Direct. Goodwill is amortised by way of charges against profits over periods ranging from 5 to 20 years.

Tangible fixed assets, mainly comprising gas field assets and power stations, had a net book value of £2,763 million (2001: £2,058 million). During the year gas field assets, including the Rough gas storage facilities, and power stations totalling £590 million were acquired. At the year end, the proven and probable gas reserves represented by our field interests amounted to 2,846 billion cubic feet (bcf) (2001: 3,232 bcf), which included 404 bcf (2001: 446 bcf) in North America. At the year end, hardware and software costs relating to our major investments in CRM had a net book value of £237 million.

The group's investment in joint ventures stood at £74 million (2001: £112 million), comprising

its share of gross assets of £810 million and share of gross liabilities of £736 million, of which £629 million related to borrowings. These investments related principally to the investments in 60% of Humber Power Limited, 50% interest in the AA's joint ventures with HBOS and 50% of Luminus NV.

#### Working capital

Current assets less current liabilities, excluding net indebtedness and Goldfish funding amounted to a deficit of £243 million (2001: deficit of £625 million). Excluding Goldfish, growth in trade debtors and accrued energy income has given rise to a net increase of £565 million in working capital.

#### Goldfish Bank

Goldfish Bank debtors, mainly in respect of credit card balances receivable, were £792 million (2001: £ 673 million), offset by customer savings account balances of £286 million (2001: £ nil). Goldfish Bank borrowings amounted to £430 million (2001: £610 million).

#### Net debt

Net debt (excluding the Goldfish Bank facility of £430 million and the £196 million of non-recourse debt raised on the water heater assets acquired with Enbridge Services Inc) increased to £529 million at 31 December 2002 from £433 million at the previous year end.

#### Issue of share capital

In February 2002 £426 million, net of expenses, was raised via the issue of 232 million ordinary shares.

#### Provisions and other creditors due after more than one year

Together these increased during the year to £1,384 million (2001: £1,218 million). Increases

in respect of decommissioning costs, mainly from acquisitions, and deferred corporation tax have more than offset the decrease in provisions for deferred PRT.

#### Financial risk management

The board has established objectives and policies for managing financial risks, to enable Centrica to achieve its long term shareholder value growth targets within a prudent risk management framework. These objectives and policies are regularly reviewed.

Currency, interest rate, liquidity and counterparty risks are managed centrally by a treasury and risk management team, within parameters set by the board. This team is also responsible for managing the relationships with the agencies setting the company's credit ratings and managing the cost of its debt capital. Energy market price and weather risks are managed by business led energy and risk management teams operating within group established policies. Where appropriate, financial instruments are used to manage financial risks as explained below and in note 29 on pages 59 to 62. Goldfish Bank interest rate risks are managed by a treasury team with Lloyds TSB Bank plc within parameters set by the Goldfish Bank board.

#### Credit rating

The company's credit ratings from Moody's Investors Service/Standard & Poor's remain unchanged at A2/A (long term) and P1/A-1 (short term) and with a stable outlook.

#### Currency risk

Through wholly-owned US and Canadian subsidiaries, the group has operational exposure in Canadian and US dollars. Canadian dollar translation exposure is hedged by maintaining a portfolio

of Canadian dollar financial liabilities, which approximate to the net asset value of the Canadian operations. US dollar exposure has been hedged by borrowing on a short term basis through a combination of US commercial paper programme and currency instruments. In addition there is an element of exposure to the euro through the 50% interest in Luminus, which has been hedged by selling euro forward on a rolling basis. Exposures to foreign currency movements from operating activities are also hedged through the use of forward foreign exchange contracts. All debt raised in US dollars through the US commercial paper programme, apart from that hedging the US translation exposure, is either swapped into sterling or another functional currency as part of the translation hedging operations described above.

#### Interest rate risk

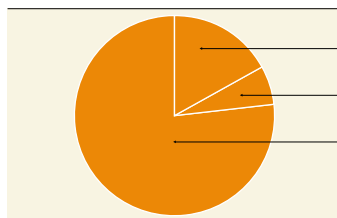
Throughout the year, the group's policy has been to maintain approximately 50% of long term borrowings at a fixed rate of interest. This is achieved by using derivative financial instruments, such as interest rate swaps, to adjust the interest basis of the portfolio of long term debt (see note 29 on pages 59 to 62). At the year end debt has been raised on both a fixed and floating rate basis.

#### Liquidity

Cash forecasts identifying the liquidity requirements of the group are produced frequently. These are reviewed regularly by the board to ensure that sufficient financial headroom exists for at least a 12 month period. The group policy includes maintaining a minimum level of committed facilities and an objective that a proportion of debt should be long term, spread over a

# Group financial review continued

## Capital funding 31 December 2002



Net debt, excluding Goldfish Bank working capital borrowings – £529 million  
Non-recourse debt (Consumers' Waterheater Income Trust) – £196 million  
Equity including minority interest – £2,402 million

range of maturities. Details of the maturity profile of borrowings are given in note 29 on pages 59 to 62. At 31 December 2002, the group had undrawn committed facilities of £1 billion (2001: £935 million), which were used as a backstop for the US commercial paper programme.

### Counterparty risk

The board's policy is to limit counterparty exposures by setting credit limits for each counterparty, where possible by reference to published credit ratings. Exposures are measured in relation to the nature, market value and maturity of each contract or financial instrument. Surplus cash is invested in short term financial instruments and only deposited with counterparties with a minimum credit rating of A3/A- or P1/A-1 in Moody's Investors Service/ Standard & Poor's long term and short term ratings respectively. Energy trading activities are undertaken with counterparties for whom specific credit limits are set. All contracted and potential exposures are reported to the financial risk management committee of the board.

### Commodity price risk

The key commodity price risks facing the group are first, natural gas and electricity prices both in the short term market and in respect of long term contracts and, secondly, escalation indices on long term gas contracts, of which the most influential are oil product prices and general price inflation.

The group's policy is to hedge a proportion of the exposure for a number of years ahead matched to the underlying sale and purchase risk profiles. The group aims to manage

its risk by using financial instruments such as oil and gas swaps and gas derivatives and bilateral agreements for gas and power, as well as asset ownership.

The financial risk management committee regularly monitors the extent of the group's commodity price exposure and the level of hedging activity alongside the availability of forward prices and market liquidity.

The acquisition of the Glanford Brigg power station has further contributed to the company's target to cover around a quarter of its electricity requirement from its own sources in 2002.

### Weather risk

Gas sales volumes, and to a lesser extent electricity volumes, are influenced by temperature and other weather factors. In Britain, the weather derivatives market remains relatively immature. We again entered into a number of weather derivative transactions for the winter period October 2002 to March 2003 in order to hedge part of the group's weather exposure.

### Accounting policies

The principal accounting policies remain unchanged over last year and are described in note 1 to the financial statements on pages 35 to 37. Where appropriate, wording has been expanded to more fully explain policies, particularly in relation to financial instruments, and energy trading activities.

In keeping with many other major companies, adoption of FRS 17 Retirement Benefits, has been deferred in line with the revised timetable announced by the Accounting Standards Board. Accordingly, the group has continued to report under SSAP 24 Accounting for Pension Costs.

In accordance with FRS 17, additional disclosures are contained in note 26 on pages 55 and 56. If the standard had been fully adopted in 2002, profit would have been reduced by £47 million (2001: £16 million) and net assets would have been reduced by £507 million (2001: £117 million). Full adoption is not mandatory until 2005, but the group will continue to keep this under review.

**Phillip Bentley**  
Group Finance Director

# Corporate responsibility

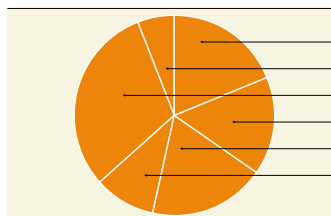


Bruno Peek OBE, chairman of the Golden Jubilee Summer Party, test-fires the British Gas Jubilee Beacon that illuminated Buckingham Palace during the weekend celebrations.



Energy Angel Eleanor Whitehead whose school, Little Gaddesden Primary, signed on for the next stage of British Gas's award winning 'Think Energy' educational programme.

## Centrica community investment



Centrica's community spend is focused on a number of priority areas, linked to issues relevant to our business.

Our businesses are focused on delivering essential products and services to millions of people every day. Continued and sustainable success requires that we accept and respond to our social responsibilities. By understanding our impact on society, the economy and the wider environment, we can develop positive relationships with stakeholders to benefit both business and the community.

Corporate responsibility is integral to all our activities. Our framework is set and co-ordinated by the Centrica corporate responsibility committee that was formed in 2002. Detailed information about our range of corporate responsibility activities is available at [www.centrica.com/responsibility](http://www.centrica.com/responsibility).

The effectiveness of our approach was illustrated by Centrica's inclusion in the 2002 FTSE4Good Index and, for the first time, in the Dow Jones Sustainability Indexes for 2003.

We are aware not only of the positive business potential of demonstrating our commitment to corporate responsibility, but also of the negative impact of poor performance in this area.

Corporate responsibility concerns have been fully integrated into the group's risk management structures. These address the financial impact on the business of social and environmental threats as well as the potential impact on the reputation of our brands.

Our corporate responsibility activities fall into four main categories:

### Environment

Our prime responsibility is managing the impact of our operations on the environment. We also have a responsibility for

helping our customers make informed decisions about using our products and services in a way that minimises any negative impact on the environment. British Gas plays a leading role in helping to achieve the government's fuel poverty and climate change targets through the provision of free or subsidised energy efficiency products. During our Energy Efficiency Standards of Performance (EESoP) programme, which finished in April 2002, British Gas provided 1.4 million energy efficient products to 585,000 households throughout Britain, in total saving 5,250 GWh of energy.

From April 2002, EESoP was replaced by the Energy Efficiency Commitment, a three year programme with an energy saving target of around 27,000 GWh. British Gas is on target to deliver these savings. Key to this success has been our ability to engage customers through new product innovation and groundbreaking customer propositions. Through our Warm-A-Life programme, more than 70,000 disadvantaged customers have received a range of benefits including free insulation products, benefits assessment to ensure that they are claiming everything that they are entitled to and discounts on British Gas energy bills.

In 2002, we worked hard on delivering our environmental programme. Notable improvements included increasing the recycling in our offices from 18% to 34% and improving their energy efficiency by implementing projects that saved more than 4.5 million kWh per annum. In terms of environmental management, sites that were certified to ISO14001 have completed their reassessment and the British Gas Service Centres and AA Service Centres achieved certification for the first time.

We published our second environment report in March 2002.

We also promoted environmental good practice in the home through our 'Think Energy' education programme for schools. To date, more than 14,000 primary and secondary schools in Britain have signed up for the programme, involving an estimated one million school children between the ages of 7 to 14. The programme will be extended to include 14 to 16 year olds from 2003. During 2002, 'Think Energy' won a British Commitment to the Environment Premier Award.

### Community

Our community programme addresses issues relevant to our business and, where possible, we also support our employees' volunteering activities. Communities will benefit most from our investment if there is a sound business case for it, since this provides the best foundation for sustained involvement.

We contributed £5.66 million to community causes in 2002 as measured by the London Benchmarking Group model, which includes both cash and in-kind support.

Our UK charity of the year initiative enables employees across the group to raise funds for a charity chosen by a panel of employees. From April 2001 until July 2002, our partner was the Cystic Fibrosis Trust and our employees raised more than £475,000 to fund vital research and treatment for the UK's most common life threatening inherited disease. The partnership received an Institute of Public Relations Sword of Excellence award in July.

We hope for similar success with our new chosen charity, the Meningitis Trust. Between

its launch in September 2002 and the end of the year, employees raised more than £150,000.

In North America, we launched 'Direct in the Community'. The programme seeks to play a leadership role in fostering, supporting and encouraging charitable initiatives that provide services related to safe and affordable housing, especially for adults, families, older people and people with disabilities.

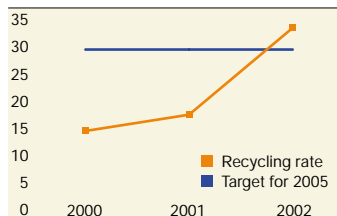
The British Gas partnership with Help the Aged continues to support some of Britain's most vulnerable older people. Since its launch in 1999, British Gas has provided Help the Aged with more than £5.4 million of support and to date there have been 1.6 million beneficiaries of partnership initiatives. The partnership received the Business in the Community Excellence Award for cause related marketing in July.

We have enjoyed a successful association with Carers UK since 1996. In 2002 we sought to identify 'hidden' carers and guide them to information, advice and support. Promotion, including a bill message to more than two million customers, also generated awareness among our employees about Centrica's carer friendly employment policies. Our chief executive is president of the charity.

The AA Accessible Hotel of the Year Awards highlight the importance of ensuring equal access for people with disabilities to hotels and guest accommodation in the lead up to the next phase of the Disability Discrimination Act in 2004. During 2002, AA hotel inspectors assessed 60 hotels and guest houses selected from the results of a detailed questionnaire returned from more than 300 of the

# Corporate responsibility continued

## Material recycled from Centrica offices (%)



The success of our recycling initiatives has meant that we have already exceeded our target for 2005, initially set in 2000.



Sir Roy Gardner is joined by meningitis sufferer Samuel Cloke to launch the 'Every Second Counts' partnership – a year-long partnership with our employee charity of the year, Meningitis Trust.



Employees in Cardiff ride the world's largest bicycle to raise funds for Cystic Fibrosis Trust, Centrica employee charity of the year 2001 to 2002.



Rod Kenyon, director of the British Gas Engineering Academy, is joined by a group of trainees to launch the academy.

AA's 8,000 strong list. The awards will be repeated in 2003 to make more establishments aware of the need for improved accessibility.

The AA Foundation for Road Safety Research published reports in 2002 on the safety of young male and female drivers, when and why older drivers give up driving and on safety in pan-European tunnels. During the year, research continued on the effect of surface conditions on road safety and accidents on high speed dual carriageways.

In December, it was announced that One.Tel would be working with the Samaritans, the emotional health charity, to promote its new telephone directory enquiries service. During 2003, One.Tel will donate 1p for every call made to the new service generating vital funds for the charity.

### Marketplace

We try to take a responsible approach to the marketing and selling of our products and services. We take care of our customers' daily essentials and provide the necessary access and expertise to ensure they benefit fully from the products and services we offer. For example, we currently provide over 500 communications each day to customers who are blind or visually impaired in the format they require, which includes Braille, large print and audio.

Some of our customers have specific needs. Current services include the Home Energy Care Register, the password scheme, providing information in alternative formats and using access technology such as text phones. We have developed our own website accessibility guidelines based on internationally recognised standards and intend that all our business websites will meet and exceed these standards in the near future.

We have reviewed the needs of hearing- and speech-impaired customers in collaboration with the RNID and the Royal Association for Deaf People. Text phones have been installed throughout the business and the AA has developed a text messaging service so that hearing and speech-impaired members can communicate effectively via their mobile phones.

The British Gas 'here to HELP' initiative was launched in 2002 to help tackle household poverty in the most deprived communities in Britain. From a package of £150 million, British Gas's investment of more than £70 million is supported by additional government and social housing provider funding. Over the next three years, 500,000 homes will be supported in urban, suburban and rural areas through a network of local authorities, housing associations and charity organisations. Households are offered energy efficiency measures and advice along with other services delivered by our charity partners.

### Workplace

Relationships with all our employees are based on trust and respect for the individual. We aim to attract, develop, reward and retain high quality people who are motivated to achieve our business objectives. Our employment policies seek to create an environment that motivates and engages all our employees, rewards performance, and satisfies material needs whilst supporting equality of opportunity for all. This is achieved through policies such as family leave, carers, personal development and supporting employees to find a successful balance between work and personal life. A new guide to sound business practice was developed in 2002, setting out

how we expect our employees to act in a variety of situations. This is being disseminated in 2003.

The growing diversity among our customers and employees presents us with opportunities for change. In an increasingly competitive environment, it is essential that we recognise the importance of operating as an inclusive organisation, through embracing diversity in the workforce and selecting the very best employees from a wide and varied choice of applicants. We work with a number of partners to achieve this goal including the Employers' Forum on Disability, an organisation chaired by our chief executive.

Diversity modules form part of the training for all our customer facing employees and a disability awareness training package has also been developed. More than 29,000 booklets giving practical advice on how best to serve disabled people have been issued throughout the business.

We have created employment opportunities for individuals from disadvantaged backgrounds. More than 180 individuals have been employed through targeted recruitment in our contact centres. In July 2002 we received a Business in the Community award for our investment in disabled people as employees and customers.

British Gas has committed to recruiting 200 gas engineers, targeting the long term unemployed and those who have trouble finding a career that fits in with their lifestyle. The engineer training course, developed with the Gas and Water Industries National Training Organisation, includes a part-time option aimed at single parents. The initiative is part of the

government backed Ambition Energy programme, chaired by Centrica's chief executive, to address an anticipated shortage of skilled and qualified gas engineers.

We are delighted that, in recognition of its commitment to the development and training of its employees, the AA has received corporate Investors in People accreditation.

Nearly three quarters of our employees took part in the annual global employee satisfaction survey in 2002, up from under two thirds in 2000. The survey measures four key improvement drivers – customer focus, performance and development, management impact and working life. Part of the performance related element of directors' remuneration is linked to this survey.

The health and safety of our employees is of paramount importance. Our performance is targeted and monitored through key performance indicators. In 2002, the amount of time lost to injuries or occupational ill health was low. Injuries have been attributable mainly to slips, trips and falls, and our accident prevention programmes focus on the underlying causes of these and other near miss events.

We have also taken steps to protect employees who may encounter violence while they do their jobs, for example gas engineers, roadside patrols and debt collectors. We have launched an occupational road risk programme to manage the risks to employees who drive in the course of their employment. Good practice workshops share new safety techniques and opportunities for performance improvement.



# Board of directors



1 Sir Michael Perry GBE



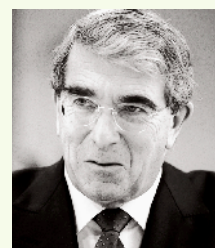
2 Helen Alexander



3 Mike Alexander



4 Phillip Bentley



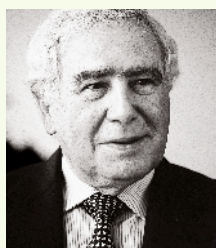
5 Roger Carr



6 Mark Clare



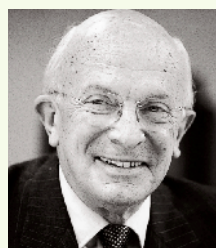
7 Sir Roy Gardner



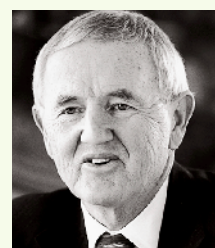
8 Sir Sydney Lipworth



9 Patricia Mann OBE



10 Sir Brian Shaw



11 Robert Tobin



12 Roger Wood

## 1 Sir Michael Perry GBE Chairman (69) A, N, R

Sir Michael Perry became chairman of Centrica plc in 1997. He was a non-executive director of British Gas plc from June 1994 until demerger. He is a member of the supervisory board of Royal Ahold NV, president of the Marketing Council, chairman of the Shakespeare Globe Trust and chairman of the Oxford University Faculty Board for Management.

## 2 Helen Alexander Non-executive director (46) A, C, R

Helen Alexander joined the board on 1 January 2003. She is chief executive of The Economist Group, a trustee of the Tate Gallery and was formerly a non-executive director of BT Group plc and Northern Foods plc.

## 3 Mike Alexander Chief operating officer (55) C, E

It was announced on 4 February 2003 that, by agreement of the company, Mike Alexander would be retiring from the board with effect from 28 February 2003. He was managing director of British Gas Trading from 1997 until the end of 2001 and from 1 January 2002, chief operating officer, Centrica plc.

## 4 Phillip Bentley Group finance director (44) E

Phillip Bentley joined Centrica plc in 2000 from Diageo plc, where he was finance director of GuinnessUDV. Prior to that, he was group treasurer and director of risk management of Diageo plc from 1997 and group treasurer of Grand Metropolitan plc from 1995. He is a non-executive director of Kingfisher plc.

## 5 Roger Carr Non-executive director (56) A, R

Roger Carr was appointed to the board in 2001. He is the senior non-executive director of Six Continents plc and Cadbury Schweppes plc and a senior adviser to Kohlberg, Kravis Roberts Co Ltd. He was previously chief executive of Williams plc and chairman of Thames Water plc and Chubb plc. He is a member of the Industrial Development Advisory Board and the CBI council.

## 6 Mark Clare Deputy chief executive and managing director, British Gas (45) C, E

Mark Clare joined British Gas plc in 1994 as group financial controller and was appointed finance director of Centrica plc in 1997. In 2000, he was appointed deputy chief executive and from 1 January 2002, managing director of British Gas. He is a non-executive director of BAA plc and The Energy Saving Trust Ltd.

## 7 Sir Roy Gardner Chief executive (57) E, N

Sir Roy Gardner was appointed finance director of British Gas plc in 1994. From 1995, he had responsibility for the business units which subsequently formed Centrica plc. Prior to joining British Gas plc, he was managing director of GEC-Marconi Ltd and a director of GEC plc. He is non-executive chairman of Manchester United plc, president of Carers UK and chairman of the Employers' Forum on Disability.

## 8 Sir Sydney Lipworth Non-executive director (71) A, C, R

Sir Sydney Lipworth was appointed a director in 1999 and retired from the board following the annual general meeting on 13 May 2002.

## 9 Patricia Mann OBE Senior non-executive director (65) A, C, N, R

Patricia Mann was a non-executive director of British Gas plc from 1995 until demerger. She was vice president international of J Walter Thompson Co Ltd and remains a director of JWT Trustees Ltd. She is on the board of the UK Centre for Economic and Environmental Development and is a former director of the Woolwich Building Society and Yale and Valor plc.

## 10 Sir Brian Shaw Non-executive director (69) A, R

Sir Brian Shaw joined the board in 1999 following the acquisition of the Automobile Association, of which he was non-executive chairman. He is a former chairman of Furness Withy, ANZ Grindlays Bank and the Port of London Authority. Sir Brian is an elder brother of Trinity House and a bencher of Gray's Inn.

## 11 Robert Tobin Non-executive director, US citizen (64) A, R

Robert Tobin was appointed to the board on 1 January 2003. He is a member of the supervisory board of Royal Ahold NV. Until September 2001, he was chairman of Ahold USA, a subsidiary of Royal Ahold NV. Since 2000, he has been chairman of the board of directors of the Worldwide Retail Exchange.

## 12 Roger Wood Managing director, the AA (60) C, E

Roger Wood joined British Gas plc in 1996 as managing director of British Gas Services. In 1999, following the acquisition of the AA business, he became managing director, home & road services. On 1 January 2002, he was appointed managing director of the AA. Previously, he was director general of Matra Marconi Space NV, group vice president of Northern Telecom Ltd and a UK director at ICL.

### Key to membership of committees

A Audit committee  
 E Executive committee  
 R Remuneration committee  
 C Customer service committee  
 N Nominations committee



# Directors' report

The directors present their report and the audited group accounts of Centrica plc for the year ended 31 December 2002.

## Principal activities

The principal activities during the year were:

- the provision of gas, electricity and energy related products and services in Great Britain, North America and Europe;
- the operation of gas fields in Great Britain and North America and power stations in Great Britain;
- energy trading in the UK, North American and European markets;
- roadside assistance and other motoring services in the UK and Europe;
- the provision of financial services in the UK; and
- the provision of telecommunications services in the UK.

## Business review

The chairman's statement, and the operating and financial review featured on pages 4 to 15 report on the activities of the group during the year, recent events and any likely further business developments.

## Financial results

The financial results of the group are discussed in the group financial review on pages 16 to 18 of this report.

## Major acquisitions and disposals

In May, the acquisition of the Toronto based home and business services operation Enbridge Services Inc for C\$1 billion (£438 million) was completed. The acquisition comprised 1.75 million customer relationships and 1.3 million waterheaters which were leased to customers. In December, the waterheater assets were transferred to the Consumers' Waterheater Income Fund (CWIF), which listed units and debt securities on the Toronto Stock Exchange, implying an enterprise value of C\$1 billion. The group retained a 41.9% equity and voting interest in the CWIF.

In June, agreement was reached to dispose of non-core interests in the Liverpool Bay Fields in consideration for a package of offshore gas assets in the North Sea and a cash balance, with a total value of approximately £88 million.

In June, Regional Power Generators Ltd, which owns and operates the 240MW Glanford Brigg power station in Lincolnshire, was acquired for £37 million.

In August, the acquisition of 212,000 natural gas customers of NewPower Holdings, Inc and its subsidiaries in Ohio and Pennsylvania was completed for US\$26 million (£17 million).

In August, Electricity Direct (UK) Ltd, the UK's largest independent commercial electricity supplier, was acquired for £50 million.

In November, offshore gas storage facilities in the North Sea and an associated onshore terminal were acquired for a net cash consideration of £488 million. The Secretary of State for Trade and Industry has to decide whether to clear the acquisition, refer it to the Competition Commission for further investigation or accept undertakings in lieu of a reference.

In November, the group's liquefied petroleum gas (LPG) business was sold for £40 million.

In December, the group acquired the electricity supply operations of Texas based Central Power and Light Company and West Texas Utilities Company, for a purchase price of approximately US\$246 million (£154 million).

In December, agreement was reached to acquire the retail gas and electricity supply businesses of ATCO Group in Alberta, Canada, with 988,000 customers, for C\$128.5 million (£52 million), payable over two years. This acquisition is conditional on legislative changes and regulatory consents in 2003.

## Post balance sheet events

Details of post balance sheet events are disclosed in note 30 to the financial statements on page 62.

## Dividends

An interim dividend of 1.4 pence per ordinary share was paid on 27 November 2002. The directors recommend that, subject to approval at the annual general meeting (AGM) on 12 May 2003, a final dividend of 2.6 pence per ordinary share be paid on 18 June 2003 to those shareholders registered on 2 May 2003. This makes a total dividend for the year of 4.0 pence per share (2001: 3.1 pence per share).

## Related party transactions

Details of related party transactions are set out in note 28 on page 58.

## Creditor payment policy

It is the group's policy to:

- agree the terms of payment in advance with the supplier;
- ensure that suppliers are aware of the terms of payment; and
- pay in accordance with contractual and other legal obligations.

The number of days' purchases outstanding as at 31 December 2002 was 34 (2001: 32) for the group (excluding Accord Energy Trading Limited) and 41 days (2001: 42 days) for the company.

## Employment policies

The group employed an average of 38,051 people during 2002. 35,563 were employed in the UK, 301 in the rest of Europe and 2,187 in North America.

The group is committed to pursuing equality and diversity in all its employment activities, with particular emphasis on recruitment and selection, training and development, appraisal and promotion. By supporting and encouraging the diversity of our people, we aim to increase employee motivation and provide better service to our diverse customer base in the community at large. This approach is reflected in our employee policies and procedures and we are proud to offer a range of benefits that go beyond the requirements of legislation. For example, we have a comprehensive 'carers policy', which enables employees to balance the demands of long term caring commitments with the requirements of their job.

The group continues to support the Government's New Deal for people with disabilities, the aim of which is to recruit unemployed disabled people and carers into the group's operations. Centrica's experience of embracing diversity is being shared with other UK employers through its membership of the Employers' Forum on Disability and the Employers' Forum on Age.

We comply with national gender pay policies and are committed to implementing them through a programme of equal pay audits.

## Employee communications

Employees are regularly provided with a wide range of information concerning the direction and performance of the group by means of employee briefing arrangements such as team briefs, intranet, CDs and company magazines. We also actively seek employee involvement through regular employee surveys and action planning forums. Employees' views are also taken into account by means of local consultative bodies. The group continues to be a strong supporter of Investors in People.

## Employee share schemes

The group encourages employee share ownership through the operation of tax authority approved share schemes open to all eligible employees, including executive directors.

Each year, the company operates sharesave schemes in the UK and Ireland which enable eligible employees to acquire

shares in the company at the end of a three or five year saving period. A total of 17,446 employees in the UK and Ireland participate in the schemes.

During the year, the company launched a share incentive plan, which enables eligible UK employees to buy Centrica shares, subject to monthly limits, out of pre-tax pay. In addition, the company awards one free matching share for every two shares an employee buys, subject to a monthly limit of 20 matching shares. A total of 5,065 employees participate in the plan.

### Corporate responsibility

Information relating to the group's impact on society, the economy and the wider environment is given on pages 19 to 20. A comprehensive guide on these matters including the company's policies and procedures is available at [www.centrica.com/responsibility](http://www.centrica.com/responsibility).

The company's reporting on such matters is being developed having regard to the ABI's disclosure guidelines. The system of internal control described on page 24 covers significant risks associated with social, environmental and health and safety matters.

### Charitable and political donations

An outline of the group's involvement in the community appears on pages 19 to 20. Charitable donations in the UK during the year amounted to £4.7 million (2001: £4.0 million). In line with group policy, no donations were made for political purposes.

### Share capital

The company's authorised and issued share capital as at 31 December 2002, together with details of shares issued during the year, is set out in note 20 on page 48.

### Material shareholdings

At 17 February 2003, the following material shareholdings were recorded in the register maintained in accordance with the Companies Act 1985:

Legal & General Investment Management Ltd	150,067,973	3.53%
Aviva plc	145,117,187	3.41%
Barclays plc	134,330,258	3.16%

### Directors

The board of directors section on page 21 gives details of all directors who served during the period between 1 January 2002 and the date of this report. On 13 May 2002, Sir Sydney Lipworth retired as a director of the company. It was announced on 4 February 2003 that, by agreement of the company, Mike Alexander would be retiring from the board with effect from 28 February 2003. Helen Alexander and Robert Tobin were appointed as non-executive directors on 1 January 2003. On 19 February 2003, Paul Walsh agreed to become a non-executive director of the company with effect from 1 March 2003.

In accordance with the articles of association, Sir Michael Perry, Sir Roy Gardner and Sir Brian Shaw will retire by rotation at the 2003 AGM. Sir Michael and Sir Roy will be proposed for re-election. Sir Brian will not be seeking re-election, having by then reached the age of 70.

It being the first AGM since their appointment, Helen Alexander, Robert Tobin and Paul Walsh will be proposed for election. All have considerable experience of leading consumer facing international businesses.

The biographical details of all directors being proposed are given in the notice of AGM. Full details of directors' service contracts, emoluments and share interests can be found in the remuneration report on pages 25 to 30.

### Auditors

Following the conversion by PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, a resolution to appoint the new firm, PricewaterhouseCoopers LLP, as auditors to the company will be proposed at the AGM.

### Authority to purchase shares

The directors were authorised at the 2002 AGM to purchase the company's own shares, within certain limits and as permitted by the Articles of Association. Although no such purchases have been made to date pursuant to this authority, the directors will seek to renew the authority at the 2003 AGM.

### Corporate governance

The group is committed to high standards of corporate governance. Following the recommendations in the reports on the Role and Effectiveness of Non-Executive Directors (the Higgs Report) and Audit Committees (the Smith Report), the board is reviewing its governance arrangements and will consider making changes as necessary and appropriate. Throughout the year, the company fully complied with the provisions of the Combined Code on Corporate Governance (the Code) and applied the principles of the Code as follows:

### The board

An effective board of directors leads and controls the group. The board, which meets at least 10 times a year, has a schedule of matters reserved for its approval. One of its meetings each year is substantially devoted to the development of strategy. During 2002, there was full attendance at board and audit, remuneration and nominations committee meetings, other than by one director who missed one board meeting.

Comprehensive briefing papers including management accounts are circulated to each director one week prior to board meetings. A procedure is in place to enable all directors to obtain independent professional advice in respect of their duties. They also have access to the advice and services of the company secretary.

The names of the directors and their biographical details including committee memberships appear on page 21. Throughout the year, the chairman and the other non-executive directors were independent of management and the senior independent director, as required by the Code, was Patricia Mann. The non-executive directors, including the chairman, meet independently of management on a regular basis.

All directors joining the board are required to submit themselves for election at the next AGM. They are subject to re-election every third year thereafter. The non-executive directors are initially appointed for a three year term and, subject to review and re-election, can serve up to a maximum of three such terms.

The board has delegated authority to a number of committees to deal with specific aspects of the management and control of the group. These committees have specific terms of reference and meet on a regular basis. The minutes of the meetings of these committees are made available to all the directors on a timely basis.

### Executive committee

The executive committee, chaired by Sir Roy Gardner, meets weekly. It oversees the management of the group and is the decision making body for those matters not reserved to the board and within the limits set out in the group's delegated authority and expenditure control policies.

There are five sub-committees of the executive committee: the group risk management committee; the group financial risk management committee; the corporate responsibility committee; the health, safety and environment committee; and the business continuity steering group.

## Audit committee

The audit committee, which meets four times a year, consists entirely of independent non-executive directors. It was chaired throughout the year by Roger Carr.

The audit committee considers the nature and scope of the audit process and its cost effectiveness. It reviews the internal audit programme, matters brought to its attention by both the internal and external auditors and the annual and interim financial statements before submission to the board. It also reviews the system of internal control and reports its findings to the board.

The audit committee also monitors the independence of the external auditors. Note 4 to the financial statements on page 40, sets out the group's policy to seek competitive tenders for all major consultancies and advisory projects.

From the beginning of 2002, in recognition of increasing public concern over the effect of consulting services on auditors' independence, this policy was strengthened such that the external auditors' consulting arm, PwC Consulting, would not be invited to tender for any further general consultancy work unless their proprietary skill base was uniquely valuable. In addition, the external auditors may still be used in respect of taxation advice and financial due diligence on transactions. All such assignments are reported to the audit committee on a quarterly basis, along with a full breakdown of all non-audit fees incurred during the year.

As a matter of best practice and in accordance with auditing standard 610, our external auditors have held discussions with the audit committee on the subject of audit independence and have confirmed their independence in writing.

## Remuneration committee

The remuneration committee, which meets four times a year, consists entirely of independent non-executive directors. It is chaired by Patricia Mann. The role of this committee and details of how the company applies the principles of the Code in respect of directors' remuneration are set out on pages 25 to 30.

## Nominations committee

The nominations committee, chaired by Sir Michael Perry, makes recommendations to the board for appointments of replacement or additional directors. It met formally on two occasions during the year.

## Customer service committee

This committee, which determines and monitors customer service targets, is one of the key drivers of the long term success of the group. It was chaired by Sir Sydney Lipworth until his retirement from the board on 13 May 2002. From then until January 2003, it was chaired by Mark Clare. Helen Alexander was appointed chairman of this committee with effect from February 2003.

## AA motoring policy committee

This committee, chaired by Sir Brian Shaw, acted as an advocate on public policy issues affecting motorists. With effect from January 2003, this committee was disbanded and its work has been carried out by the independent AA Motoring Trust.

## Relations with shareholders

The company has a programme of communication with its shareholders. As well as share price information, news releases and the annual report, the Centrica website includes speeches from the AGM, presentations to the investment community and a section for shareholder services.

The board believes that the AGM presents a useful opportunity for dialogue with private shareholders, many of whom are also customers. At the AGM, the chief executive presents a review of the businesses of the group. Representatives from the group's brand units are available for discussion in the exhibition area both before and after the

meeting. Centrica also holds regular meetings with its major institutional shareholders.

All shareholders have the opportunity to cast their votes at the AGM by proxy, by post or via the internet. Shareholders can register to receive all their communications online, benefiting both themselves and the company.

## Internal control

The board of directors is responsible for the group's system of internal control, which is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

## Identification, assessment and management of risks

The company places great importance on internal control and risk management. A risk aware and control conscious environment is fostered throughout the group. The board, directly or through its committees, sets objectives, performance targets and policies for management of key risks facing the group. These include strategic planning, acquisitions, investments, expenditure control, treasury, environment, health and safety, trading and customer service.

Across the group, each business has a risk management committee that seeks to identify, assess and advise on the management of operational risks. In addition, the group risk management committee considers the risks which might affect the company at group level.

The processes of newly acquired companies are integrated with those of the group.

## Assurance

The business assurance function undertakes internal audit reviews according to an annual plan approved by the audit committee. The results of their work is reported to the audit committee on a quarterly basis.

## The board's review of the system of internal control

The board of directors, with the advice of the audit committee, has reviewed the effectiveness of the internal control system operated (as described above) throughout the period 1 January 2002 to the date of this report and is satisfied that the group complies with the guidance contained in the Turnbull Committee report on Internal Control.

## Going concern

After making enquiries, the board has a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, we continue to adopt the going concern basis in preparing the financial statements, which are shown on pages 32 to 67.

By order of the board



**Grant Dawson**  
General Counsel and Company Secretary  
20 February 2003

Registered office:  
Millstream  
Maidenhead Road  
Windsor  
Berkshire SL4 5GD  
Company registered in England and Wales No. 3033654

# Remuneration report

## Composition and role of the remuneration committee

The board has established a remuneration committee, which is chaired by Patricia Mann. The other members of the committee in 2002 were Roger Carr, Sir Sydney Lipworth (until his retirement on 13 May 2002), Sir Michael Perry and Sir Brian Shaw. Helen Alexander and Robert Tobin became members of the committee when they joined the board on 1 January 2003. All of the members of the committee are independent non-executive directors.

The committee makes recommendations to the board, within formal terms of reference, on the policy and framework of executive remuneration and its cost to the company. The committee is also responsible for the implementation of remuneration policy and determining specific remuneration packages for each of the executive directors. The committee has access to advice provided by the group head of reward (Mike New), the group human resources director (Anne Minto), the company secretary (Grant Dawson), the chief executive (Sir Roy Gardner) and external consultants. During 2002, the committee consulted, but did not formally appoint, Towers Perrin, who provided survey and other information on executive compensation to assist in the formulation of the committee's recommendations. Towers Perrin also provided advice to the group on retirement benefits and change management processes during the year.

This report explains how the company has applied the principles in the Combined Code on Corporate Governance that relate to directors' remuneration. It will be submitted to the forthcoming AGM for approval. No director votes on any matter relating to his or her own remuneration.

## Framework and policy on executive directors' remuneration

The group's remuneration policy is designed to provide competitive rewards for its executive directors and other senior executives, taking into account the company's performance, the markets in which the group operates and pay and conditions elsewhere in the group.

In constructing the remuneration packages, the committee aims to achieve a balance between fixed and variable compensation for each director. Accordingly, a significant proportion of the remuneration package depends on the attainment of demanding performance objectives, both short and long term. In agreeing the level of base salaries and the annual performance bonus scheme, the committee takes into consideration the total remuneration that executives could receive. The committee reviews the packages and varies individual elements when appropriate from year to year.

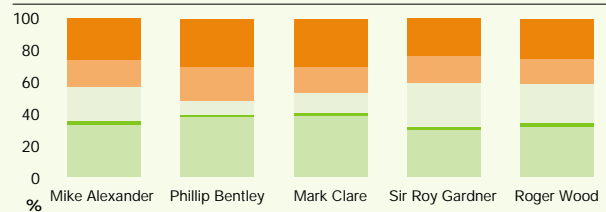
The current practice is to make conditional awards each year under both the executive share option scheme (ESOS) and the long term incentive scheme (LTIS). These schemes are designed to align the interests of executive directors and other senior executives with the longer term interests of shareholders by rewarding them for delivering increased shareholder value.

As a matter of policy, all executive directors and certain senior executives are expected to retain a minimum shareholding in the company at least equal in value to the executive's base salary.

The committee believes that these arrangements, which are further explained below, are important in providing a potential remuneration package that will attract, retain and continue to motivate executive directors and senior executives in a marketplace that is increasingly challenging and competitive in both commercial and human resource terms. It is intended that the current remuneration policy, which has previously been approved by shareholders, will continue for 2003 and succeeding years.

In 2002, the total compensation of the executive directors, detailed on page 27, consisted of components in the following proportions:

## Relative proportions of components of executive directors' remuneration 2002



**Fixed elements:** Salary Benefits Pension  
**Variable elements:** Performance bonus ESOS + LTIS

Note: Salary and benefits are amounts received during 2002; pension is the increase in transfer value less director's contributions during 2002; performance bonus is that paid in respect of 2002; and ESOS and LTIS is the estimated value of the awards made in 2002 based on a Black Scholes model, provided that all performance conditions are met, at the end of the relevant performance periods.

## Components of remuneration

### Base salary

The committee seeks to establish a base salary for each executive director determined by individual performance and external market data from independent sources, in particular salary levels for similar positions in comparable companies. Base salaries are reviewed annually. Base salary is the only element of remuneration that is pensionable.

### Annual performance bonus

To recognise performance against agreed objectives, the committee has put in place an annual bonus scheme for executive directors similar to that applying to other senior executives in the group. Annual bonuses for executive directors are determined by the achievement of demanding individual, business and corporate objectives. The scheme provided the potential for a maximum bonus payment of 60% of base salary should every element of every objective be achieved in full. Annual bonus objectives and targets are approved by the committee and, in 2002, related to financial performance, customer and employee satisfaction and personal performance, each at 20% of base salary. For executive directors with business unit responsibilities, the scheme is structured to reflect the performance of their business unit as well as that of the group. No bonus at all is payable to an individual if their agreed minimum personal performance target is not met.

### Executive share option scheme (ESOS)

Options granted under the ESOS only become exercisable if and to the extent that performance conditions are satisfied three years after the date of grant. If exercisable, they remain so until the tenth anniversary of grant. Performance conditions are based on the extent to which growth in the company's earnings per share (EPS growth) exceeds growth in the Retail Prices Index (RPI growth) over a three year performance period. EPS is calculated as fully-diluted earnings per share adjusted for exceptional charges and goodwill amortisation. The committee believes that this method of calculating EPS provides an independent and verifiable measure of the company's performance.

In respect of each grant of options, the committee has determined that, for the option to be exercisable in full, EPS growth must exceed RPI growth by 18 percentage points or more over the three year performance period. No part of the option grant will be exercisable if EPS growth fails to exceed RPI growth by at least 9 percentage points over the performance period. The proportion of the option grant exercisable by the



## Remuneration report continued

executive will increase on a sliding scale between 40% and 100% if EPS growth exceeds RPI growth by between 9 and 18 percentage points over the performance period.

The company's EPS growth may be re-measured annually for a further two years, but always from the date of grant of the options, with the performance conditions increasing proportionately. The committee believes that, in relation to the ESOS, EPS growth in excess of RPI growth is the most appropriate measure for determining the increase in value delivered to shareholders by the company's executive directors and senior executives. The committee reviews the appropriateness of the performance measure and the specific targets set when considering each new grant of options.

In April 2002, options were granted to each executive director equal to twice his base salary and, at the same or lower rates, to certain other senior executives. Details of options granted to executive directors are shown on page 30. It is the company's intention that new shares be issued, subject to institutional guidelines, to satisfy the exercise of options granted under the ESOS.

Three of the executive directors hold options under the restructured executive share option scheme (RESOS). The RESOS was put in place to replace options which executives had previously held over British Gas plc shares and which were cancelled at demerger. There are no performance conditions attaching to options under the RESOS. Further details are given on page 30.

### Long term incentive scheme (LTIS)

Allocations of shares are made annually to executive directors and other senior executives under the LTIS. These awards are subject to challenging performance conditions based on the company's total shareholder return (TSR) relative to the returns of a comparator group, since this ensures that the executives are not rewarded unless the company has outperformed its peers in creating shareholder value. The committee has determined that, in the absence of a meaningful 'natural' comparator group for the company, the companies comprising the FTSE 100 at the start of the relevant performance period (the LTIS comparator group) constitute the most appropriate comparator group for the purpose of the LTIS. The committee reviews the appropriateness of the performance measure and the specific target set when considering each new allocation of shares under the LTIS. In assessing the extent of satisfaction of the performance condition, the committee uses data provided by Hoare Govett.

Allocations made prior to May 2001 are subject to a performance period of either three or four years (at the participant's choice), followed by a retention period of two years. Changes to these arrangements were approved at the 2001 AGM. Allocations made from May 2001 will be released to the participant under normal circumstances after the three year performance period, provided the performance conditions have been met.

The actual number of shares eventually released to the participant depends on the company's TSR over the entire performance period relative to the LTIS comparator group. The maximum annual allocation of shares only vests and is released to the executive if the company's TSR over the performance period is ranked in 25th position or above relative to the 99 other companies in the LTIS comparator group. No shares vest if the TSR over the performance period is ranked below 50th position in the LTIS comparator group. Between 25th and 50th position, shares vest on a sliding scale from 100% to 40%.

In April 2002, LTIS allocations equal to three quarters of base salary were awarded to executive directors and, at the same or lower rates, to certain other senior executives. The maximum number of shares that could eventually be

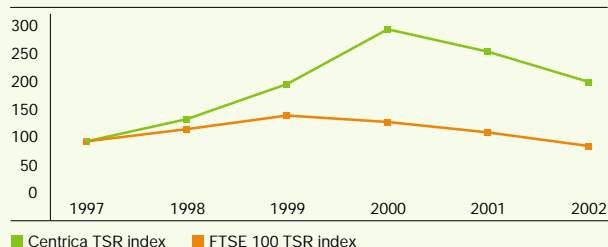
transferred to each executive director upon satisfaction of the performance criteria appears on page 29.

Prior to 2002, the trustee bought shares in the market to match the likely future requirements for shares under LTIS releases. Any shortfall will be satisfied by the issue of new shares.

### TSR: Centrica and FTSE 100: 1997 to 2002

The following table shows graphs of the company's TSR performance and that of the FTSE 100 index. As required by the Directors' Remuneration Report Regulations 2002, this uses a rolling definition of the FTSE 100, whereas the definition used for the purposes of the LTIS is the FTSE 100 as constituted at the beginning of the period. In order to demonstrate the delivery of shareholder value during the respective performance periods, TSR graphs for LTIS awards that vested in March and October 2002 are shown in the tables on page 29.

### TSR indices – Centrica and FTSE 100: 1997-2002



### Other employment benefits

In common with other senior management, executive directors are entitled to a range of benefits, including a contributory, final salary pension (see pages 27 and 28), a company car, life assurance, private medical insurance and a financial counselling scheme. They are also eligible, on the same basis as other employees, to participate in the company's Inland Revenue-approved sharesave and share incentive plans. These are open to all eligible employees and provide a long term savings and investment opportunity.

### Service contracts

It is the company's policy for the notice period in executive directors' service contracts not to exceed one year. The committee retains a level of flexibility in order to offer contracts to new executive directors that contain an initial notice period in excess of one year, provided that after the first such period the notice period reduces to one year.

The executive directors' service contracts have no fixed term but provide that either the director or the company may terminate the employment by giving one year's written notice and that the company may pay compensation in lieu of notice. Phillip Bentley's contract provides for an initial notice period of two years, which reverted in November 2002 to one year on the same basis as the other executive directors. The dates of the executive directors' service contracts are disclosed in the table on page 27.

Upon Mike Alexander's retirement from the board on 28 February 2003, he will forfeit all of the options granted to him under the ESOS (see the table on page 30) and the conditional allocations of shares made to him under the LTIS on 2 October 2000, 1 October 2001 and 2 April 2002 (see the table on page 29). The performance targets in respect of the allocations of shares made to him under the LTIS on 1 October 1998 and 7 October 1999 have previously been achieved and those shares will be released to him at the end of the retention periods on 30 September 2003 and 30 September 2004, respectively. Mike Alexander will not receive any payments other than his pension, the details of which are disclosed on pages 27 and 28.

### External appointments of executive directors

The board believes that experience of other companies' practices and challenges is valuable both for the personal development of its executive directors and for the company. It is therefore the company's policy to allow each executive director to accept one non-executive directorship of another company, although the board retains the discretion to vary this policy. Fees are retained by the individual director. Details of individual directors' external appointments are given in their biographies on page 21.

### Non-executive directors

Non-executive directors do not hold service contracts. The dates of their appointment are shown in the table below. Their appointment is subject to the articles of association. Their fees are determined having regard to the need to attract individuals of the right calibre and experience, the time and responsibilities entailed and the fees paid by other companies. Their fees are approved by the board, upon the recommendation of the executive committee, whose members are the executive directors listed in the table below, together with Grant Dawson, general counsel and company secretary. The executive committee received survey and other information from the remuneration consultants, Towers Perrin. The non-executive directors, including the chairman, do not participate in any of the company's share schemes, incentive plans or pension schemes.

In addition to their fees as non-executive directors of the company, Sir Brian Shaw received fees for consultancy services to the AA Motoring Policy Unit and Sir Sydney Lipworth received fees for services as a non-executive director of Goldfish Bank Limited.

The remuneration report from page 25 to page 27 up to this statement has not been audited. From this point until the end of the report on page 30, the disclosures, with the exception of the two line graphs on page 29, have been audited.

### Directors' emoluments

		Base salary/fees £000	Annual performance bonus £000	Benefits <sup>(i)</sup> £000	Total emoluments <sup>(ii)</sup> 2002 £000	Total emoluments <sup>(ii)</sup> 2001 <sup>(iii)</sup> £000
<b>Executive directors</b>	Date of service contract					
Mike Alexander	10 January 2002	389	199	29	617	506
Phillip Bentley <sup>(iv)</sup>	13 September 2000	400	231	16	647	536
Mark Clare	21 March 2001	418	181	27	626	553
Sir Roy Gardner	21 March 2001	678	376	44	1,098	847
Roger Wood	21 March 2001	389	194	25	608	559
		2,274	1,181	141	3,596	3,001
<b>Non-executive directors</b>	Date of appointment					
Roger Carr	1 January 2000	34	–	–	34	30
Sir Sydney Lipworth <sup>(v)</sup>	12 March 1999	22	–	–	22	45
Patricia Mann	4 December 1996	34	–	–	34	30
Sir Michael Perry	4 December 1996	195	–	–	195	180
Sir Brian Shaw <sup>(vi)</sup>	23 September 1999	54	–	–	54	50
		339	–	–	339	335
<b>Total emoluments</b>		2,613	1,181	141	3,935	3,336

(i) Benefits include all taxable benefits arising from employment by the company, mainly the provision of a company car.

(ii) The following are excluded from the table above:

- pensions – see below and page 28;
- share options – see page 30. The aggregate of the amount of gains made by executive directors on the exercise of share options was £305,950; and
- long term incentives – see pages 28 and 29. The aggregate value of shares vested to executive directors under the LTIS was £4,630,479.

(iii) The total emoluments figure for 2001 excludes £30,000 paid to Francis Mackay for his services as a director during that year.

(iv) In addition to the emoluments shown above, Phillip Bentley received a payment of £200,000 (2001: £250,000) as the second and final tranche of compensation for loss of entitlement under his previous employer's performance bonus and share option schemes.

(v) The figure for Sir Sydney Lipworth for 2002 includes fees of £8,333 in respect of services as a non-executive director of Goldfish Bank Limited while a director of Centrica plc.

(vi) The figures for Sir Brian Shaw include fees of £20,000 per annum in respect of consultancy services to the AA Motoring Policy Unit.

### Directors' pensions

The pension arrangements for the executive directors, who are all members of the Centrica staff pension scheme, are shown below. The staff pension scheme is a funded, Inland Revenue-approved, final salary, occupational pension scheme. Its rules provide for the following main features:

- normal retirement at age 65;
- right to an immediate, unreduced pension on retirement at age 60;
- right to an immediate, unreduced pension on leaving service after age 55, subject to 10 years' service and company consent;
- right to an immediate, unreduced pension on leaving service on reorganisation or for redundancy after age 50;
- life assurance cover of four times pensionable salary;
- spouse's pension on death in service payable at the rate of two thirds of the member's prospective pension and, on death after retirement, two thirds of accrued pension. Children's pensions are also payable;
- members' contributions payable at the rate of 4% of pensionable earnings;
- pension payable in the event of retirement due to ill health;
- pensions in payment and in deferment guaranteed to increase in line with the increase in the RPI; and
- no discretionary practices are taken into account in calculating transfer values.

## Remuneration report continued

All benefits are subject to Inland Revenue limits. Where such limitation is due to the earnings 'cap', benefits are increased to the level that would otherwise have been paid and are provided via the Centrica unapproved pension scheme. This scheme is unfunded but the benefits are secured by a charge over Centrica's assets to give security equivalent to the pensions provided to other employees. An appropriate provision in respect of their accrued value has been made in the company's balance sheet.

### Pension benefits earned by directors (£)

	Accrued pension as at 31 December 2002 <sup>(i)</sup>	Accrued pension as at 31 December 2001	Increase in accrued pension <sup>(ii)</sup>	Transfer value as at 31 December 2002	Transfer value as at 31 December 2001	Contributions paid in 2002 <sup>(iii)</sup>	Difference in transfer values less contributions	Transfer value of the increase in accrued pension excluding inflation <sup>(iv)</sup>
Mike Alexander <sup>(v),(vi)</sup>	176,700	160,400	16,300	2,598,800	2,328,300	14,513	255,987	181,777
Phillip Bentley <sup>(vii)</sup>	19,600	9,500	10,100	196,400	93,100	14,513	88,787	83,410
Mark Clare <sup>(vi)</sup>	74,300	61,900	12,400	793,000	643,200	14,513	135,287	104,576
Sir Roy Gardner <sup>(viii)</sup>	183,400	140,000	43,400	2,883,800	2,227,100	14,513	642,187	619,708
Roger Wood <sup>(viii)</sup>	89,300	73,200	16,100	1,645,400	1,325,200	14,513	305,687	254,634

(i) Accrued pension is that which would be paid annually on retirement at age 65, based on eligible service to 31 December 2002.

(ii) The increase in accrued pension during the year excludes any pension arising from additional voluntary contributions. The increase in accrued pension adjusted to exclude inflation may be derived by discounting the figure in the first column by the rate of inflation (1.7% – see note (iv)) and subtracting the figure in the second column.

(iii) Contributions were paid in the year by the directors under the terms of the scheme up to the maximum rate of 15% of the earnings 'cap'.

(iv) The rate of inflation used was 1.7%, the annual rate to 30 September 2002, the date used for pension increases under the scheme.

(v) The accrued pension shown for Mike Alexander includes a credit in relation to a transfer from a previous employer's pension scheme.

(vi) With effect from 1 January 1998, the pensions for Mike Alexander and Mark Clare have accrued at the rate of 2.26% (approximately  $\frac{1}{44}$ ) and 2.28% (approximately  $\frac{1}{44}$ ) of pensionable salary respectively for each year of pensionable service. Pensions in relation to service prior to 1 January 1998 will continue to accrue at the rate of 1.67% ( $\frac{1}{60}$ ) of pensionable salary.

(vii) The pension for Phillip Bentley accrues at the rate of 2.31% (approximately  $\frac{1}{43}$ ) of pensionable salary for each year of pensionable service.

(viii) The pensions for Sir Roy Gardner and Roger Wood accrue at the rate of 3.33% ( $\frac{1}{30}$ ) of pensionable salary per year of service.

### Directors' interests in shares

The directors' beneficial interests (which include those of their families) in the ordinary shares in the company and the executive directors' interests in the long term incentive scheme (LTIS) are shown in the following two tables:

	Shareholdings as at 31 December 2002	Shareholdings as at 1 January 2002	LTIS: total allocations as at 31 December 2002	LTIS: total allocations as at 1 January 2002
Directors as at 31 December 2002				
<b>Executive directors</b>				
Mike Alexander	328,194	27,849	773,614	1,129,858
Phillip Bentley	80,095	50,000	453,857	317,069
Mark Clare	354,625	24,539	840,895	1,187,130
Sir Roy Gardner	771,661	166,569	1,382,870	2,012,367
Roger Wood	366,011	55,197	800,876	1,208,491
<b>Non-executive directors</b>				
Roger Carr	4,700	4,700	–	–
Patricia Mann	2,142	2,142	–	–
Sir Michael Perry	15,900	15,900	–	–
Sir Brian Shaw	1,000	1,000	–	–

(i) As at 17 February 2003, the beneficial shareholdings of the executive directors had increased from the totals shown at 31 December 2002 by the following numbers of shares: Mike Alexander 93; Phillip Bentley 20,093; Mark Clare 10,093; Sir Roy Gardner 30,093; Roger Wood 20,000; and Sir Michael Perry 10,000.

(ii) As at 31 December 2002, 27,238,473 shares (1 January 2002: 39,361,377) were held by the trustee of the employee share trust under the LTIS rules. As with other employees, the directors are deemed to have a potential interest in those shares, being beneficiaries under the trust. These interests remained unchanged as at 17 February 2003.

(iii) From 1 January 2002 to 17 February 2003, none of the directors had any beneficial interests in the company's securities other than ordinary shares, nor any non-beneficial interests in any of the company's securities, or those of its subsidiary or associated undertakings.

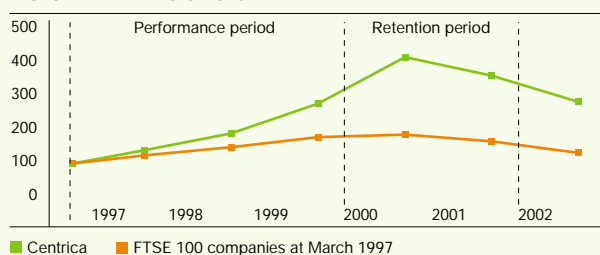
The following table gives details of the LTIS allocations held by each director:

	Vested during 2002		In retention period		In performance period		
	4 March 1997 <sup>(i)</sup>	1 October 1997 <sup>(i)</sup>	1 October 1998 <sup>(ii)</sup>	7 October 1999 <sup>(ii)</sup>	2 October 2000 <sup>(iii)</sup>	1 October 2001 <sup>(iv)</sup>	2 April 2002 <sup>(v)</sup>
Mike Alexander	282,843	205,184	178,024	142,415	185,994	135,398	131,783
Phillip Bentley	–	–	–	–	181,671	135,398	136,788
Mark Clare	282,843	205,184	181,431	151,703	221,422	144,547	141,792
Sir Roy Gardner	500,186	362,851	340,716	272,446	312,943	223,225	233,540
Roger Wood	312,616	226,782	189,949	154,799	188,947	135,398	131,783
Market price at allocation date	64.00p	94.25p	118.00p	161.50p	220.50p	214.50p	227.00p
End of qualifying period <sup>(v)</sup>	2/3/2002	30/9/2002	30/9/2003	30/9/2004	1/10/2005	30/9/2004	1/4/2005
Market price at vesting date <sup>(vi)</sup>	215.88p	165.46p					

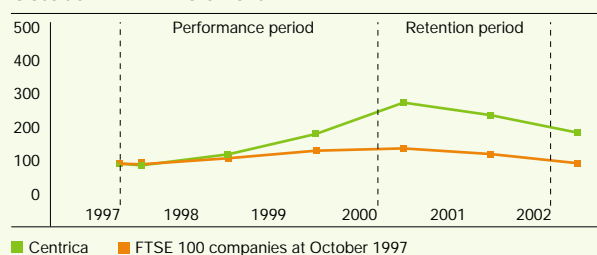
- (i) At the end of the respective performance periods (2 March 2000 and 30 September 2000), the company ranked in sixth and fourth positions respectively in the relevant LTIS comparator groups. Accordingly, 100% of the allocations were released on the vesting dates (4 March 2002 and 1 October 2002 respectively) following the expiry of the two year retention period. These shares were subject to income tax at the individual's marginal rate, based on the market value of the shares at the date of vesting. The income tax liability was satisfied by the sale of sufficient shares and, accordingly, the directors only received the net number of shares following disposal, which is reflected in the shareholdings as at 31 December 2002 in the second table on page 28.
- (ii) At the end of the respective performance periods (30 September 2001 and 30 September 2002), the company ranked fourth in the relevant LTIS comparator groups. Accordingly, 100% of the allocations are being held in trust for a further two years at the end of which time they will be released to the directors at the trustee's discretion.
- (iii) The performance period relating to this allocation will end on 1 October 2003. If and to the extent that the performance condition is met, the relevant number of shares will then be held in trust for two years, at the end of which time they will be released to the directors at the trustee's discretion.
- (iv) The respective performance periods relating to these allocations will end on 30 September 2004 and 1 April 2005. If and to the extent that the performance conditions are met, the allocations will vest and the relevant number of shares will be released to the directors, at the trustee's discretion.
- (v) The end of the qualifying period is the date on which it is judged whether or not the qualifying conditions (see LTIS section on page 26) have been fulfilled.
- (vi) The vesting date was the next business day after the end of the qualifying period.

The following tables, which have not been audited, show the TSR performance of Centrica and the respective TSR comparator groups over the qualifying periods relating to the two LTIS awards that vested during 2002:

**TSR indices – Centrica and FTSE 100:  
March 1997 LTIS award**



**TSR indices – Centrica and FTSE 100:  
October 1997 LTIS award**





# Remuneration report continued

## Directors' interests in share options

Full details of the options over ordinary shares in the company held by executive directors who served during the year and any movements in those options in the year are shown below:

	Options held as at 1 January 2002	Options granted during year	Options exercised during year <sup>(iv)</sup>	Options held as at 31 December 2002	Exercise price (pence)	Date from which exercisable	Expiry date
<b>Mike Alexander</b>							
RESOS <sup>(i)</sup>	86,145	–	86,145 <sup>(a)</sup>	–	90.266	Oct 1996	Oct 2003
ESOS <sup>(ii)</sup>	308,269	–	–	<b>308,269</b>	240.050	Jun 2004	May 2011
ESOS <sup>(ii)</sup>	–	351,423	–	<b>351,423</b>	224.800	Apr 2005	Apr 2012
Sharesave <sup>(iii)</sup>	7,435	–	7,435 <sup>(b)</sup>	–	46.400	Jun 2002	Nov 2002
Sharesave <sup>(iii)</sup>	14,967	–	–	<b>14,967</b>	92.200	Jun 2003	Nov 2003
Sharesave <sup>(iii)</sup>	–	1,863	–	<b>1,863</b>	177.600	Jun 2007	Nov 2007
	416,816	353,286	93,580	<b>676,522</b>			
<b>Phillip Bentley</b>							
ESOS <sup>(ii)</sup>	308,269	–	–	<b>308,269</b>	240.050	Jun 2004	May 2011
ESOS <sup>(ii)</sup>	–	364,768	–	<b>364,768</b>	224.800	Apr 2005	Apr 2012
Sharesave <sup>(iii)</sup>	5,071	–	–	<b>5,071</b>	191.000	Jun 2004	Nov 2004
	313,340	364,768	–	<b>678,108</b>			
<b>Mark Clare</b>							
RESOS <sup>(i)</sup>	177,645	–	–	<b>177,645</b>	81.060	Oct 1997	Oct 2004
ESOS <sup>(ii)</sup>	329,098	–	–	<b>329,098</b>	240.050	Jun 2004	May 2011
ESOS <sup>(ii)</sup>	–	378,113	–	<b>378,113</b>	224.800	Apr 2005	Apr 2012
Sharesave <sup>(iii)</sup>	37,176	–	37,176 <sup>(c)</sup>	–	46.400	Jun 2002	Nov 2002
Sharesave <sup>(iii)</sup>	–	9,318	–	<b>9,318</b>	177.600	Jun 2007	Nov 2007
	543,919	387,431	37,176	<b>894,174</b>			
<b>Sir Roy Gardner</b>							
RESOS <sup>(i)</sup>	1,336,446	–	–	<b>1,336,446</b>	81.889	Nov 1997	Nov 2004
ESOS <sup>(ii)</sup>	508,227	–	–	<b>508,227</b>	240.050	Jun 2004	May 2011
ESOS <sup>(ii)</sup>	–	622,775	–	<b>622,775</b>	224.800	Apr 2005	Apr 2012
Sharesave <sup>(iii)</sup>	37,176	–	37,176 <sup>(b)</sup>	–	46.400	Jun 2002	Nov 2002
Sharesave <sup>(iii)</sup>	–	9,318	–	<b>9,318</b>	177.600	Jun 2007	Nov 2007
	1,881,849	632,093	37,176	<b>2,476,766</b>			
<b>Roger Wood</b>							
ESOS <sup>(ii)</sup>	308,269	–	–	<b>308,269</b>	240.050	Jun 2004	May 2011
ESOS <sup>(ii)</sup>	–	351,423	–	<b>351,423</b>	224.800	Apr 2005	Apr 2012
Sharesave <sup>(iii)</sup>	37,176	–	37,176 <sup>(b)</sup>	–	46.400	Jun 2002	Nov 2002
Sharesave <sup>(iii)</sup>	–	9,318	–	<b>9,318</b>	177.600	Jun 2007	Nov 2007
	345,445	360,741	37,176	<b>669,010</b>			

**(i) Restructured executive share option scheme (RESOS)**

Options granted to company employees under the British Gas plc executive share option scheme prior to February 1997 were cancelled and replaced at demerger by non-Inland Revenue-approved options to acquire Centrica shares. The replacement options were granted on the same terms as British Gas executive share options, with the same exercise date and aggregate exercise price per share, and the number of shares placed under option was adjusted to take account of the demerger. No further options have been or will be granted under this scheme.

**(ii) Executive share option scheme (ESOS)**

Options were granted to executives under the terms of the Centrica executive share option scheme on 31 May 2001 and 2 April 2002. For details of the operation of this scheme see page 25.

**(iii) Sharesave scheme**

The company operates an Inland Revenue-approved all-employee savings-related share option scheme. The scheme is designed to provide a long term savings and investment opportunity for employees and is described on page 22.

**(iv) Exercise of share options**

Options were exercised at the following dates and prices: (a) 5 April 2002 at 225 pence; (b) 5 June 2002 at 207.5 pence; and (c) 1 July 2002 at 202.75 pence.

No director's options lapsed during the year.

The closing price of a Centrica ordinary share on the last trading day of 2002 (31 December) was 171 pence. The range during the year was 239 pence (high) and 150 pence (low).

This report on remuneration has been approved by the board and signed on its behalf by



**Grant Dawson**

General Counsel and Company Secretary  
20 February 2003

## Statement of directors' responsibilities for preparing the financial statements

The directors are required by the Companies Act 1985 to prepare financial statements for each year which give a true and fair view of the state of affairs of the company and of the group as at the end of the financial year and of the profit or loss for the financial year.

The directors consider that, in preparing the financial statements on pages 32 to 67, the company has used appropriate accounting policies, consistently applied and supported by

reasonable and prudent judgements and estimates, and that all applicable accounting standards have been followed.

The directors have responsibility for ensuring that the company keeps accounting records which disclose with reasonable accuracy the financial position of the company and the group and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

## Independent auditors' report to the members of Centrica plc

We have audited the financial statements which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the principal accounting policies note. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the directors' remuneration report ('the auditable part').

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report including the opinion has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the directors' remuneration report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report, the unaudited part of the directors' remuneration report, the chairman's statement, the chief executive's statement, the operating and financial review, the group financial review, the statement of corporate responsibility, the corporate governance statement and the gas and liquids reserves.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's

or group's corporate governance procedures or its risk and control procedures.

### Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the directors' remuneration report. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the directors' remuneration report are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group at 31 December 2002 and of the profit and cash flows of the group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

The maintenance and integrity of the Centrica plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



### PricewaterhouseCoopers

Chartered Accountants and Registered Auditors  
1 Embankment Place  
London WC2N 6RH  
20 February 2003

# Financial statements

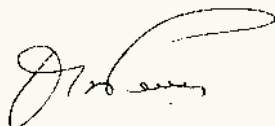
		2002			2001		
	Notes	Results for the year before goodwill amortisation and exceptional charges £m	Goodwill amortisation and exceptional charges £m	Results for the year £m	Results for the year before goodwill amortisation and exceptional charges £m	Goodwill amortisation and exceptional charges £m	Results for the year £m
<b>Group profit and loss account</b>							
Year ended 31 December							
<b>Turnover:</b>							
Continuing operations before acquisitions		14,003	–	14,003	12,611	–	12,611
Acquisitions		312	–	312			
Continuing operations		14,315	–	14,315	12,611	–	12,611
Share of joint ventures' turnover		207	–	207	229	–	229
Group and share of joint ventures' turnover		14,522	–	14,522	12,840	–	12,840
Less share of joint ventures' turnover		(207)	–	(207)	(229)	–	(229)
<b>Group turnover</b>	3	14,315	–	14,315	12,611	–	12,611
Cost of sales	4	(11,328)	–	(11,328)	(10,224)	–	(10,224)
<b>Gross profit</b>		2,987	–	2,987	2,387	–	2,387
Operating costs:							
Exceptional items	5	–	–	–	–	(80)	(80)
Other	4	(2,108)	(116)	(2,224)	(1,755)	(86)	(1,841)
		(2,108)	(116)	(2,224)	(1,755)	(166)	(1,921)
<b>Group operating profit:</b>							
Continuing operations before acquisitions		857	(104)	753	632	(166)	466
Acquisitions		22	(12)	10			
Continuing operations		879	(116)	763	632	(166)	466
Share of operating profit in joint ventures and associates – continuing operations	3	53	(7)	46	47	(2)	45
<b>Operating profit including joint ventures and associates:</b>							
Continuing operations before acquisitions		910	(111)	799	679	(168)	511
Acquisitions		22	(12)	10			
Continuing operations	3	932	(123)	809	679	(168)	511
Loss on disposal of business	5	–	(14)	(14)	–	–	–
Loss on disposal of fixed assets	5	–	(14)	(14)	–	–	–
Net interest payable:							
Group		(47)	–	(47)	(32)	–	(32)
Share of joint ventures and associates	7	(15)	–	(15)	(11)	–	(11)
		(62)	–	(62)	(43)	–	(43)
<b>Profit on ordinary activities before taxation</b>		870	(151)	719	636	(168)	468
Taxation on profit on ordinary activities	8	(243)	(7)	(250)	(164)	9	(155)
<b>Profit on ordinary activities after taxation for the financial year</b>		627	(158)	469	472	(159)	313
Minority interests (equity and non-equity)	23	9	–	9	10	–	10
<b>Profit attributable to the group</b>		636	(158)	478	482	(159)	323
Dividends	9			(172)			(124)
<b>Transfer to reserves</b>	21			306			199
		Pence		Pence	Pence		Pence
<b>Earnings per ordinary share</b>							
basic	10			11.4			8.1
diluted	10			11.3			8.0
adjusted basic	10	15.2			12.1		

The notes on pages 35 to 63 form part of these financial statements.

## Group balance sheet

31 December	Notes	2002 £m	2001 £m
<b>Fixed assets</b>			
Intangible assets	11	1,813	1,524
Tangible assets	12	2,763	2,058
Investments:			
Share of gross assets of joint ventures		810	709
Share of gross liabilities of joint ventures		(736)	(597)
	13	74	112
Other investments	13	28	55
		4,678	3,749
<b>Current assets</b>			
Stocks	14	180	193
Debtors:			
Goldfish Bank debtors (amounts falling due within one year)	15	781	673
Goldfish Bank debtors (amounts falling due after more than one year)	15	11	-
Other debtors (amounts falling due within one year)	15	2,598	1,923
Other debtors (amounts falling due after more than one year)	15	134	130
		3,524	2,726
Current asset investments	16	320	454
Cash at bank and in hand		28	72
		4,052	3,445
<b>Creditors (amounts falling due within one year)</b>			
Goldfish Bank borrowings	17	(430)	(610)
Other borrowings	17	(289)	(361)
Other amounts falling due within one year:			
Goldfish Bank customer deposits		(286)	-
Other creditors		(3,155)	(2,871)
	18	(3,441)	(2,871)
		(4,160)	(3,842)
<b>Net current liabilities</b>			
		(108)	(397)
<b>Total assets less current liabilities</b>			
		4,570	3,352
<b>Creditors (amounts falling due after more than one year)</b>			
Borrowings	17	(784)	(598)
Other creditors	18	(122)	(34)
		(906)	(632)
<b>Provisions for liabilities and charges</b>			
	19	(1,262)	(1,184)
<b>Net assets</b>			
		2,402	1,536
<b>Capital and reserves – equity interests</b>			
Called up share capital	20	236	223
Share premium account	21	537	62
Merger reserve	21	467	467
Profit and loss account	21	1,008	750
<b>Shareholders' funds</b>			
Minority interests (equity and non-equity)	22	2,248	1,502
	23	154	34
<b>Total capital employed</b>			
		2,402	1,536

The financial statements were approved by the board of directors on 20 February 2003 and were signed on its behalf by:



**Sir Michael Perry** GBE  
Chairman



**Phillip Bentley**  
Group Finance Director

The notes on pages 35 to 63 form part of these financial statements.



## Financial statements continued

### Statement of total recognised gains and losses

Year ended 31 December	Notes	2002 £m	2001 £m
Profit for the financial year		478	323
Exchange translation differences		(8)	–
<b>Total gains and losses recognised since last annual report</b>		<b>470</b>	<b>323</b>

Profit for the financial year includes joint ventures' and associates' profit after tax of £15 million (2001: £27 million).

### Group cash flow statement

Year ended 31 December	Notes	2002 £m	2001 £m
<b>Cash inflow from operating activities<sup>(i)</sup></b>	25a	<b>717</b>	<b>825</b>
<b>Dividends received from joint ventures and associates</b>		<b>57</b>	<b>16</b>
<b>Returns on investments and servicing of finance</b>	25b	<b>(25)</b>	<b>(15)</b>
<b>Taxation paid</b>	25c	<b>(192)</b>	<b>(109)</b>
<b>Capital expenditure and financial investment</b>	25d	<b>(402)</b>	<b>(337)</b>
<b>Acquisitions and disposals</b>	25e	<b>(935)</b>	<b>(607)</b>
<b>Equity dividends paid</b>		<b>(138)</b>	<b>(115)</b>
<b>Cash outflow before use of liquid resources and financing</b>		<b>(918)</b>	<b>(342)</b>
<b>Management of liquid resources</b>	25f	<b>134</b>	<b>(257)</b>
<b>Financing</b>	25g	<b>747</b>	<b>686</b>
<b>(Decrease)/increase in net cash</b>		<b>(37)</b>	<b>87</b>

(i) Cash inflow from operating activities includes movements on the Goldfish Bank working capital facility.

### Reconciliation of net cash flow to movement in debt, net of cash and current asset investments

Year ended 31 December	Notes	2002 £m	2001 £m
<b>(Decrease)/increase in net cash</b>		<b>(37)</b>	<b>87</b>
Movement in Goldfish Bank working capital facility		180	(610)
Cash inflow from increase in other debt and lease financing		(117)	(635)
Cash (inflow)/outflow from (decrease)/increase in liquid resources		(134)	257
Change in debt, net of cash and current asset investments resulting from cash flows		(108)	(901)
Loans and finance leases acquired		–	(37)
Exchange adjustments		(4)	12
Movement in debt, net of cash and current asset investments		(112)	(926)
Debt, net of cash and current asset investments, at 1 January		(1,043)	(117)
<b>Debt, net of cash and current asset investments, at 31 December</b>	25h	<b>(1,155)</b>	<b>(1,043)</b>
Of which:			
Goldfish Bank		(430)	(610)
Other businesses – non-recourse debt		(196)	–
Other businesses – recourse debt		(529)	(433)
<b>Total group</b>		<b>(1,155)</b>	<b>(1,043)</b>

The notes on pages 35 to 63 form part of these financial statements.

# Notes to the financial statements

## 1 Principal accounting policies

### Accounting principles

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention and the Companies Act 1985 except for the accounting policy for energy trading activities; further details explaining this departure are in note 2. In accordance with the transitional arrangements of FRS 17 Retirement Benefits, additional disclosures are contained in the notes to the financial statements.

The accounting policies, where applicable, are materially in accordance with the SORP issued by the Oil Industry Accounting Committee entitled Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities.

### Basis of preparation

The group financial statements comprise a consolidation of the accounts of the company and all of its subsidiary undertakings and incorporate the results of its share of all joint ventures and associates. The results of undertakings acquired are consolidated from the date the group gains control. No profit and loss account is presented for the company as permitted by Section 230(3) of the Companies Act 1985.

An associated undertaking (associate) is an entity in which the group has a long term equity interest and over which it exercises significant influence. The consolidated financial statements include the group portion of the operating profit or loss, exceptional items, interest, taxation and net assets of associates (the equity method).

A joint venture is an entity in which the group has a long term interest and shares control with one or more co-venturers. The consolidated financial statements include the group portion of turnover, operating profit or loss, exceptional items, interest, taxation, gross assets and gross liabilities of the joint venture (the gross equity method).

Under FRS 5 Reporting the Substance of Transactions, the Consumers' Waterheater Income Fund has been consolidated as a quasi-subsi-dary.

### Turnover

Turnover represents amounts receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes.

Energy supply: Turnover for energy supply activities includes an assessment of energy supplies to customers between the date of the last meter reading and the year end (unread). Unread gas and electricity is estimated using historical consumption patterns and is included in accrued energy income within debtors.

Home services: Where the group has an ongoing obligation to provide services, revenues are apportioned on a time basis, and amounts billed in advance are treated as deferred income and excluded from current turnover.

AA road services: Membership subscriptions are apportioned on a time basis over the period of the membership.

Financial services: Turnover includes interest receivable, fees and commissions receivable from financial services activities.

Telecommunications: Turnover is recognised on the basis of telephony services actually provided to customers in the financial period.

### Cost of sales

Energy supply includes the cost of gas and electricity produced and purchased, and related transportation and royalty costs, bought in materials and services, and direct labour and related overheads on installation works, repairs and service contracts. Gas production costs include petroleum revenue taxes (PRT), calculated on a unit of production basis, with changes in estimates dealt with prospectively over the remaining lives

of gas fields. Financial services cost of sales also includes finance charges on working capital facilities used to finance banking receivables, and interest payable on customer deposits.

### Employee share schemes

The group has a number of employee share schemes, detailed in the directors' report on pages 22 and 23. As permitted by UITF Abstract 17, the group does not recognise the difference between market value and option price to employees in relation to the UK sharesave scheme within the profit and loss account, on the basis that the scheme is UK Inland Revenue-approved. Upon vesting, the difference between market value and the option price is taken directly to reserves. The cost of potential share awards under the group's long term incentive schemes is charged to the profit and loss account over the period to which the performance criteria of each allocation relates. Cost is defined as the difference between the contribution receivable from employees and the market value at the date of grant, or the actual cost of shares where market purchases are made at, or around, grant date. Cost also includes provision for employer's National Insurance charges expected to arise at exercise dates.

### Research and development expenditure

Research and development expenditure is charged to the profit and loss account as incurred.

### Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at closing rates of exchange. The results of overseas subsidiary undertakings and joint ventures are translated into sterling at average rates of exchange for the relevant period. Differences resulting from the retranslation of the opening net investment in overseas subsidiary undertakings and from the retranslation of the opening net assets and the results of these entities for the year are taken to reserves, and are reported in the statement of total recognised gains and losses.

Exchange differences on monetary assets and liabilities are taken to the profit and loss account, except that exchange differences on foreign currency borrowings used to finance or hedge foreign currency net investments in overseas subsidiary undertakings and joint ventures are taken directly to reserves and are reported in the statement of total recognised gains and losses. All other exchange movements are dealt with through the profit and loss account.

### Intangible fixed assets

Goodwill arising on the acquisition of a business acquired after 1 January 1998 is included in the balance sheet at cost, less accumulated amortisation and any provisions for impairment. On the acquisition of a subsidiary undertaking (including unincorporated businesses), joint venture or associate, fair values are attributed to the assets and liabilities acquired. Goodwill, which represents the difference between the purchase consideration and the fair values of those net assets, is capitalised and amortised on a straight-line basis over a period which represents the directors' estimate of its useful economic life. Goodwill which arose on acquisitions after 1 January 1998 is being amortised over periods ranging from 5 to 20 years. Goodwill which arose prior to 1998 was written off directly to the profit and loss reserve. If an undertaking is subsequently disposed, the appropriate unamortised goodwill or goodwill written off to reserves is dealt with through the profit and loss account in the period of disposal as part of the gain or loss on disposal.

### Tangible fixed assets

Tangible fixed assets are included in the balance sheet at cost, less accumulated depreciation and any provisions for impairment.

# Notes to the financial statements continued

## 1 Principal accounting policies continued

In the case of investments in customer relationship management (CRM) and other technology infrastructure, cost includes contractors' charges, payments on account, materials, direct labour and directly attributable overheads. Capitalisation begins when expenditures for the asset are being incurred and activities that are necessary to prepare the asset for use are in progress.

Capitalisation ceases when substantially all the activities that are necessary to prepare the asset for use are complete. Depreciation commences at the point of commercial deployment.

Freehold land is not depreciated. Other tangible fixed assets, except exploration and production assets, are depreciated on a straight-line basis at rates sufficient to write-off the cost, less estimated residual values, of individual assets over their estimated useful lives. The depreciation periods for the principal categories of assets are as follows:

Freehold and leasehold buildings	up to 50 years
Plant	5 to 20 years
Power stations	20 years
Equipment and vehicles	3 to 10 years
Storage	up to 30 years

Assets held under finance leases are depreciated over the shorter of the lease term or their useful economic life.

Exploration and production assets are capitalised using the successful efforts method and depreciated from the commencement of production in the fields concerned, using the unit of production method, based on all of the proven and probable developed reserves of those fields. Changes in these estimates are dealt with prospectively. The net carrying value of fields in production is compared on a field-by-field basis with the likely future net revenues to be derived from the estimated remaining commercial reserves. A provision is made where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues.

### Leases

Assets held under finance leases are capitalised and included in tangible fixed assets at cost. The obligations relating to finance leases, net of finance charges in respect of future periods, are included within borrowings. The interest element of the rental obligation is allocated to accounting periods during the lease term to reflect the constant rate of interest on the remaining balance of the obligation for each accounting period. Rentals under operating leases are charged to the profit and loss account as incurred.

### Asset impairments

Intangible and tangible fixed assets are reviewed for impairments if events or changes in circumstances indicate that the carrying amount may not be recoverable. When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of expected future cash flows of the relevant income generating unit or disposal value, if higher. If an asset is impaired, a provision is made to reduce the carrying amount to its estimated recoverable amount.

### Investments

Other fixed asset investments are included in the balance sheet at cost, less accumulated provisions for amortisation and any impairment.

Current asset investments are stated at the lower of cost and net realisable value.

### Stocks

Stocks are valued at the lower of cost or estimated net realisable value.

### 'Take or Pay' contracts

Where payments are made to external suppliers under 'Take or Pay' obligations for gas not taken, they are treated as prepayments and are included within debtors.

### Decommissioning costs

Provision is made for the net present value of the estimated cost of decommissioning gas production facilities at the end of the producing lives of fields, and decommissioning storage facilities at the end of the useful life of storage facilities based on price levels and technology at the balance sheet date. Changes in these estimates are dealt with prospectively. When this provision gives access to future economic benefits, an asset is recognised. Decommissioning assets are amortised using the unit of production method, based on proven and probable reserves, except for decommissioning assets relating to storage facilities, which are amortised on a straight-line basis over the useful economic life of the storage facilities. The unwinding of the discount on the provision is included in the profit and loss account within the net interest charge.

### Pensions and other post retirement benefits

Pensions and other post retirement benefits are accounted for in accordance with SSAP 24 Pension Costs. Additional disclosures are also made in the notes to the financial statements as required under the transitional arrangements set out in FRS 17 Retirement Benefits. The cost of providing retirement pensions and other benefits is charged to the profit and loss account over the periods benefiting from employees' service. The difference between the charge to the profit and loss account and the contributions paid to the pension schemes is shown as a provision in the balance sheet. The regular pension cost, variations from the regular pension cost and interest are all charged within employee costs, and the straight-line method is applied for amortising surpluses and interest.

### Long term sales contracts

Provision is made for the net present cost, using a risk free discount rate, of any expected losses on long term sales contracts. The provision is based on the difference between the contracted sales price and the expected weighted average cost of gas.

### Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits in the foreseeable future from which the reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the financial statements. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

## 1 Principal accounting policies continued

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in the future has been entered into by the subsidiary or associate.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is measured on a non-discounted basis.

### Financial instruments

#### a) Debt instruments

Debt instruments are stated at the amount of net proceeds received after deduction of issue costs, adjusted to amortise any discount or premium evenly over the term of the debt.

#### b) Derivative financial instruments

The group uses a range of derivative financial instruments for both trading purposes and to manage (hedge) exposures to financial risks, such as interest rate, foreign exchange and energy price risks arising in the normal course of business. The accounting treatment for these instruments is dependent on whether they are entered into for trading or non-trading (hedging) purposes. A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the group in line with the group's risk management policies. In addition, there must be a demonstrable link to an underlying transaction, pool of transactions or specified future transaction or transactions. Specified future transactions must be reasonably certain to arise for the derivative to be accounted for as a hedge.

A discussion on how the group manages its financial risks is included in the group financial review on pages 17 and 18.

Derivative financial instruments are accounted for as follows:

#### Energy trading activities

The group engages in swaps, futures, forwards and options in gas, electricity and weather, for trading purposes. Open financial and physical trading positions are marked to market using externally derived market prices. Marked to market gains and losses are recognised immediately in the profit and loss account, within cost of sales. This is a departure from the Companies Act 1985 as disclosed within note 2. The corresponding fair value debtors or creditors are included within the balance sheet.

#### Energy hedging activities

The group engages in gas, electricity, oil and weather derivatives to hedge against price exposures arising within the energy supply, procurement and retail operations. The derivatives are matched to the specific exposures they are designed to reduce, with gains and losses recognised in the profit and loss account in the same period as the income and costs of the underlying hedged transactions.

#### Treasury hedging activities

The group uses interest rate swaps, forward rate agreements, foreign currency swaps and forward exchange contracts to manage exposures to interest rates arising on underlying debt and cash positions or probable future commitments and foreign exchange risks arising on foreign currency assets and borrowings, foreign currency forecasted transactions and the retranslation of overseas net investments. All instruments are used for hedging purposes to alter the risk profile on existing underlying exposures and probable future commitments in line with the group's risk management policies.

Amounts payable or receivable in respect of interest rate swaps and forward rate agreements are recognised as adjustments to the net interest charge over the term of the contracts.

Currency swap agreements and forward exchange contracts are retranslated at the rates ruling in the agreements and contracts. Resulting gains or losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs. Where used to hedge overseas net investments, gains or losses are recorded in the statement of total recognised gains and losses, with interest recorded in the profit and loss account.

Where derivatives used to manage interest rate risk or to hedge other anticipated cash flows are terminated before the underlying debt matures or the hedged transaction occurs, the resulting gain or loss is recognised on a basis that matches the timing and accounting treatment of the underlying debt or hedged transaction. When an anticipated transaction is no longer likely to occur or finance debt is terminated before maturity, any deferred gain or loss that has arisen on the related derivative is recognised in the profit and loss account, together with any gain or loss on the terminated item.

## 2 Accounting policy for energy trading activities

Energy trading financial derivatives and open positions on physical energy trading contracts are marked to market using externally derived market prices. This is not in accordance with the general provisions of Schedule 4 of the Companies Act 1985, which requires that these contracts be stated at the lower of cost and net realisable value or that, if revalued, any revaluation difference be taken to a revaluation reserve. However, the directors consider that these requirements would fail to provide a true and fair view of the profit for the year since the marketability of energy trading contracts enables decisions to be taken continually whether to hold or sell them. Accordingly the measure of profit in any period is properly made by reference to market values. The effect of the departure on the financial statements is an increase in profit for the year amounting to £7 million (2001: £2 million) and an increase in net assets at 31 December 2002 amounting to £9 million (2001: £2 million).



## Notes to the financial statements continued

### 3 Segmental analysis

The segmental analysis reflects, in the opinion of the directors, how the group's activities were managed during the year. The segmental analysis has changed from last year in order to reflect the brand unit divisions that are now utilised in the day-to-day management of the business. These have been structured to mirror the brand focused customer relationships that are at the core of the Centrica business model<sup>(iv)</sup>. All activities were continuing.

	Turnover		Operating profit/(loss) before exceptional charges and goodwill amortisation, including share of results of joint ventures and associates		Operating profit/(loss) after exceptional charges and goodwill amortisation, including share of results of joint ventures and associates		Net assets/(liabilities)	
	year ended 31 December		year ended 31 December		year ended 31 December		31 December	
a) By business segment	2002 £m	2001 £m	2002 £m	2001 £m	2002 £m	2001 £m	2002 £m	2001 £m
British Gas residential:								
Continuing operations	6,047	5,909	244	(46)	243	(81)	347	257
Acquisitions <sup>(ii)</sup>	-		-		-		-	
	6,047	5,909	244	(46)	243	(81)	347	257
Centrica Business Services:								
Continuing operations	883	581	64	44	60	37	267	235
Acquisitions <sup>(ii)</sup>	88		1		(1)		86	
	971	581	65	44	59	37	353	235
Centrica energy management group (CEMG):								
Continuing operations <sup>(iv)</sup>	5,160	4,571	522	573	522	543	265	25
Acquisitions <sup>(ii)</sup>	11		(2)		(2)		439	
	5,171	4,571	520	573	520	543	704	25
The AA:								
Continuing operations	758	689	74	72	24	8	682	746
Acquisitions <sup>(ii)</sup>	2		(1)		(1)		3	
	760	689	73	72	23	8	685	746
Goldfish Bank:								
Continuing operations	93	22	(40)	(32)	(54)	(37)	181	112
Acquisitions <sup>(ii)</sup>	-		-		-		-	
	93	22	(40)	(32)	(54)	(37)	181	112
One.Tel:								
Continuing operations	151	65	5	4	1	5	54	59
Acquisitions <sup>(ii)</sup>	2		(3)		(5)		(1)	
	153	65	2	4	(4)	5	53	59
Centrica North America:								
Continuing operations	909	768	36	68	5	39	611	652
Acquisitions <sup>(ii)</sup>	209		27		19		581	
	1,118	768	63	68	24	39	1,192	652
Other operations:	2	6	5	(4)	(2)	(3)	49	53
Unallocated net liabilities <sup>(iii)</sup>							(1,162)	(603)
Group	14,315	12,611	932	679	809	511	2,402	1,536

#### b) By geographical area of operation

UK:								
Continuing operations	13,079	11,831	879	609	805	472	1,794	1,436
Acquisitions <sup>(ii)</sup>	103		(5)		(9)		527	
	13,182	11,831	874	609	796	472	2,321	1,436
Rest of Europe:								
Continuing operations	15	12	(5)	2	(11)	-	51	51
North America:								
Continuing operations	909	768	36	68	5	39	611	652
Acquisitions <sup>(ii)</sup>	209		27		19		581	
	1,118	768	63	68	24	39	1,192	652
Unallocated net liabilities <sup>(iii)</sup>							(1,162)	(603)
Group	14,315	12,611	932	679	809	511	2,402	1,536

See opposite for footnotes (i) – (v)

### 3 Segmental analysis continued

	Turnover	
	2002 £m	2001 £m
c) By geographical destination		
UK:		
Continuing operations	12,598	11,226
Acquisitions <sup>(ii)</sup>	103	
	12,701	11,226
Rest of Europe:		
Continuing operations	496	607
North America:		
Continuing operations	909	776
Acquisitions <sup>(ii)</sup>	209	
	1,118	776
Rest of world:		
Continuing operations	-	2
Group	14,315	12,611

(i) Turnover includes energy trading turnover of £4,304 million (2001: £3,570 million).

(ii) Acquisitions are explained in note 24.

(iii) Unallocated net liabilities comprised:

	2002 £m	2001 £m
Fixed asset investments	26	52
Accrued interest payable	(7)	(2)
Dividends payable	(110)	(76)
Taxation	(346)	(144)
Debt, net of cash and money market investments (except for the Goldfish Bank working capital facility)	(725)	(433)
	(1,162)	(603)

The group's share of operating losses of associates before exceptional charges and goodwill amortisation for the year ended 31 December 2002 was £1 million (2001: £nil) and after exceptional charges and goodwill amortisation for the year ended 31 December 2002 was a loss of £2 million (2001: loss of £1 million).

The group's share of turnover and operating profits of joint ventures for the year ended 31 December was:

	Turnover		Operating profit/(loss) before exceptional charges and goodwill amortisation		Operating profit/(loss) after exceptional charges and goodwill amortisation	
	2002 £m	2001 £m	2002 £m	2001 £m	2002 £m	2001 £m
British Gas residential	25	24	2	2	2	2
Centrica energy management group (CEMG)	77	142	40	28	40	28
The AA	63	51	16	17	16	17
Goldfish Bank	-	11	-	-	-	-
Other operations	42	1	(4)	-	(10)	(1)
	207	229	54	47	48	46

- (iv) The effect of this change on the 2001 segmental analysis of turnover was to split the turnover of the previously reported UK Energy Supply segment of £10,302 million into British Gas residential, Centrica Business Services and Centrica energy management group, to include British Gas home services turnover of £722 million and Telecommunications turnover (excluding One.Tel) of £37 million within British Gas residential, to combine AA road services and AA personal finance to form the AA segment and to reallocate turnover previously reported in other businesses of £62 million to the AA. The effect on the 2001 segmental analysis of operating profit before exceptional charges and goodwill amortisation was to split the operating profit of the previously reported UK Energy Supply segment of £652 million into British Gas residential, Centrica Business Services and Centrica energy management group, to include British Gas home services operating profit of £36 million and Telecommunications operating loss (excluding One.Tel) of £101 million within British Gas residential, to combine AA road services and AA personal finance to form the AA segment and to reallocate operating losses previously reported in other businesses to British Gas residential of £16 million and to the AA of £2 million. The effect on the 2001 segmental analysis of operating profit after exceptional charges and goodwill amortisation was to split the operating profit of the previously reported UK Energy Supply segment of £601 million into British Gas residential, Centrica Business Services and Centrica energy management group, to include British Gas home services operating profit of £30 million and Telecommunications operating loss (excluding One.Tel) of £116 million within British Gas residential, to combine AA road services and AA personal finance to form the AA segment, and to reallocate operating losses previously reported in other businesses to British Gas residential of £16 million and to the AA of £2 million. The effect on the 2001 segmental analysis of net assets was to split the net assets of the previously reported UK Energy Supply segment of £678 million into British Gas residential, Centrica Business Services and Centrica energy management group, to include British Gas home services net liabilities of £162 million within British Gas residential, to combine AA road services and AA personal finance to form the AA segment, and to reallocate net assets of £1 million previously reported in other businesses to British Gas residential, and to reallocate net liabilities of £4 million previously reported in other businesses to the AA.
- (v) Inter-segment transfers from Centrica energy management group to British Gas residential and Centrica Business Services totalled £4,142 million (2001: £4,363 million).

## Notes to the financial statements continued

	2002			2001		
	Goodwill amortisation & exceptional charges £m	Other costs £m	Total £m	Goodwill amortisation & exceptional charges £m	Other costs £m	Total £m
<b>4 Costs</b>						
Cost of sales <sup>(i)</sup> :						
Continuing operations before acquisitions	-	11,141	11,141	-	10,224	10,224
Acquisitions	-	187	187	-	-	-
Continuing operations	-	11,328	11,328	-	10,224	10,224
Operating costs <sup>(i)</sup> :						
Continuing operations before acquisitions	104	2,005	2,109	166	1,755	1,921
Acquisitions	12	103	115	-	-	-
Continuing operations	116	2,108	2,224	166	1,755	1,921
Total costs recognised in arriving at group operating profit	116	13,436	13,552	166	11,979	12,145

Gross profit attributable to acquisitions amounted to £125 million, and to continuing operations before acquisitions £2,862 million.

	2002 £m	2001 £m
Group operating profit is stated after charging:		
Amortisation of goodwill	116	86
Amortisation of fixed asset investments	7	14
Depreciation:		
Owned assets <sup>(ii)</sup>	357	331
Leased assets	33	26
	390	357
Profit on disposal of fixed assets <sup>(iii)</sup>	18	13
Operating lease rentals:		
Plant and machinery	31	7
Other	42	22
	73	29
Auditors' remuneration:		
Statutory audit		
Company	0.2	0.2
Subsidiary undertakings	1.5	1.4
Other audit	1.2	0.9
Other non-audit <sup>(iv)</sup>	6.3	7.1
	9.2	9.6

(i) Gas transportation costs of £1,459 million (2001: £1,759 million) and electricity transportation and distribution charges of £647 million (2001: £395 million) were included within cost of sales. Operating costs were all considered to be administrative expenses.

(ii) Depreciation and amortisation of owned assets for the year ended 31 December 2002 included £nil (2001: £25 million) of asset impairment. Of this impairment charge, £nil (2001: £20 million) has been treated as exceptional.

(iii) The profit on disposal of tangible fixed assets was £6 million (2001: £7 million) and profit on sale of fixed asset investments (against the previously impaired cost of the investment) was £12 million (2001: £6 million).

(iv) It is the group's policy to seek competitive tenders for all major consultancy and advisory projects. Appointments are made taking into account other factors including expertise and experience. The auditors have been engaged on assignments additional to their statutory audit duties where their expertise and experience with the group are particularly important, including tax advice and due diligence reporting on acquisitions. Other charges comprised due diligence of £0.5 million (2001: £2.1 million), taxation advice of £0.6 million (2001: £1.2 million) and consulting projects of £5.2 million (2001: £3.8 million), including amounts of £5 million (2001: £3 million) paid to the consulting business of the auditors prior to its sale in October 2002.

	2002 £m	2001 £m
<b>5 Exceptional items</b>		
a) Recognised in arriving at operating profit		
Continuing operations:		
Business integration costs	-	(35)
Energy trading costs	-	(37)
Other	-	(8)
<b>Total recognised in arriving at operating profit</b>	<b>-</b>	<b>(80)</b>

## 5 Exceptional items continued

	2002 £m	2001 £m
b) Recognised after operating profit		
Continuing operations:		
Loss on disposal of business <sup>(i)</sup>	(14)	–
Loss on disposal of fixed assets <sup>(ii)</sup>	(14)	–
<b>Total recognised after operating profit</b>	<b>(28)</b>	<b>–</b>

- (i) During the year the group recognised a £14 million loss on disposal of the LPG business. The loss included £11 million relating to the write-off of unamortised goodwill, further information of which is provided in note 24.
- (ii) The group decided to reduce the operations of Golf England Limited, a subsidiary undertaking, and recognised a £14 million provision in respect of losses on disposal of fixed assets.

## 6 Directors and employees

	2002 £m	2001 £m
a) Employee costs		
Wages and salaries	905	716
Social security costs	73	59
Other pension and retirement benefits costs (note 26)	68	54
Long term incentive scheme	11	14
Employee Profit Sharing Scheme	–	6
	<b>1,057</b>	<b>849</b>

Details of directors' remuneration, share options, long term incentive scheme interests and pension entitlements on pages 25 to 30 of the remuneration report form part of these financial statements. Details of employee share schemes are given on pages 22 to 23 and in note 20.

	2002 Number	2001 Number
b) Average number of employees during the year		
British Gas residential	19,584	17,546
Centrica Business Services	842	368
Centrica energy management group (CEMG)	585	450
The AA	11,640	9,911
Goldfish Bank	189	59
One.Tel	740	638
Centrica North America	2,187	438
Other operations	2,284	2,140
	<b>38,051</b>	<b>31,550</b>
Great Britain	35,563	30,832
North America	2,187	438
Rest of Europe	301	280
	<b>38,051</b>	<b>31,550</b>

	2002			2001		
	Interest payable £m	Interest receivable £m	Total £m	Interest payable £m	Interest receivable £m	Total £m
<b>7 Net interest</b>						
<b>Cost of servicing net debt (excluding Goldfish Bank)</b>						
Interest receivable by the parent and subsidiary companies	–	16	16	–	23	23
Interest payable on bank loans and overdrafts	(40)	–	(40)	(24)	–	(24)
Finance lease charges	(11)	–	(11)	(14)	–	(14)
	(51)	16	(35)	(38)	23	(15)
<b>Other interest</b>						
Share of joint ventures' interest payable <sup>(i)</sup>	(15)	–	(15)	(11)	–	(11)
Notional interest arising on discounted items	(15)	–	(15)	(12)	–	(12)
Interest on supplier early payment arrangements <sup>(ii)</sup>	–	13	13	–	11	11
Interest on customer finance arrangements <sup>(iii)</sup>	(7)	–	(7)	(8)	–	(8)
Other	(3)	–	(3)	(8)	–	(8)
	(40)	13	(27)	(39)	11	(28)
<b>Interest (payable)/receivable</b>	<b>(91)</b>	<b>29</b>	<b>(62)</b>	<b>(77)</b>	<b>34</b>	<b>(43)</b>

Product income generated by AA personal finance and Goldfish Bank for the year ended 31 December 2002 was £100 million (2001: £23 million), £69 million of the increase related to the inclusion of Goldfish Bank as a subsidiary of the group for a full year. Financial services product charges were £33 million (2001: £nil). This related entirely to Goldfish Bank. Both financial services income and charges have been included within group operating profit.

- (i) The share of associates' interest (payable)/receivable is £nil (2001: £nil).
- (ii) Interest on supplier early payment arrangements arose on the prepayment of gas transportation charges.
- (iii) The interest cost relates to subsidised credit arrangements provided to customers purchasing central heating installation.

## Notes to the financial statements continued

<b>8 Tax</b>	2002 £m	2001 £m
<b>a) Analysis of tax charge for the year</b>		
The tax charge comprises:		
<b>Current tax</b>		
UK corporation tax	148	157
Tax on exceptional items <sup>(i)</sup>	(2)	(9)
Adjustments in respect of prior years	16	(43)
	<b>162</b>	<b>105</b>
<b>Foreign tax</b>		
Foreign tax	17	6
Adjustments in respect of prior years	–	(2)
	<b>17</b>	<b>4</b>
Total current tax	<b>179</b>	<b>109</b>
<b>Deferred tax</b>		
Origination and reversal of timing differences	(9)	(10)
Deferred petroleum revenue tax relief	55	49
Exceptional deferred tax charge <sup>(ii)</sup>	9	–
Total deferred tax	<b>55</b>	<b>39</b>
<b>Share of joint ventures' tax</b>	<b>16</b>	<b>7</b>
<b>Total tax on profit on ordinary activities</b>	<b>250</b>	<b>155</b>

(i) The tax credit arising on exceptional items related to those costs identified as exceptional in note 5.

(ii) The exceptional tax charge in 2002 comprised an increase in deferred tax provisions arising from the supplementary charge applicable to profits on 'ring-fenced' offshore gas production.

### b) Factors affecting the tax charge for the year

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2002 £m	2001 £m
<b>Profit on ordinary activities before tax</b>	<b>719</b>	<b>468</b>
Less: share of joint ventures' and associates' profit before tax	(31)	(34)
<b>Group profit on ordinary activities before tax</b>	<b>688</b>	<b>434</b>
Tax on group profit on ordinary activities at standard UK corporation tax rate of 30% (2001: 30%)	<b>207</b>	<b>130</b>
Effects of:		
Expenses not deductible for tax purposes, including goodwill amortisation	51	61
Depreciation in excess of capital allowances	7	50
Utilisation of tax losses and other short term timing differences	(82)	(40)
Deferred petroleum revenue tax relief	(55)	(49)
Higher tax rates on overseas earnings	6	2
Adjustments to tax charge in respect of prior years	16	(45)
Supplementary charge applicable to upstream profits	12	–
Overseas losses or taxation not available for credit	17	–
<b>Group current tax charge for the year</b>	<b>179</b>	<b>109</b>

### c) Factors that may affect future tax charges

The group earns its profits primarily in the UK, therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 30%. Fair values are attributed to fixed assets on acquisition of businesses and companies and amortisation or depreciation is subsequently provided based upon those amounts. Were the assets to be sold at the book values at the balance sheet date without the benefit of tax planning arrangements, the amount of tax that would be payable is estimated in aggregate to be £168 million of which £146 million is provided in the balance sheet as deferred tax. There is, however, no intention to sell any of these assets in the foreseeable future and therefore the crystallisation of the above tax charge is considered to be remote.



## 9 Dividends

	2002 £m	2001 £m
2001 final dividend in respect of share issues after the balance sheet date	3	–
Interim dividend of 1.4p (2001: 1.2p) per ordinary share	59	48
Proposed final dividend of 2.6p (2001: 1.9p) per ordinary share	110	76
	<b>172</b>	<b>124</b>

The interim dividend was paid on 27 November 2002 and the proposed final dividend is payable on 18 June 2003 to shareholders on the register at the close of business on 2 May 2003.

## 10 Earnings per ordinary share

Earnings per ordinary share has been calculated by dividing the earnings for the financial year of £478 million (2001: £323 million) by the weighted average number of ordinary shares in issue during the year of 4,181 million (2001: 3,984 million). The number of shares excluded 27 million ordinary shares (2001: 34 million), being the weighted average number of the company's own shares recorded on the group balance sheet during the year in accordance with UITF Abstract 13 ESOP Trusts.

The directors believe that the presentation of an adjusted basic earnings per ordinary share, being the basic earnings per ordinary share adjusted for exceptional charges and goodwill amortisation, assists with understanding the underlying performance of the group. The reconciliation of basic to adjusted basic earnings per ordinary share is as follows:

	2002		2001	
	£m	Pence per ordinary share	£m	Pence per ordinary share
Earnings – basic	478	11.4	323	8.1
Exceptional items net of tax	35	0.9	71	1.8
Goodwill amortisation	123	2.9	88	2.2
Earnings – adjusted basic	636	15.2	482	12.1
Earnings – diluted	478	11.3	323	8.0

In addition to basic and adjusted basic earnings per ordinary share, information is presented for diluted earnings per ordinary share. Under this presentation, there are no adjustments to the reported earnings for either 2002 or 2001, but the weighted average number of shares used as the denominator is adjusted. The adjustments relate mainly to notional share awards made to employees under the long term incentive scheme and the share options granted to employees under the savings-related share option scheme, as follows:

	2002 million shares	2001 million shares
Weighted average number of shares in issue	4,181	3,984
Estimated vesting of long term incentive scheme shares	35	34
Dilutive effect of shares to be issued at a discount to market value under the savings-related share option scheme	10	43
Potentially dilutive shares issuable under the executive share option scheme	1	1
Weighted average number of shares used in the calculation of diluted earnings per ordinary share	<b>4,227</b>	<b>4,062</b>

## Notes to the financial statements continued

### 11 Intangible fixed assets – goodwill

	£m
<b>Cost</b>	
1 January 2002	1,684
Acquisitions <sup>(i)</sup>	466
Disposals	(17)
Exchange adjustments	(56)
<b>31 December 2002</b>	<b>2,077</b>
<b>Amortisation</b>	
1 January 2002	160
Charge for the year	116
Disposals	(6)
Exchange adjustments	(6)
<b>31 December 2002</b>	<b>264</b>
<b>Net book value</b>	
<b>31 December 2002<sup>(ii)</sup></b>	<b>1,813</b>
31 December 2001	1,524

(i) Acquisitions included £8 million for the revision of provisional fair values relating to the recoverability of certain receivables on the Enron Direct acquisition made in 2001.

(ii) The net book value of goodwill at 31 December related to the following acquisitions:

	2002 £m	2001 £m	Amortisation period years
The AA	829	879	15-20
Goldfish Bank	124	138	10
Direct Energy	279	332	15
Energy America	41	52	15
Enron Direct	53	49	15
One.Tel	49	53	15
Enbridge Services Inc	167	–	15
Electricity Direct	78	–	15
WTU and CPL	167	–	15
NewPower	8	–	5
British Gas LPG	–	11	20
Other	18	10	5-20
	<b>1,813</b>	<b>1,524</b>	

### 12 Tangible fixed assets

	Land and buildings <sup>(i)</sup> £m	Plant, equipment <sup>(ii)(iii)</sup> and vehicles <sup>(iv)</sup> £m	Power generation <sup>(v)</sup> £m	Storage, exploration and production <sup>(vi)(v)</sup> £m	Total £m
<b>Cost</b>					
1 January 2002	123	713	169	3,324	4,329
Additions	2	395	4	69	470
Acquisitions	–	234	46	544	824
Disposals	(12)	(96)	(2)	–	(110)
Disposal of subsidiary	(2)	(77)	–	(179)	(258)
Revision of abandonment asset	–	–	–	6	6
Exchange adjustments	–	(25)	–	(19)	(44)
<b>31 December 2002</b>	<b>111</b>	<b>1,144</b>	<b>217</b>	<b>3,745</b>	<b>5,217</b>
<b>Depreciation and amortisation</b>					
1 January 2002	28	318	2	1,923	2,271
Charge for the year	6	130	12	242	390
Disposals	(8)	(78)	(2)	–	(88)
Disposal of subsidiary	–	(40)	–	(79)	(119)
<b>31 December 2002</b>	<b>26</b>	<b>330</b>	<b>12</b>	<b>2,086</b>	<b>2,454</b>
<b>Net book value</b>					
<b>31 December 2002</b>	<b>85</b>	<b>814</b>	<b>205</b>	<b>1,659</b>	<b>2,763</b>
31 December 2001	95	395	167	1,401	2,058

(i) The net book value of the group's land and buildings at 31 December 2002 comprised freehold of £44 million (2001: £48 million), long leasehold of £23 million (2001: £26 million) and short leasehold of £18 million (2001: £21 million).

(ii) The net book value of the group's tangible fixed assets held under finance leases at 31 December 2002 within plant, equipment and vehicles was £8 million (2001: £9 million), power generation £73 million (2001: £167 million) and within storage, exploration and production was £120 million (2001: £136 million). The depreciation and amortisation charge for the year in respect of finance leased assets included £4 million (2001: £nil) on plant, equipment and vehicles, £10 million (2001: £6 million) on power generation and £19 million (2001: £20 million) on storage, exploration and production assets.

See opposite for footnotes (iii) – (v)

## 12 Tangible fixed assets continued

- (iii) The amounts capitalised in the year in respect of customer relationship management (CRM) infrastructure included within plant, equipment and vehicles at 31 December 2002 amounted to £180 million (2001: £60 million).
- (iv) The net book value of the fixed assets of the Consumers' Waterheater Income Fund (the Fund) within plant, equipment and vehicles was £182 million (2001: £nil). Debt issued by a subsidiary of the Fund, without recourse to the group, is secured on the assets, as set out in note 32.
- (v) Included within the group's exploration and production assets at 31 December 2002 were costs of £60 million pending determination (2001: £16 million). The net book value of the group's decommissioning costs at 31 December 2002 were £17 million (2001: £11 million).

	Joint ventures and associates				Total £m
	Shares <sup>(i)</sup> £m	Loans £m	Own shares <sup>(ii)</sup> £m	Other investments £m	
<b>13 Fixed asset investments</b>					
<b>Share of net assets/cost</b>					
1 January 2002	57	23	65	5	150
Disposals and transfers <sup>(iii), (iv) and (v)</sup>	2	(19)	(14)	–	(31)
Dividends receivable	(59)	–	–	–	(59)
Share of profits less losses for the year	22	–	–	–	22
<b>31 December 2002</b>	<b>22</b>	<b>4</b>	<b>51</b>	<b>5</b>	<b>82</b>
<b>Goodwill</b>					
1 January 2002	70	–	–	–	70
Disposals	(11)	–	–	–	(11)
Goodwill amortisation	(7)	–	–	–	(7)
Exchange adjustments	3	–	–	–	3
<b>31 December 2002</b>	<b>55</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>55</b>
<b>Amounts written off</b>					
1 January 2002	(12)	(2)	(36)	(3)	(53)
Amortisation under long term incentive schemes	–	–	(7)	–	(7)
Disposals <sup>(iv)</sup>	11	–	14	–	25
<b>31 December 2002</b>	<b>(1)</b>	<b>(2)</b>	<b>(29)</b>	<b>(3)</b>	<b>(35)</b>
<b>Net book value</b>					
<b>31 December 2002</b>	<b>76</b>	<b>2</b>	<b>22</b>	<b>2</b>	<b>102</b>
31 December 2001	115	21	29	2	167

- (i) The group's share of net assets of associates was £2 million (2001: £3 million). The group's share of joint ventures' gross assets and gross liabilities principally comprised its interests in Humber Power Limited (a power station), Centrica Personal Finance Limited (AA and British Gas personal loans activities), AA Financial Services (AA credit card activities) and Luminus NV (energy supply). The group's share of joint ventures' gross liabilities included loans payable to the group amounting to £4 million (2001: £12 million). The share of Humber Power Limited's gross liabilities includes £269 million (2001: £270 million) of lease finance, of which £254 million (2001: £258 million) is repayable after more than five years. Although the group holds a majority of the voting rights in Humber Power Limited, it is restricted in its ability to exercise these rights under an agreement with the other shareholder. Consequently the investment has not been consolidated but has been accounted for as a joint venture.

	2002					2001	
	Humber Power Limited £m	Centrica Personal Finance Limited £m	AA Financial Services £m	Luminus NV £m	Other £m	Total £m	£m
Investments in joint ventures							
Share of gross assets	346	349	45	62	8	810	709
Share of gross liabilities	(327)	(345)	(45)	(13)	(6)	(736)	(597)
	19	4	–	49	2	74	112
Share of net assets of associates						2	3
						76	115
Net (debt)/cash included in above	(251)	(333)	(43)	2	(2)	(627)	(675)

- (ii) The Centrica Employees Share Trust held 27 million (2001: 39 million) shares in the company. This represented 0.64% of the called up ordinary share capital (2001: 1%), which had a market value at 31 December 2002 of £47 million and a nominal value of £2 million (2001: £88 million and £2 million respectively). During the year 12,213,398 shares (2001: 1,272,944 shares) were transferred from trust in respect of awards held by employees. All other investments were unlisted.
- (iii) On 22 November 2002, Humber Power Limited repaid a £15 million loan to the group. Since the acquisition the group has entered into tolling agreements with Humber Power Limited for 750 MWh of capacity through to 2014.
- (iv) The group's 42% interest in the Spalding Energy Company Limited was disposed of during the year for consideration of £16 million. The group recognised a profit on disposal of £12 million, against the previously impaired cost of investment.
- (v) Transfers comprised AA Buyacar which became a 100% subsidiary of the group on 29 November 2002 when the 30% interest not previously owned by the group was acquired.

The principal undertakings of the group are listed in note 31 on page 62.

## Notes to the financial statements continued

	2002 £m	2001 £m
<b>14 Stocks</b>		
Gas in storage	67	140
Other raw materials and consumables	96	44
Finished goods and goods for re-sale	17	9
	<b>180</b>	<b>193</b>

	2002		2001	
	Within one year £m	After one year £m	Within one year £m	After one year £m
<b>15 Debtors</b>				
<b>Amounts falling due</b>				
a) Goldfish Bank debtors:				
Trade debtors: loans and advances to customers	761	10	652	–
Prepayments and accrued income	1	1	2	–
Other	19	–	19	–
	<b>781</b>	<b>11</b>	<b>673</b>	<b>–</b>
b) Other businesses' debtors:				
Trade debtors	785	44	479	–
Accrued energy income	1,427	–	1,168	–
Deferred corporation tax	–	36	–	91
Other debtors	246	5	196	2
Prepayments and other accrued income:				
'Take or Pay'	13	–	7	2
Other	127	49	73	35
	<b>140</b>	<b>49</b>	<b>80</b>	<b>37</b>
	<b>2,598</b>	<b>134</b>	<b>1,923</b>	<b>130</b>

	2002 £m	2001 £m
<b>16 Current asset investments</b>		
Money market investments	320	454

Current asset investments included £159 million (2001: £142 million) held by the group's insurance subsidiary undertakings and £10 million (2001: £9 million) held by the Law Debenture Trust, on behalf of the company, as security to cover unfunded pension liabilities. These amounts were not readily available to be used for other purposes within the group.

	2002		2001	
	Within one year £m	After one year £m	Within one year £m	After one year £m
<b>17 Borrowings</b>				
<b>Amounts falling due</b>				
a) Goldfish Bank borrowings				
Bank loans and overdrafts (note 29d)	430	–	610	–
b) Other businesses' borrowings				
Bank loans and overdrafts	13	–	16	–
Sterling bonds <sup>(i)</sup>	–	518	–	493
Canadian dollar bonds <sup>(ii)</sup>	–	196	–	–
Commercial paper	237	–	307	–
Loan notes	3	–	5	–
Obligations under finance leases <sup>(iii)</sup>	36	70	33	105
	<b>289</b>	<b>784</b>	<b>361</b>	<b>598</b>

- (i) Sterling bonds are repayable as follows: between one and two years £nil (2001: £nil); between two and five years £125 million (2001: £100 million); and after five years £400 million (2001: £400 million). The bonds bear interest at fixed rates between 5.375% and 5.875% (2001: 5.375% and 5.875%). The bonds have a face value of £525 million (2001: £500 million) and are stated net of £7 million (2001: £7 million) of issuance discount.
- (ii) Canadian dollar bonds are repayable between four and five years bearing interest at a floating rate. The bonds were issued by the Consumers' Waterheater Income Trust, a wholly-owned subsidiary of the Consumers' Waterheater Income Fund, which is treated as a quasi-subsiary and consolidated into the group accounts. The debt is secured solely on the assets of the Fund and its subsidiaries, without recourse to the group. Summary financial information for the Fund is given in note 32.
- (iii) Group obligations under finance leases after more than one year at 31 December 2002 were repayable as follows: between one and two years £39 million (2001: £37 million); between two and five years £31 million (2001: £68 million); and after five years £nil (2001: £nil).

	2002		2001	
	Within one year £m	After one year £m	Within one year £m	After one year £m
<b>18 Other creditors</b>				
<b>Amounts falling due</b>				
Goldfish Bank customer deposits	286	–	–	–
Trade creditors	1,343	–	1,141	–
Taxation and social security	137	–	127	–
Other creditors	715	23	659	2
Accruals and deferred income:				
Transportation <sup>(i)</sup>	18	–	183	–
Other accruals and deferred income	832	99	685	32
	850	99	868	32
Dividend payable (note 9)	110	–	76	–
	3,441	122	2,871	34

(i) The group has the option to either prepay or accrue its gas transportation charges in Great Britain. For much of the year, the group prepaid these charges. The group prepaid most of these charges for December 2002, but did not prepay them in December 2001.

	1 January 2002 £m	Foreign exchange £m	Transfers, acquisitions and disposals £m	Revisions £m	Profit and loss charge £m	Utilised in the year £m	31 December 2002 £m
<b>19 Provisions for liabilities and charges</b>							
Decommissioning costs	129	–	67	6	4	–	206
Deferred petroleum revenue tax	519	–	–	–	75	(199)	395
Deferred corporation tax <sup>(i)</sup>	134	(1)	145	–	–	–	278
Pension and other retirement benefits (note 26)	116	–	(2)	–	68	(107)	75
Restructuring costs	13	–	–	–	18	(10)	21
Sales contract loss and renegotiation provisions	227	–	–	–	14	(23)	218
Other	46	–	20	–	23	(20)	69
	1,184	(1)	230	6	202	(359)	1,262

(i) Group deferred tax (assets)/liabilities comprised:

	Amounts provided		Potential assets unrecognised	
	2002 £m	2001 £m	2002 £m	2001 £m
Accelerated capital allowances	436	230	(56)	(93)
Deferred petroleum revenue tax	(158)	(156)	–	–
Other timing differences including losses carried forward	(36)	(31)	(107)	(105)
	242	43	(163)	(198)
Deferred corporation tax liability	278	134		
Deferred corporation tax asset included in debtors (note 15)	(36)	(91)		
	242	43		

#### Decommissioning costs

Provision has been made for the estimated net present cost of decommissioning gas production facilities at the end of their producing lives. The estimate has been based on proven and probable reserves, price levels and technology at the balance sheet date. The timing of decommissioning payments are dependent on the lives of a number of fields but are anticipated to occur between 2005 and 2042. The revision in the year is due to an increase in the estimate for gas field abandonment costs. The profit and loss charge represents £4 million of notional interest (2001: £3 million).

#### Deferred petroleum revenue tax

The provision for tax on gas and oil activities has been calculated on a unit of production basis.

#### Deferred corporation tax

A deferred tax provision has been made in respect of accelerated capital allowances and other timing differences, net of recognised deferred tax assets.

#### Pension and other retirement benefits

This provision included the difference between charges to the profit and loss account and the contributions paid to the pension schemes in respect of retirement pensions and other related benefits.

#### Restructuring costs

The provision represented costs relating to surplus properties, redundancy and other costs relating to reorganisations. Surplus properties arose mainly following the closure of retail operations in both British Gas Energy Centres and in the AA. The provision relating to surplus properties was calculated as the lower of the difference between rental costs and sublet income over the remainder of the leases and the potential cost to surrender those leases. The provision for redundancy costs reflected announced restructuring plans. The majority of these sums were expected to be spent between 2004 and 2005.



# Notes to the financial statements continued

## 19 Provisions for liabilities and charges continued

### Sales contract loss and renegotiation provisions

The sales contract loss provision represented the net present cost, using a risk free discount rate, of expected losses on onerous long term sales contracts, based on the difference between the contracted sales price and the expected weighted average cost of gas. These contracts terminate between 2005 and 2006. The profit and loss charge included £14 million of notional interest (2001: £15 million).

In previous years, the group renegotiated certain long term 'Take or Pay' contracts which would have resulted in commitments to pay for gas that would be excess to requirements and/or at prices above likely market rates. The provision represented the net present cost of estimated payments due to suppliers as consideration for the renegotiations, which are due for settlement between 2003 and 2008.

### Other

Other provisions principally cover estimated liabilities in respect of claims reflected in the group's insurance subsidiaries, Goldfish credit card loyalty points, outstanding litigation, and provision for National Insurance payable in respect of long term incentive scheme liabilities. The National Insurance provision was based on a share price of 171 pence at 31 December 2002 (2001: 222 pence).

## 20 Called up share capital

	2002 £m	2001 £m
<b>Authorised share capital of the company</b>		
4,950,000,000 ordinary shares of 5 <sup>1</sup> / <sub>2</sub> pence each (2001: 4,950,000,000 ordinary shares of 5 <sup>1</sup> / <sub>2</sub> pence each)	275	275
100,000 cumulative redeemable preference shares of £1 each	-	-
<b>Allotted and fully paid share capital of the company</b>		
4,252,856,414 ordinary shares of 5 <sup>1</sup> / <sub>2</sub> pence each (2001: 4,020,931,056 ordinary shares of 5 <sup>1</sup> / <sub>2</sub> pence each)	236	223

During 2002, 231,925,358 ordinary shares were allotted and issued pursuant to a cash placing in February and, throughout the year, to satisfy the exercise of share options and the matching element of the share incentive plan as follows:

For the year ended 31 December	2002	2001
Number	231,925,358	7,512,180
Nominal value (£m)	12.9	0.4
Consideration (net of issue costs 2002: £6 million; 2001: £nil) (£m)	488 <sup>(i)</sup>	17

(i) Consideration of £488 million included £44 million in respect of employee share schemes and £444 million received from third parties.

	Options outstanding over ordinary shares		Latest exercise date	Exercise prices
	2002 million	2001 million		
RESOS <sup>(i)</sup>	2.1	2.2	November 2004	81.060p to 90.266p
ESOS <sup>(ii)</sup>	13.5	5.6	April 2012	240.050p and 224.800p
UK sharesave <sup>(iii) (iv)</sup>	61.6	78.0	November 2007	92.200p to 202.600p
Irish sharesave <sup>(iii)</sup>	0.3	0.3	May 2008	132.800p to 168.700p
Total 31 December	77.5	86.1		

(i) Details of the RESOS appear on page 30 in note (i) to the table of directors' interests in share options.

(ii) Details of the ESOS appear on pages 25 and 26.

(iii) Details of the UK and Irish sharesave schemes appear on pages 22 and 23.

(iv) As permitted by UITF 17 (revised 2000), the group does not recognise the cost of awards to employees in the profit and loss account for the year, on the basis that it operates a UK Inland Revenue-approved sharesave scheme.

The closing price of a Centrica ordinary share on 31 December 2002 was 171 pence (2001: 222 pence).

### Long term incentive scheme

At 31 December 2002, 34 million shares (2001: 40 million) were outstanding in respect of allocations made under the long term incentive scheme, which includes allocations of 23 million shares (2001: 23 million) that are subject to performance conditions and allocations of 11 million shares (2001: 17 million) that have reached the conclusion of the performance period but are subject to a two year retention period. Details of the operation of the long term incentive scheme, in which the executive directors participate, can be found in the remuneration report on page 26.

The Centrica Employees Share Trusts were established to acquire ordinary shares in the company, by subscription or purchase, with funds provided by way of interest free loans from the company to satisfy rights to shares on the vesting of allocations made under the company's long term incentive arrangements.

Since the beginning of 2002, no further shares have been acquired by the trust. Any future shortfall will be satisfied by the allotment and issue of new shares.

At 31 December 2002, the trusts held 27 million (2001: 39 million) ordinary shares in the company which had a market value of £47 million (2001: 39 million ordinary shares with a market value of £88 million). Dividends due on shares held in trust are waived in accordance with the trust deeds. All administration costs are borne by the group.

	Share premium account £m	Merger reserve £m	Profit and loss account <sup>(i)</sup> £m	Total £m
<b>21 Reserves</b>				
1 January 2002	62	467	750	1,279
Retained profit for the year	–	–	306	306
Exchange translation differences <sup>(ii)</sup>	–	–	(8)	(8)
Issue of ordinary share capital <sup>(iii)</sup>	475	–	(44)	431
Shares to be issued under long term incentive scheme <sup>(iv)</sup>	–	–	4	4
<b>31 December 2002</b>	<b>537</b>	<b>467</b>	<b>1,008</b>	<b>2,012</b>

- (i) Cumulative goodwill taken directly to the profit and loss reserve at 31 December 2002 amounted to £85 million (2001: £85 million). This goodwill had been taken to reserves as a matter of accounting policy and will be charged in the profit and loss account should there be a subsequent disposal of the business to which it related.
- (ii) Exchange gains of £84 million (2001: £18 million) on foreign currency borrowings have been offset in full in reserves against exchange losses of £92 million (2001: £18 million) on the net investment in overseas undertakings.
- (iii) The share issue movement in the group profit and loss account represented the difference between the share issue prices (being the market prices on the date of exercise of options) and the share option prices. This difference was funded by the company and its subsidiaries. Shares were allotted to a qualifying share ownership trust, for subsequent transfer to eligible employees, who have exercised options.
- (iv) Centrica intends to fund certain of its long term incentive schemes through the issue of new shares when these schemes vest. The amount shown represents the expected value of the shares to be issued using the market price at the date allocations were granted.

	2002 £m	2001 £m
<b>22 Movement in shareholders' funds</b>		
1 January	1,502	1,298
Profit attributable to the group	478	323
Dividends	(172)	(124)
Goodwill adjustment	–	(2)
Exchange translation differences	(8)	–
Issue of shares net of reserves movement on employee share schemes	444	7
Shares to be issued under long term incentive scheme	4	–
Net movement in shareholders' funds for the financial year	746	204
<b>31 December</b>	<b>2,248</b>	<b>1,502</b>

	Equity £m	Non-equity £m	Total £m
<b>23 Minority interests</b>			
1 January 2002	34	–	34
Minority interest arising during the year	21	108	129
Loss on ordinary activities after taxation	(9)	–	(9)
<b>31 December 2002</b>	<b>46</b>	<b>108</b>	<b>154</b>

Equity minority interests at 31 December 2002 related to a 30% economic interest held by Lloyds TSB Bank plc in the Goldfish Bank Limited. Non-equity minority interests at 31 December 2002 related to the 58.1% of units in the Consumers' Waterheater Income Fund (note 32), listed on the Toronto Stock Exchange.

## Notes to the financial statements continued

### 24 Acquisitions and disposals

#### (i) Acquisitions

During the year the group acquired controlling interests in Enbridge Services Inc, Regional Power Generators Ltd (Regional Power), Electricity Direct (UK) Limited (Electricity Direct), Dynegy Storage Limited, Dynegy Offshore Processing UK Limited, and Dynegy Onshore Processing UK Limited (collectively known as Rough gas storage facilities), WTU Retail Energy LP (WTU) and CPL Retail Energy LP (CPL) and selected assets from NewPower Holdings Inc (NewPower). The group also made a number of smaller acquisitions which are aggregated in section h. The acquisition method of accounting was adopted in all cases. The analysis of assets and liabilities acquired, and the fair value of these acquisitions, were as shown below. In addition the group acquired interests in a number of gas fields, in exchange for its interest in the Liverpool Bay gas fields. The fair values at 31 December 2002 are provisional because the directors have not yet reached a final determination on all aspects of the fair value exercise.

	Book value £m	Accounting policy alignment <sup>(i)</sup> £m	Fair value adjustment <sup>(ii)</sup> £m	Fair value £m
<b>a) Enbridge Services Inc</b>				
Intangible fixed assets	20	(13)	(7)	–
Tangible fixed assets	264	(37)	–	227
Stock	11	–	–	11
Debtors (amounts falling due within one year)	24	–	1	25
Debtors (amounts falling due after more than one year)	55	–	–	55
Creditors (amounts falling due within one year)	(29)	–	–	(29)
Provisions	(44)	–	–	(44)
Net assets acquired	301	(50)	(6)	245
Goodwill arising <sup>(iii)</sup>				193
Cash consideration				438

The group acquired Enbridge Services Inc on 7 May 2002. The profit after tax for Enbridge Services Inc from 1 January 2002 to 7 May 2002 was £10 million. The profit for the previous financial year was £38 million.

- (i) Accounting policy alignments have been made in respect of certain items previously capitalised within fixed assets and intangibles.
- (ii) The book value of assets and liabilities has been adjusted to align with the fair value of the assets and liabilities acquired.
- (iii) Goodwill arising is amortised over 15 years.

	Book value £m	Accounting policy alignment <sup>(i)</sup> £m	Fair value adjustment <sup>(ii)</sup> £m	Fair value £m
<b>b) Regional Power (Brigg)</b>				
Tangible fixed assets	78	–	(32)	46
Stock	3	2	(1)	4
Debtors (amounts falling due within one year)	2	–	9	11
Creditors (amounts falling due within one year)	(2)	–	(12)	(14)
Provisions	(19)	–	9	(10)
Net assets acquired	62	2	(27)	37
Goodwill arising				–
Cash consideration				37

The group acquired Regional Power on 28 June 2002. The loss after tax and minority interests for Regional Power from 1 January 2002 to 28 June 2002 was £5 million. The loss for the previous financial year was £19 million.

- (i) Adjustments were made to align the accounting policies of Regional Power with those of the group.
- (ii) The book value of assets and liabilities has been adjusted to align with the fair value of the assets and liabilities acquired. Tangible fixed assets have been valued at their estimated value in use. Adjustments have been made to debtors and creditors to value certain long term gas purchase contract arrangements at market value.

## 24 Acquisitions and disposals continued

	Book value £m	Accounting policy alignment <sup>(i)</sup> £m	Fair value adjustment <sup>(ii)</sup> £m	Fair value £m
<b>c) Electricity Direct</b>				
Tangible fixed assets	6	–	–	6
Debtors (amounts falling due within one year)	71	(11)	(11)	49
Bank overdrafts	(30)	–	–	(30)
Creditors (amounts falling due within one year)	(49)	–	(6)	(55)
Net liabilities acquired	(2)	(11)	(17)	(30)
Goodwill arising <sup>(iii)</sup>				80
Consideration				50
Cash consideration				38
Contingent consideration <sup>(iv)</sup>				12
				50

The group acquired Electricity Direct on 5 August 2002. The loss after tax and minority interests for Electricity Direct from 1 April 2002 to 5 August 2002 was £9 million. The profit after tax and minority interests for the previous financial year was £4 million.

- (i) Adjustments were made to align the accounting policies in respect of commission payments with those of the group.  
(ii) The book value of debtors has been adjusted based on management's estimate of recoverable value.  
(iii) Goodwill arising is amortised over 15 years.  
(iv) Contingent consideration comprises amounts paid but held in escrow. The calculation of final payments from escrow to the vendors, or repayments to the group, is contingent upon verification of certain working capital balances acquired. The final payment is expected to be between £nil and £12 million.

	Book value £m	Accounting policy alignment <sup>(i)</sup> £m	Fair value adjustment <sup>(ii)</sup> £m	Fair value £m
<b>d) Rough gas storage facilities</b>				
Tangible fixed assets	339	–	124	463
Stock	9	–	(5)	4
Debtors (amounts falling due within one year)	12	–	–	12
Cash at bank and in hand	184	–	–	184
Creditors (amounts falling due within one year)	(18)	–	–	(18)
Provisions	(126)	(31)	–	(157)
Net assets acquired	400	(31)	119	488
Goodwill arising				–
Cash consideration				488

The group acquired Dynegy Storage Limited, Dynegy Offshore Processing UK Limited and Dynegy Onshore Processing UK Limited on 14 November 2002. The profit after tax and minority interest for the acquired entities from 1 January 2002 to 14 November 2002 was £8 million. The profit after tax for the previous financial year was £9 million.

- (i) Adjustments were made to align the accounting policies for abandonment and deferred tax provisions with those of the group.  
(ii) The book value of assets and liabilities has been adjusted to align with the fair value of the assets and liabilities acquired.  
Tangible fixed assets have been valued at their estimated value in use.

The acquisition is a merger qualifying for investigation under the Fair Trading Act 1973. As such, the Secretary of State for Trade and Industry will decide whether to clear the merger, refer it to the Competition Commission for further investigation or accept undertakings in lieu of a reference.

	Book and Fair value £m
<b>e) WTU and CPL</b>	
Debtors (amounts falling due within one year)	103
Creditors (amounts falling due within one year)	(76)
Creditors (amounts falling due after more than one year)	(40)
Net liabilities acquired	(13)
Goodwill arising <sup>(i)</sup>	167
Consideration	154
Cash consideration	95
Deferred consideration <sup>(ii)</sup>	26
Contingent consideration <sup>(iii)</sup>	33
	154

The group acquired the businesses on 23 December 2002. Prior to the acquisition WTU and CPL formed part of an integrated utility and there is therefore no historical information available relating to the profitability of these retail customer components.

- (i) Goodwill arising is amortised over 15 years.  
(ii) Deferred consideration will be paid within one year.  
(iii) Contingent consideration is expected to be paid annually from February 2004 to February 2007 and is dependent on annual business performance up to 31 December 2006. It is stated net of an estimated amount recoverable from the vendor of £40 million in relation to the liability for regulatory claw back, dependent upon the retention of customers above specific levels in 2002 and 2003, time apportioned to the date of change in ownership.

## Notes to the financial statements continued

### 24 Acquisitions and disposals continued

	Book and fair value £m
<b>f) NewPower</b>	
Stock	8
Net assets acquired	8
Goodwill arising <sup>(i)</sup>	9
Consideration	17
Cash consideration	14
Deferred consideration <sup>(ii)</sup>	3
	17

The group acquired a selected list of customers and inventory from NewPower Holdings Inc on 31 July 2002. Prior to acquisition the customers formed part of the above legal entity and its subsidiary undertakings. In these circumstances it is not practical to provide details of results for financial periods before acquisition.

- (i) Goodwill arising is amortised over five years.  
(ii) Deferred consideration is payable within one year.

	Book value £m	Accounting policy alignment <sup>(i)</sup> £m	Fair value adjustments <sup>(ii)</sup> £m	Fair value £m
<b>g) Interests in gas fields acquired as swap for Liverpool Bay</b>				
Tangible fixed assets	46	4	4	54
Cash at bank and in hand	38	–	–	38
Provisions for liabilities and charges	–	(4)	–	(4)
Net assets acquired	84	–	4	88
Goodwill arising				–
Consideration				
Fair and book value of assets disposed				88

On 28 November 2002, the group acquired interests in the following fields, along with £38 million, in exchange for its 8.9% interest in Liverpool Bay: Armada (5.58%), Goldeneye (4.50%), Renee (17.26%), Rochelle (17.26%) and Rubie (4.78%). Prior to acquisition the assets acquired formed an integral part of the business of the ENI Group. As a result information relating to prior period profitability is not readily available.

- (i) Adjustments have been made to align the accounting policies with those of the group.  
(ii) The book value of the assets and liabilities has been adjusted to align with the fair value of the assets and liabilities acquired.

	Book value £m	Accounting policy alignments <sup>(i)</sup> £m	Fair value adjustments <sup>(ii)</sup> £m	Fair value £m
<b>h) Other acquisitions</b>				
Tangible fixed assets	21	1	6	28
Creditors (amounts falling due within one year)	(2)	–	–	(2)
Provisions for liabilities and charges	–	(1)	–	(1)
Net assets acquired	19	–	6	25
Goodwill arising <sup>(iii)</sup>				9
Consideration				34
Cash consideration				29
Deferred consideration <sup>(iv)</sup>				5
				34

During the year, the group acquired the assets and business of Stapleton's (Tyre Services) Limited (on 1 June 2002), the broadband assets and business of Iomart Group plc (on 7 January 2002), Alternative Energy Solutions Ltd (AES) (on 14 February 2002), and interests in a number of gas fields (on 17 January 2002, 28 August 2002 and 20 December 2002).

- (i) Adjustments were made to align the accounting policies of the acquired businesses with those of the group.  
(ii) The book value of assets and liabilities has been adjusted to align with the fair value of the assets and liabilities acquired.  
(iii) Goodwill is being amortised over periods ranging from 5 to 20 years.  
(iv) Deferred consideration is payable within one year.



## 24 Acquisitions and disposals continued

### (ii) Disposals

The group disposed of its liquid petroleum gas business, British Gas LPG on 30 November 2002. The analysis of the assets and liabilities sold and consideration received is given below:

	£m
Tangible fixed assets	39
Stock	1
Debtors (amounts falling due within one year)	7
Creditors (amounts falling due within one year)	(4)
Net assets sold	43
Goodwill sold	11
Loss arising on disposal	(14)
Cash consideration received	40

The profit made by British Gas LPG from 1 January 2002 to the date of disposal was £4 million.

## 25 Notes to the group cash flow statement

### a) Reconciliation of operating profit to operating cash flow

	2002 £m	2001 £m
Group operating profit	763	466
Exceptional charges	–	80
Group operating profit before exceptional charges	763	546
Amortisation of goodwill	116	86
Depreciation and impairment	390	337
Amortisation of investments	7	14
Profit on sale of investments	(12)	(6)
Profit on sale of fixed assets	(6)	(7)
Provisions	(161)	(173)
Change in working capital:		
Stocks – decrease/(increase)	30	(54)
Goldfish Bank debtors – (increase)/decrease	(119)	19
Goldfish Bank working capital facility – (decrease)/increase <sup>(i)</sup>	(180)	20
Goldfish Bank customer accounts – increase	286	–
Other debtors – (increase)	(541)	(89)
Other creditors – increase	160	176
	(364)	72
Cash inflow from operating activities before exceptional payments:		
Continuing operations before acquisitions	712	773
Acquisitions	21	96
Continuing operations	733	869
Payments relating to exceptional charges:		
Contract renegotiations	(5)	(13)
Business integration	(10)	(27)
Other	(1)	(4)
	(16)	(44)
Cash inflow from operating activities after exceptional payments	717	825

(i) The Goldfish Bank working capital facility primarily finances the Goldfish Bank credit card and other receivable balances.

In accordance with generally accepted practice for banking activities, movements on this working capital facility are included within operating cash flow rather than within financing.

### b) Returns on investments and servicing of finance

	2002 £m	2001 £m
Interest received	29	27
Interest paid	(42)	(28)
Interest element of finance lease rental payments	(12)	(14)
	(25)	(15)

Interest income/charges on banking receivables and related working capital facilities are included within operating cash flow in note 25a.

### c) Taxation paid

	2002 £m	2001 £m
UK corporation tax paid	(196)	(109)
Overseas tax paid	–	(6)
Consortium tax relief received	4	6
	(192)	(109)

## Notes to the financial statements continued

### 25 Notes to the group cash flow statement continued

#### d) Capital expenditure and financial investment

	2002 £m	2001 £m
Purchase of tangible fixed assets	(449)	(312)
Sale of tangible fixed assets	28	11
Purchase of own shares	–	(14)
Loans to joint ventures repaid/(made)	19	(22)
	(402)	(337)

#### e) Acquisitions and disposals

	2002 £m	2001 £m
Payments on acquisition of Goldfish	–	(710)
Payments on acquisition of other subsidiary undertakings	(1,107)	(402)
Payments on acquisition of joint ventures and associates	(4)	(80)
Payments of deferred consideration <sup>(i)</sup>	(70)	(17)
Total cash payments	(1,181)	(1,209)
Cash acquired	222	17
Overdraft acquired	(30)	(12)
Drawdown from Goldfish Bank working capital facility	–	590
Proceeds from disposals	54	7
	(935)	(607)

Cash consideration, net of cash and overdrafts acquired, at acquisition date rates of exchange totals £959 million (note 24).

The difference of £44 million to acquisition cash flows noted above is due to foreign exchange movements.

(i) Deferred consideration includes £68 million in respect of the 2001 Goldfish acquisition.

#### f) Management of liquid resources

	2002 £m	2001 £m
Net sale/(purchase) of current asset investments	134	(257)

Liquid resources comprised short term deposits with banks which mature within one year of the date of inception.

#### g) Financing

	£m	£m
Debt due within one year:		
Net increase in short term borrowings	309	196
Repayment of loans	(381)	(22)
Capital element of finance lease rentals	(32)	(32)
Bonds issued	221	493
Realised net foreign exchange gain <sup>(i)</sup>	57	–
Investment by equity and non-equity minority shareholders	129	44
Issue of ordinary share capital <sup>(ii)</sup>	444	7
	747	686

(i) Where currency swap agreements are used to hedge overseas net investments, the realised net gains are recognised in financing cash flows.

(ii) Cash inflow from the issue of ordinary share capital is stated net of issue costs of £6 million.

	1 January 2002 £m	Cash flow £m	Debt acquired (excluding cash and overdrafts) £m	Exchange adjustments and other non-cash investments <sup>(i)</sup> £m	31 December 2002 £m
<b>h) Analysis of debt, net of cash and money market investments</b>					
Cash at bank and in hand	72	(40)	–	(4)	28
Overdrafts	(16)	3	–	–	(13)
		(37)			
Bonds	(493)	(221)	–	–	(714)
Loan notes due within one year	(5)	2	–	–	(3)
Obligations under finance leases	(138)	32	–	–	(106)
Goldfish Bank working capital facility	(610)	180	–	–	(430)
Other borrowings	(307)	70	–	–	(237)
		63			
Current asset investments	454	(134)	–	–	320
	(1,043)	(108)	–	(4)	(1,155)
Of which:					
Goldfish Bank working capital facility	(610)	180	–	–	(430)
Other businesses – non-recourse debt	–	(196)	–	–	(196)
Other businesses – recourse debt	(433)	(92)	–	(4)	(529)
	(1,043)	(108)	–	(4)	(1,155)

(i) This included an exchange loss on cash of £4 million (2001: gain £12 million).

## 26 Pensions

Substantially all of the group's UK employees at 31 December 2002 were members of one of the four main schemes in the group: the Centrica Staff Pension Scheme, the Centrica Engineers' Pension Scheme, the Centrica Management Pension Scheme and the AA Staff Pension Scheme. They are subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contributions which, together with the specified contributions payable by the employees and proceeds from the schemes' assets, are expected to be sufficient to fund the benefits payable under the schemes.

The Centrica Unapproved Pension Scheme is an unfunded arrangement which provides benefits to certain employees whose benefits under the main schemes would otherwise be limited by the 'earnings cap'.

Independent actuarial valuations for Statement of Standard Accounting Practice (SSAP) 24 purposes at 31 March 2001 showed aggregate actuarial asset values and those values relative to benefits due to members, (calculated on the basis of pensionable earnings and services on an ongoing basis using the projected unit method) as follows:

	Asset values £m	Asset values relative to liabilities %
Centrica Staff Pension Scheme	713	105
Centrica Engineers' Pension Scheme	396	106
Centrica Management Pension Scheme	254	115
AA Staff Pension Scheme	676	117
The long term assumptions applied to calculate group pension costs, as agreed with the independent actuary, are set out below:	2002 %	2001 %
Rate of price inflation and pension increases	2.50	2.50
Annual rate of return on investments	6.70	6.70
Future increases in employee earnings	4.50	4.50
Dividend growth	3.75	3.75
The pension costs arising, together with unfunded pension costs, and the reconciliation to the balance sheet provision was as follows:	2002 £m	2001 £m
Regular pension costs	95	84
Amortisation of surplus	(21)	(21)
Interest	74	63
Net pension costs	(10)	(12)
Contributions paid	64	51
(Decrease)/Increase in provision for pension costs	(107)	(26)
Pension provision at 1 January	(43)	25
Pension provision at 31 December	98	73
Pension provision at 31 December	55	98
AA post retirement private medical insurance <sup>(i)</sup>	21	18
Direct Energy Marketing Limited post retirement benefits <sup>(ii)</sup>	(1)	-
Pension and other retirement benefits provision (note 19)	75	116

### Other retirement benefits

- (i) The group has a commitment to provide post retirement private medical insurance cover for certain AA current and past employees. The triennial independent actuarial valuation undertaken at 31 December 2001, assuming a 2.5% per annum real increase in premiums disclosed a liability of £27 million. The provision under this scheme as recognised under SSAP 24 was £21 million (2001: £18 million). The net cost to the group of retirement benefits under this scheme was £3 million (2001: £3 million).
- (ii) The group has a commitment to provide certain pension and other post retirement benefits to employees of Direct Energy Marketing Limited (Canada). The Direct Energy Marketing Limited pension plan was established on 1 March 2002 and an independent actuarial valuation carried out on 7 May 2002, which disclosed a surplus in respect of pension benefits of £6 million and a deficit in respect of non-pension post retirement benefits of £4 million, resulting in a net surplus of £2 million. The net cost to the group of retirement benefits under this scheme was £1 million and the net surplus recognised at 31 December 2002 was £1 million. The total net cost to the group of other retirement benefits on a SSAP 24 basis was £4 million (2001: £3 million).

Additional disclosures regarding the group's defined benefit pension schemes, the unapproved pension arrangement and the post retirement medical plan are required under the transitional provisions of FRS 17 Retirement Benefits. The disclosures provide information which will be necessary for the full implementation of FRS 17 in due course.

The latest full actuarial valuations were carried out as at the following dates: the approved pension schemes at 31 March 2001, the unapproved pension scheme at 6 April 2002, the Direct Energy Marketing Limited pension plan at 7 May 2002 and the post retirement medical liability at 31 December 2001. These have been updated to 31 December 2002 for the purposes of meeting the requirements of FRS 17. Investments have been valued, for this purpose, at market value.

	31 December 2002 %	31 December 2001 %
The major assumptions used for the actuarial valuation were:		
Rate of increase in employee earnings	4.3	4.5
Rate of increase in pensions in payment	2.3	2.5
Discount rate	5.75	5.8
Inflation assumption	2.3	2.5

## Notes to the financial statements continued

### 26 Pensions continued

The market value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were:

	Expected rate of return per annum 2002 %	Valuation 2002 £m	Expected rate of return per annum 2001 %	Valuation 2001 £m
31 December				
Equities	8.4	1,503	8.0	1,759
Bonds	4.8	267	5.2	274
Property	6.9	62	7.1	60
Cash and other assets	4.0	50	4.5	100
Total fair value of assets	7.7	1,882	7.5	2,193
Present value of schemes' liabilities		(2,713)		(2,526)
Deficit in the schemes		(831)		(333)
Related deferred tax asset		249		100
Net pension liability		(582)		(233)

Under SSAP 24 the balance sheet on page 33 includes a provision of £75 million at 31 December 2002 (2001: £116 million). Had FRS 17 been implemented in full at that date the net assets of the group would have been reduced by £507 million (2001: £117 million), and the net charge for pension costs in the profit and loss account would have increased by £47 million (2001: £16 million) compared with that under SSAP 24, as set out below:

	FRS 17 £m	SSAP 24 £m	Increase/ (decrease) £m
For the year ended 31 December 2002			
Amount charged to operating profit	133	68	65
Amount credited to net finance income	(18)	–	(18)
Net charge to profit and loss account	115	68	47

	2002 £m
Analysis of the amount that would have been charged to operating profit under FRS 17	
Current service cost	131
Past service cost	2

	2002 £m
Analysis of the amount that would have been credited to net finance income under FRS 17	
Expected return on pension scheme assets	170
Interest on pension scheme liabilities	(152)

	2002 £m
Analysis of the actuarial gain/(loss) that would have been recognised in the statement of total recognised gains and losses	
Actual return less expected return on pension scheme assets	(588)
Experience gains and losses arising on the scheme liabilities	(3)
Changes in assumptions underlying the present value of the scheme liabilities	99
Actuarial (loss) to be recognised in the statement of total recognised gains and losses before adjustment for tax	(492)

	2002
History of experience gains and losses	
<b>Difference between the expected and actual return on scheme assets:</b>	
Amount (£m)	(588)
Percentage of scheme assets	31.2%
<b>Experience gains and losses on scheme liabilities:</b>	
Amount (£m)	(3)
Percentage of the present value of scheme liabilities	0.1%
<b>Total actuarial loss recognised in the statement of total recognised gains and losses:</b>	
Amount (£m)	(492)
Percentage of the present value of scheme liabilities	18.1%

	2002 £m
The movement in deficit during the year under FRS 17 would have been:	
Deficit in schemes at beginning of year	(333)
Movements in the year to 31 December 2002:	
Current service cost	(131)
Past service cost	(2)
Employer contributions	107
Other finance income	18
Acquisition of surplus in year	2
Actuarial loss	(492)
Deficit in schemes at end of year	(831)

## 27 Commitments and contingencies

### a) Acquisitions

On 10 December 2002 the group reached agreement to acquire the retail gas and electricity supply businesses of the ATCO Group in Alberta, Canada for consideration of approximately £52 million, payable over two years.

The transaction is subject to the satisfaction of certain conditions, including the receipt of required regulatory approvals and the promulgation of legislation that reflects the market refinements announced by the Minister of Energy in August 2002. It is expected that the Alberta Legislature will consider these legislative changes in the spring of 2003. Completion is expected by mid to late 2003.

### b) Capital expenditure

At 31 December 2002, the group had placed contracts for capital expenditure amounting to £106 million (2001: £31 million) of which £72 million relates to the investment in customer relationship management (CRM) infrastructure (2001: £nil).

### c) Decommissioning costs

The company and its wholly-owned subsidiary, Hydrocarbon Resources Limited, have agreed to provide security to BG International Limited, which, as original licence holder for the Morecambe gas fields, will have exposure to decommissioning costs relating to the Morecambe gas fields should liabilities not be fully discharged by the group. The security is to be provided when the estimated future net revenue stream from the Morecambe gas fields falls below 150% of the estimated cost of such decommissioning. The nature of the security may take a number of different forms and will remain in force unless and until the costs of such decommissioning have been irrevocably discharged and the relevant Department of Trade and Industry decommissioning notice in respect of the Morecambe gas fields has been revoked.

### d) Lease commitments

At 31 December non-cancellable operating lease commitments of the group for the following year were:

	Land and buildings		Other	
	2002 £m	2001 £m	2002 £m	2001 £m
Expiring:				
Within one year	4	–	1	3
Between one and five years	7	5	24	23
After five years	38	42	3	10
	49	47	28	36

There were no commitments at 31 December 2002 under finance leases entered into, but for which inception occurs after 31 December 2002 (2001: £nil).

### e) Litigation

The group has a number of outstanding disputes arising out of its normal activities, for which appropriate provisions have been made, in accordance with FRS12.

### f) Guarantees and indemnities

The company has £1 billion of bilateral credit facilities (2001: £935 million). Hydrocarbon Resources Limited and British Gas Trading Limited have guaranteed, jointly and severally, to pay on demand any sum which the company does not pay in accordance with the facility agreements.

The group and BG Group plc have agreed, subject to certain limitations, to indemnify each other against certain actual and contingent liabilities associated with their respective businesses.

In relation to the sale and leaseback of the Morecambe gas field tangible fixed assets recorded in these financial statements, the group has given guarantees amounting to £92 million (2001: £116 million).

The group has given guarantees in connection with the finance lease obligations relating to Humber Power Limited referred to in note 13. A fixed collateral payment amounting to £225 million (2001: £225 million) is required in the event of Centrica plc failing to retain at least one credit rating which is not on credit watch above the BBB+/Baa1 level, and further collateral of £75 million is required if the credit rating falls further.

The group has given guarantees and indemnities to various counterparties in relation to wholesale energy trading and procurement activities, and to third parties in respect of gas production and energy transportation liabilities.

In connection with their energy trading, transportation and upstream activities, certain group companies have entered into contracts under which they may be required to prepay or provide credit support or other collateral in the event of a significant deterioration in credit worthiness. The extent of credit support is contingent upon the balance owing to the third party at the point of deterioration.

Following the closure of the British Gas Energy Centres Limited (Energy Centres) operations in July 1999, guarantees have been signed on certain former Energy Centres' properties as a result of reassignment of leases.



## Notes to the financial statements continued

### 27 Commitments and contingencies continued

#### g) Gas purchase contracts

The group is contracted to purchase 65 billion therms of gas (2001: 46 billion therms) in Great Britain under long term contracts. The significant increase on last year is largely due to a number of contracts that have recently been entered into where the price is linked to the market price for gas. A proportion of this gas (37 billion therms) however relates to legacy contracts at prices, mainly determined by various baskets of indices including oil prices and general inflation, which may exceed market gas prices from time to time. Whilst there remains uncertainty regarding future prices and market share, in the opinion of the directors, no general provision for onerous contract losses is required.

The total volume of gas to be taken under these long term contracts depends upon a number of factors, including the actual reserves of gas that are eventually determined to be extractable on an economic basis. Based upon the minimum volume of gas that the group is contracted to pay for in any year, the profile of the contract commitments is estimated as follows:

	2002 million therms	2001 million therms
Within five years	45,900	29,900
After five years	19,200	15,900
	65,100	45,800

The directors do not consider it feasible to estimate reliably the actual future cost of committed gas purchase as the group's weighted average cost of gas from these contracts is subject to a variety of indexation bases. The group's average cost of gas from its long term contracts for the year ended 31 December 2002 was 19.6 pence per therm (for the year ended 31 December 2001: 19.9 pence per therm. This compares to 20.8 pence per therm being the weighted average cost for the three month period ending 31 December 2001 which was used to estimate the financial commitment in 2001). Applying this value would imply a group financial commitment of approximately £12.7 billion (2001: £9.5 billion as previously stated).

The commitment profile on this same basis is set out below:	2002 £m	2001 £m
Within one year	1,900	1,900
Between one and five years	7,000	4,300
After five years	3,800	3,300
	12,700	9,500

In addition, the group has entered into two new contracts to purchase significant additional volumes of gas at market prices from Statoil (17 billion therms over 10 years from 1 July 2005) and Gasunie (27 billion therms over 10 years from 1 April 2005). Both of these contracts remain conditional at this stage and so are excluded from the numbers above.

#### h) Other

The group's use of financial instruments is explained in the group financial review on pages 17 and 18 and in note 29.

### 28 Related party transactions

#### a) Joint ventures and associates

	2002 £m	2001 £m
Purchases for the year ended 31 December:		
AccuRead Limited	17	32
Humber Power Limited <sup>(i)</sup>	74	48
AG Solutions Limited (an associate)	-	9
Loans given in the year ended 31 December:		
Humber Power Limited	-	15
Spalding Energy Company Limited	-	4
Aldbrough Limited	-	2
Goldbrand Development Limited	-	1
Loans receivable outstanding as at 31 December:		
Humber Power Limited	-	15
Spalding Energy Company Limited	-	4
Aldbrough Limited	-	2
Centrica Personal Finance Limited	2	-

All other transactions with joint ventures and associates were not material to the group.

(i) The group had a creditor balance at 31 December 2002 with Humber Power Limited of £6 million (2001: £18 million).

#### b) Pension schemes

In 2002 the group incurred £2 million (2001: £1 million) of administrative costs relating to group pension schemes.

#### c) Transactions with directors

The aggregate amount outstanding at 31 December 2002 in respect of credit cards made available by Goldfish Bank Limited to directors of the company was £47,000, and the number of directors concerned was five.

#### d) Other

Lloyds TSB Bank plc who have a 30% economic interest in Goldfish Bank Limited have made available an £850 million working capital facility to Goldfish Bank Limited, of which £430 million had been drawn down at 31 December 2002 (2001: £610 million).

The group has also entered into several derivative transactions with Lloyds TSB Bank plc to hedge against interest rate fluctuations. Other activity with Lloyds TSB Bank plc included interest receivable of £nil, interest payable of £27 million and charges of £17 million, of which £6 million has been capitalised (2001: £1 million, £1 million and £14 million respectively). Creditors at 31 December 2002 included £19 million due to Lloyds TSB Bank plc (2001: £26 million).

## 29 Financial instruments

The group's use of financial instruments is explained under the heading Financial risk management in the group financial review on pages 17 and 18. The related accounting policies are explained in note 1. As permitted within FRS 13, the disclosures set out below in 29a and 29c through 29g exclude short term debtors and creditors. Additional information on Goldfish Bank interest rate sensitivities is provided in note 29h below.

### a) Interest rate risk profile of financial instruments

#### Financial assets

The interest rate risk profile of the group's financial assets at 31 December was as follows:

	2002 Canadian Dollar	2001 Canadian Dollar	2002 Sterling	2001 Sterling	2002 Total	2001 Total
Floating interest rate (£m)	19	67	331	475	350	542
Fixed interest rate (£m)	44	–	5	5	49	5
No interest receivable (£m) <sup>(i)</sup>	–	–	5	15	5	15
Total financial assets (£m)	63	67	341	495	404	562
Weighted average fixed interest rate (%)	15	–	6.5	7.4	14.1	7.4
Weighted average period for which rate is fixed (months)	38	–	58	10	40	10
Weighted average period for which no interest is receivable (months)	–	–	–	2	–	2

With the exception of uncleared items, floating rate financial assets attract interest rates mainly based upon LIBOR for periods of one year or less.

(i) Financial assets on which no interest is paid relate to Tracker Fund investments, for which no maturity date is specified.

#### Financial liabilities

After taking into account forward foreign currency swaps, the interest rate profile of the group's financial liabilities at 31 December was as follows:

	2002 Canadian Dollar	2001 Canadian Dollar	2002 Sterling	2001 Sterling	2002 Total	2001 Total
Floating interest rate (£m)	(276)	–	(973)	(1,070)	(1,249)	(1,070)
Fixed interest rate (£m)	(2)	(3)	(288)	(496)	(290)	(499)
No interest payable (£m) <sup>(i)</sup>	(108)	–	(33)	(28)	(141)	(28)
Total financial liabilities (£m)	(386)	(3)	(1,294)	(1,594)	(1,680)	(1,597)
Weighted average fixed interest rate (%)	6.5	6.0	6.0	5.8	6.0	5.8
Weighted average period for which rate is fixed (months)	28	21	101	113	100	113
Weighted average period for which no interest is payable (months)	–	–	62	15	62	15

With the exception of uncleared items, floating rate financial liabilities bear interest at rates based upon LIBOR for periods of one day to six months.

(i) Financial liabilities on which no interest is paid include £108 million relating to non-equity minority interests. Non-equity minority interests relate to a 58.1% economic interest in the Consumers' Waterheater Income Fund, represented by units listed on the Toronto Stock Exchange, for which no maturity date is specified.

### b) Currency risk

Sterling, Canadian and US dollars were the functional currencies for all material operations in 2002 and 2001. There were no material monetary assets and liabilities in currencies other than these functional currencies, except for £9 million of monetary assets denominated in euros (2001: £16 million) and £7 million (2001: £69 million) of monetary assets denominated in US dollars. The euro assets represent short term cash flow timing differences on European gas trading. The US assets represent margin deposits placed in respect of energy trading positions. In the UK the cost of gas under long term purchase contracts is dependent upon indices, which in part are influenced by US dollar denominated oil prices. An element of the foreign (US\$) exchange risk so arising was hedged using forward foreign currency contracts (note 29g).

### c) Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December was as follows:

	2002			2001		
	Borrowings £m	Other financial liabilities £m	Total financial liabilities £m	Borrowings £m	Other financial liabilities £m	Total financial liabilities £m
In one year or less, or on demand	721	13	734	971	20	991
In more than one year but not more than two years	39	1	40	38	2	40
In more than two years but not more than five years	349	36	385	167	4	171
In more than five years	401	19	420	400	2	402
Non-equity minority interests <sup>(i)</sup>	–	108	108	–	–	–
	1,510	177	1,687	1,576	28	1,604

The maturity profile of borrowings includes £525 million (2001: £500 million) of bonds stated at face value. As disclosed in note 17, the bonds are stated in the group balance sheet net of £7 million (2001: £7 million) of issuance discount.

(i) As noted above, no maturity date is specified for non-equity minority interests.

# Notes to the financial statements continued

## 29 Financial instruments continued

### d) Borrowing facilities

At 31 December 2002, the group had undrawn committed borrowing facilities, in which all conditions precedent had been met at that date, of £1 billion (2001: £935 million). Of these facilities, 50% mature during 2003, whilst the remainder do not mature until 2006. In addition the group has access to a number of uncommitted facilities.

The principal debt facilities in use by the group at 31 December 2002 were a US commercial paper programme of US\$2 billion (2001: US\$2 billion) and a euro medium term note (EMTN) programme of US\$2 billion (2001: US\$2 billion). At 31 December 2002, US\$374 million (£237 million) had been issued under the commercial paper programme (2001: US\$446 million) and bonds totalling £525 million (2001: £500 million) had been issued under the EMTN programme. Of the commercial paper issued, US\$299 million had been swapped into sterling, and the remainder was held in US dollars. In relation to the bonds, 24% mature between two and five years and 76% mature after five years.

Goldfish Bank also has a £850 million (2001: £850 million) borrowing facility from Lloyds TSB Bank plc, from which £430 million (2001: £610 million) was drawn down at 31 December 2002.

### e) Fair values of financial assets and liabilities

The following table shows the book and fair values of the group's financial instruments at 31 December:

	2002		2001	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Primary financial instruments held or issued to finance the group's operations:				
Cash at bank and in hand and current asset investments <sup>(i)</sup>	348	348	526	526
Loan to Centrica Personal Finance Limited	2	2	-	-
Humber Power loan	-	-	15	15
Long term trade debtors <sup>(i)</sup>	44	44	-	-
Other financial assets	10	10	21	21
	404	404	562	562
Bank loans and overdrafts <sup>(i)</sup>	(13)	(13)	(16)	(16)
Commercial paper <sup>(iii)</sup>	(237)	(237)	(307)	(307)
Goldfish Bank	(430)	(430)	(610)	(610)
Bonds <sup>(iv)</sup>	(518)	(548)	(493)	(491)
Finance lease borrowings <sup>(iii)</sup>	(106)	(111)	(138)	(154)
Loan notes <sup>(i)</sup>	(199)	(199)	(5)	(5)
Other financial liabilities <sup>(i)</sup>	(69)	(69)	(28)	(28)
	(1,572)	(1,607)	(1,597)	(1,611)
Non-equity minority interests <sup>(iv)</sup>	(108)	(119)	-	-
	(1,680)	(1,726)	(1,597)	(1,611)
Derivative financial instruments held to manage the group's currency, interest rate profile and energy price exposures:				
Forward foreign currency contracts <sup>(iii)</sup> , interest rate swaps and forward rate agreements <sup>(iv)</sup>	45	30	21	21
Energy derivatives <sup>(v)</sup>	11	93	-	(92)
Derivative financial instruments held for trading:				
Energy derivatives <sup>(v)</sup>	5	5	(10)	(10)

(i) Due to the nature and/or short maturity of these financial instruments, book values approximated to fair values.

(ii) The fair values of these financial instruments are based upon discounted cash flows, using discount rates based upon the group's cost of borrowing.

(iii) Fair values have been determined by reference to closing exchange rates at 31 December.

(iv) Fair values have been determined by reference to closing prices at 31 December.

(v) The fair values of energy derivatives are calculated as the product of the volume and the difference between their strike or traded price and the corresponding market prices. The market price is based upon the corresponding closing price of that market. Where there is no organised market and/or the market is illiquid, the market price is based upon management estimates, taking into consideration all relevant current market and economic factors.

### f) Gains and losses on financial instruments held for trading

There was no net gain or loss from trading in energy derivatives included in the group profit and loss account for the year ended 31 December 2002 (2001: gain of £6 million). Energy derivatives used for this purpose comprised energy swaps, futures, forwards and options. As permitted by FRS 13, physical contracts are not cash-settled commodity contracts and have accordingly been excluded. The average fair value of instruments held during the year ended 31 December 2002 did not materially differ from the year end position. The fair value of financial assets and financial liabilities held for trading at 31 December 2002 amounted to £14 million and £9 million respectively.

## 29 Financial instruments continued

### g) Gains and losses on hedges

The group uses financial instruments to hedge its currency, interest, energy price and weather exposures. Changes in the fair value of these derivatives used are not recognised in the financial statements until the hedged position itself is recorded therein. Unrecognised and deferred gains and losses on hedges arose as analysed below:

	Unrecognised			Deferred		
	Gains £m	Losses £m	Total net gains/(losses) £m	Gains £m	Losses £m	Total net gains/(losses) £m
At 1 January 2002	66	(158)	(92)	25	(5)	20
Arising in previous years that were recognised in 2002	(9)	1	(8)	(20)	5	(15)
Arising in previous years that were not recognised in 2002	57	(157)	(100)	5	–	5
Arising in 2002	59	108	167	57	(6)	51
<b>At 31 December 2002</b>	<b>116</b>	<b>(49)</b>	<b>67</b>	<b>62</b>	<b>(6)</b>	<b>56</b>

Of which:

Expected to be recognised in 2003	78	(17)	61	31	(6)	25
Expected to be recognised in 2004 or later	38	(32)	6	31	–	31

### h) Additional disclosures for Goldfish Bank

Credit card balances and customer deposits constitute the core element of the bank's operations.

#### Derivatives

All derivatives held are used to hedge interest rate risk. The bank does not hold any derivatives for trading. At 31 December 2002 and 31 December 2001 the maturity of the notional principal amounts and replacement cost of non-trading financial instruments, all entered into with Lloyds TSB Bank plc were as follows:

	One year or less		Between one and and five years		Over five years		Total	
	Notional principal £m	Replacement cost £m	Notional principal £m	Replacement cost £m	Notional principal £m	Replacement cost £m	Notional principal £m	Replacement cost £m
Interest rate related contracts								
<b>31 December 2002</b>	<b>52</b>	<b>–</b>	<b>236</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>288</b>	<b>–</b>
31 December 2001	20	–	156	–	–	–	176	–

#### Interest rate sensitivity gap analysis

The tables below summarise the repricing mismatches of the bank's non-trading assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non- interest bearing £m	Total
							£m
31 December 2002							
Loans and advances to customers	759	1	1	10	–	–	771
Other assets	–	–	–	–	–	271	271
Customer deposits <sup>(i)</sup>	(286)	–	–	–	–	–	(286)
Goldfish Bank working capital facility	(344)	(86)	–	–	–	–	(430)
Other liabilities and shareholders' funds	–	–	–	–	–	(326)	(326)
Interest rate swaps (off balance sheet)	288	–	(52)	(236)	–	–	–
Interest rate sensitivity gap	417	(85)	(51)	(226)	–	(55)	–
Cumulative gap	417	332	281	55	55	–	–

(i) Repayable on demand.

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non- interest bearing £m	Total
							£m
31 December 2001							
Loans and advances to customers	405	–	–	–	–	259	664
Other assets	–	–	–	–	–	230	230
Goldfish Bank working capital facility	(601)	(9)	–	–	–	–	(610)
Other liabilities and shareholders' funds	–	–	–	–	–	(284)	(284)
Off balance sheet items	176	–	(20)	(156)	–	–	–
Interest rate sensitivity gap	(20)	(9)	(20)	(156)	–	205	–
Cumulative gap	(20)	(29)	(49)	(205)	(205)	–	–

# Notes to the financial statements continued

## 29 Financial instruments continued

### Fair value of non-trading instruments

At 31 December 2002 and 31 December 2001 the notional principal amounts, fair values and book values of non-trading instruments entered into with third parties were as follows:

	Notional principal amount £m	Year end positive fair value £m	Year end positive book value £m	Year end negative fair value £m	Year end negative book value £m
Interest rate swaps					
<b>31 December 2002</b>	<b>288</b>	<b>-</b>	<b>-</b>	<b>4</b>	<b>-</b>
31 December 2001	176	-	1	-	1

## 30 Post balance sheet events

As part of the arrangements to launch the Consumers' Waterheater Income Fund in Canada in December 2002, the Fund issued C\$500 million of Floating Rate Notes. On 22 January 2003 these Notes were refinanced through the issuance of two series of senior notes, pursuant to a prospectus filed with the Canadian securities regulatory authorities. The series A-1 Notes have an expected final payment date of five years and legal maturity of 11 years, and were issued at par with a coupon of 4.700%. The series A-2 Notes have an expected final payment date of seven years and legal maturity of 13 years and were issued at par with a coupon of 5.245%. Both series are non-recourse to the Centrica group, and are rated AAA by Standard & Poors and the Dominion Bond Rating Service.

On 7 February 2003 the group announced a series of four year electricity purchase contracts entered into by its wholly-owned subsidiary British Gas Trading Limited with British Energy Power and Energy Trading Limited, a subsidiary of British Energy plc, for the purchase of 38TWh of power, amounting to 20% of the group's electricity requirements over the period. More than half of the electricity purchased will be at a fixed price the remainder being linked to future electricity market prices.

On 11 February 2003 the group confirmed that it had acquired the full legal title to the King's Lynn power station for a consideration of £1, previously held under a finance lease (note 12(ii)). This followed the acquisition of the legal title to the Peterborough Power Station for a consideration of £1 announced on 23 December 2002.

## 31 Principal undertakings

31 December 2002 <sup>(i)</sup>	Country of incorporation	% group holding in ordinary shares and net assets	Principal activity
<b>Subsidiary undertakings</b>			
AA Corporation Limited	England	100	Holding company and roadside services in Ireland
AA Reinsurance Company (Guernsey) Limited	Guernsey	100	Insurance services
Accord Energy Limited	England	100	Wholesale energy trading
Automobile Association Developments Limited	England	100	Roadside and financial services
Automobile Association Insurance Services Limited	England	100	Financial services
Automobile Association Underwriting Services Limited	England	100	Roadside and financial services
British Gas Services Limited	England	100	Servicing and installation of gas heating systems
British Gas Trading Limited	England	100	Energy supply
Centrica Canada Limited	Canada	100	Holding company and gas production
Centrica Insurance Company Limited	Isle of Man	100	Insurance services
Centrica KL Limited	England	100	Power generation
Centrica Overseas Holdings Limited	England	100	Holding company
Centrica PB Limited	England	100	Power generation
Centrica Resources Limited	England	100	Gas and oil production
Centrica Storage Holdings Limited	England	100	Gas production and storage
Centrica Telecommunications Limited	England	100	Telecommunications
CPL Retail Energy LP	USA	100	Energy supply
Direct Energy Marketing Limited	Canada	100	Energy supply
Enbridge Services Inc	Canada	100	Rental and servicing of waterheaters
Energy America, LLC	USA	100	Energy supply
Electricity Direct (UK) Limited	England	100	Energy supply
GB Gas Holdings Limited	England	100	Holding company
Goldfish Bank Limited	England	75 <sup>(iii)</sup>	Financial services
Hydrocarbon Resources Limited	England	100	Gas production from the Morecambe fields
Regional Power Generators Limited	England	100	Power generation
Republic Power LP	USA	100	Energy supply
The Automobile Association Limited	Jersey	100	Roadside services
WTU Retail Energy LP	USA	100	Energy supply
<b>Joint ventures</b>			
AccuRead Limited	England	49	Meter reading
Automobile Association Financial Services <sup>(iii)</sup>	England	50	Financial services
Centrica Personal Finance Limited	England	50	Financial services
Humber Power Limited	England	60	Power generation
Luminus NV	Belgium	50	Energy supply
Motorfile Limited	England	50	Used car data checking
<b>Associates</b>			
The First Resort Limited	England	20	Travel

(i) All principal undertakings are indirectly held by the company, except for GB Gas Holdings Limited, which is a direct subsidiary undertaking.

(ii) The group has a 70% economic interest in the net assets of Goldfish Bank Limited.

(iii) Automobile Association Financial Services is unincorporated and its principal place of business is Capital House, Queen's Park Road, Handbridge, Chester CH88 3AN.



### 32 Summary financial information for the Consumers' Waterheater Income Fund (the Fund)

In the context of the short period of operation of the Fund which was inadequate to demonstrate its independent operation in practice, and Centrica's retained interest in the Fund, directors have concluded that it is appropriate to consolidate the Fund as a quasi-subsidiary in accordance with FRS 5 Reporting the Substance of Transactions. A summary of the financial information which (before elimination of intra-group items) has been consolidated into the group accounts is set out below:

<b>a) Profit and loss account</b>		2002
Period from 17 to 31 December		£m
Turnover		3
Operating costs		(1)
Net income before distributions		2
Distribution to unit holders		(2)
Retained earnings		-
There are no recognised gains or losses other than the profit for the period.		
<b>b) Balance sheet</b>		2002
31 December		£m
Intangible fixed assets – goodwill <sup>(iv)</sup>		241
Tangible fixed assets		182
		423
<b>Current assets</b>		19
<b>Creditors (amounts falling due within one year)<sup>(v)</sup></b>		(15)
<b>Net current assets</b>		4
<b>Total assets less current liabilities</b>		427
<b>Creditors (amounts falling due after more than one year)<sup>(ii)</sup></b>		(196)
<b>Provisions for liabilities and charges</b>		(42)
<b>Net assets</b>		189
<b>Capital and reserves</b>		
Class A fund units		108
Class B Exchangeable Units <sup>(iii)</sup>		81
<b>Unit holders' funds</b>		189
<b>c) Cash flow statement</b>		2002
Period from 17 to 31 December		£m
Cash inflow from operating activities		3
Taxation received		2
Acquisitions		(294)
Cash outflow before financing		(289)
Management of liquid resources		(3)
Financing		303
<b>Increase in net cash</b>		11

The Fund commenced operating on 17 December 2002 and accordingly no comparative information is available.

The initial public offering of units in the Fund closed on the Toronto Stock Exchange on 17 December 2002. At 31 December 2002 Centrica held a 42% interest in the Fund, through its wholly-owned subsidiary, Enbridge Services Inc, who hold 100% of the Class B Exchangeable units in Waterheater Holding Limited Partnership, a subsidiary of the Fund.<sup>(iii)</sup>

(i) Creditors (amounts due after more than one year) include bonds of C\$500 million gross of issue costs of C\$2 million.

The bonds bear a floating rate of interest and are repayable after four years. The bonds were issued by the Consumers' Waterheater Operating Trust (the Trust), a wholly-owned subsidiary of the Fund. The debt is secured solely on the assets of the Fund and its subsidiaries, without recourse to the Centrica group.

(ii) As disclosed in note 30, on 22 January 2003 the Trust issued C\$500m of bonds, the proceeds of which have been applied to repay the bonds in place at 31 December 2002. The bonds carry interest at a fixed rate and an expected final repayment date of between five and seven years. The issuer, guarantor and holders of this debt have acknowledged in writing that the notes do not represent obligations (as to principal or interest) of any person other than the issuer and each of the guarantors. Accordingly there is no recourse to the Centrica group.

(iii) Class B Exchangeable Units attract comparable voting rights to Units in the Fund, and are exchangeable into Units of the Fund. The Class B units are held by Enbridge Services Inc, a 100% owned subsidiary of the Centrica group.

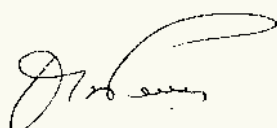
(iv) The goodwill balance eliminates on consolidation with the Centrica group. The summary financial information above has been prepared under UK generally accepted accounting practices (GAAP). Class A units in the Fund are traded on the Toronto stock exchange, and accordingly its full financial statements are prepared in accordance with GAAP in Canada. Under Canadian GAAP the Fund does not recognise a goodwill balance, and adjustments have been made under the purchase method of accounting, to allocate the excess consideration raised through the unit and debt offering to the fair value of the assets acquired by the Fund from Enbridge Services Inc.

(v) Creditors (amounts falling due within one year) include £11 million due to Enbridge Services Inc which eliminates on consolidation with the group.

# Company balance sheet

<b>Company balance sheet</b>		2002	2001
31 December	Notes	£m	(as restated) £m
<b>Fixed assets</b>			
Tangible assets	33	61	28
Investments:			
Subsidiary undertakings		1,023	788
Other investments		22	29
	34	1,045	817
		1,106	845
<b>Current assets</b>			
Debtors (amounts falling due within one year)	35	3,431	2,872
Debtors (amounts falling due after more than one year)	35	309	207
		3,740	3,079
Current asset investments	36	147	250
Cash at bank and in hand		316	-
		4,203	3,329
<b>Creditors (amounts falling due within one year)</b>			
Borrowings	37	(237)	(447)
Other creditors	38	(2,484)	(1,445)
		(2,721)	(1,892)
<b>Net current assets</b>		1,482	1,437
<b>Total assets less current liabilities</b>		2,588	2,282
<b>Creditors (amounts falling due after more than one year)</b>			
Borrowings	37	(518)	(493)
Other creditors	38	(205)	(205)
		(723)	(698)
<b>Provisions for liabilities and charges</b>	39	(33)	(36)
<b>Net assets</b>		1,832	1,548
<b>Capital and reserves – equity interests</b>			
Called up share capital	20	236	223
Share premium account	40	537	62
Profit and loss account	40	1,059	1,263
<b>Shareholders' funds</b>	41	1,832	1,548

The financial statements were approved by the board of directors on 20 February 2003 and were signed on its behalf by:



**Sir Michael Perry** CBE  
Chairman



**Phillip Bentley**  
Group Finance Director

The re-statement of the 2001 balance sheet is explained in note 34(iv).  
The notes on pages 65 to 67 form part of these financial statements, along with the accounting policies (note 1) and note 20.

# Notes to the company balance sheet

	Plant, equipment and vehicles £m
<b>33 Tangible fixed assets</b>	
<b>Cost</b>	
1 January 2002	64
Additions	45
Disposals	(7)
<b>31 December 2002</b>	<b>102</b>
<b>Depreciation and amortisation</b>	
1 January 2002	36
Charge for the year	9
Disposals	(4)
<b>31 December 2002</b>	<b>41</b>
<b>Net book value</b>	
<b>31 December 2002</b>	<b>61</b>
31 December 2001	28

No assets were held under finance leases (2001: £nil).

Amounts capitalised in respect of customer relationship management (CRM) infrastructure included within tangible fixed assets at 31 December 2002 were £26 million (2001: £nil).

	Investments in subsidiaries <sup>(i)</sup>			Total £m
	Shares £m	Loans £m	Own shares <sup>(iii)(iv)</sup> £m	
<b>34 Fixed asset investments</b>				
<b>Cost</b>				
1 January 2002 (as restated) <sup>(iv)</sup>	222	566	65	853
Additions <sup>(ii)</sup>	–	608	–	608
Disposals <sup>(ii)</sup>	–	(283)	(14)	(297)
Exchange adjustments	–	(90)	–	(90)
<b>31 December 2002</b>	<b>222</b>	<b>801</b>	<b>51</b>	<b>1,074</b>
<b>Amounts written off</b>				
1 January 2002 (as restated) <sup>(iv)</sup>	–	–	(36)	(36)
Amortisation under long term incentive schemes	–	–	(7)	(7)
Disposals	–	–	14	14
<b>31 December 2002</b>	<b>–</b>	<b>–</b>	<b>(29)</b>	<b>(29)</b>
<b>Net book value</b>				
<b>31 December 2002</b>	<b>222</b>	<b>801</b>	<b>22</b>	<b>1,045</b>
31 December 2001 (as restated) <sup>(iv)</sup>	222	566	29	817

(i) Investments comprise £1,023 million (2001: £788 million) of investments in subsidiary undertakings, being shares in subsidiaries of £222 million (2001: £222 million) and loans of £801 million (2001: £566 million), and own shares at cost of £51 million (2001 as restated: £65 million) to the Centrica Employees Share Trust.

(ii) An investment of £434 million was made during the year in Enbridge Services Inc. Following the establishment of the Consumers' Waterheater Income Fund, a repayment of part of the original investment of £283 million was made (note 32). Additional investments were also made in Centrica America Limited and Centrica Finance US Limited during the year.

(iii) The Centrica Employees Share Trust held 27 million (2001: 39 million) ordinary shares in the company. This represented 0.64% of the called up ordinary share capital (2001: 1%), which had a market value at 31 December 2002 of £47 million and a nominal value of £2 million (2001: £88 million and £2 million respectively). During the year 12,213,398 shares were transferred from the trust with respect to awards held by employees of the company and its subsidiaries.

(iv) In 2001 the company balance sheet showed the loan to the Centrica Employees Share Trust (£69 million) within fixed asset investments. This year the balance sheet has been restated to reflect the substance of the arrangements with the trust, whereby Centrica shares are held by the trust for the purpose of fulfilling awards to employees of Centrica plc and its subsidiaries under the long term incentive scheme. The balance sheet of the trust has therefore been consolidated with that of the company. This treatment is consistent with UITF 13 ESOP Trusts. £18 million of the amortisation carried forward has not been charged through the profit and loss account, but is included in amounts owed by group undertakings in note 35, as it reflects amounts recoverable from subsidiaries for awards due to their employees. At 31 December 2001, the amount owed by group undertakings relating to amortisation was £27 million, of which £16 million was due after more than one year. Debtors have been restated accordingly in note 35. Provisions have also been restated in note 39, reducing the 31 December 2001 balance by £13 million. Amounts previously included within provisions related to long term incentive scheme costs for company employees. These have now been included above within amortisation brought forward. The operation of the long term incentive scheme is described more fully in the remuneration report on page 26.

## Notes to the company balance sheet continued

	2002		2001 (as restated) <sup>(i)</sup>	
	within one year £m	after one year £m	within one year £m	after one year £m
<b>35 Debtors</b>				
Amounts owed by group undertakings <sup>(ii)</sup>	3,360	309	2,837	190
Deferred corporation tax	–	–	–	17
Other debtors	55	–	24	–
Prepayments and other accrued income	16	–	11	–
	<b>3,431</b>	<b>309</b>	<b>2,872</b>	<b>207</b>

- (i) A total of £18 million (2001: £23 million) is included relating to the accumulated cost of shares expected to be released to employees of subsidiaries under the long term incentive scheme.  
(ii) Explanation of the restatement is given in note 34(iv).

	2002 £m	2001 £m
<b>36 Current asset investments</b>		
Money market investments	147	250
£10 million (2001: £9 million) of money market investments were held by the Law Debenture Trust, on behalf of the company, as security to cover unfunded pension liabilities.		

	2002		2001	
	Within one year £m	After one year £m	Within one year £m	After one year £m
<b>37 Borrowings</b>				
<b>Amounts falling due</b>				
Bank loans and overdrafts	–	–	140	–
Bonds <sup>(i)</sup>	–	518	–	493
Commercial paper	237	–	307	–
	<b>237</b>	<b>518</b>	<b>447</b>	<b>493</b>

- (i) Bonds are sterling denominated and repayable as follows: between one and two years £nil (2001: £nil); between two and five years £125 million (2001: £100 million); and after five years £400 million (2001: £400 million). The bonds bear interest at fixed rates between 5.375% and 5.875% (2001: between 5.375% and 5.875%). The bonds have a face value of £525 million (2001: £500 million) and are stated net of £7 million (2001: £7 million) of issuance discount.

	2002		2001	
	Within one year £m	After one year £m	Within one year £m	After one year £m
<b>38 Other creditors</b>				
<b>Amounts falling due</b>				
Trade creditors	28	–	25	–
Amounts owed to group undertakings	2,239	205	1,255	205
Other creditors	16	–	10	–
Accruals and deferred income	91	–	79	–
Dividend payable	110	–	76	–
	<b>2,484</b>	<b>205</b>	<b>1,445</b>	<b>205</b>

	1 January 2002 (as restated) <sup>(ii)</sup> £m	Profit and loss charge £m	Utilised in the year £m	31 December 2002 £m
<b>39 Provisions for liabilities and charges</b>				
Pension costs <sup>(i)</sup>	12	9	(12)	9
Other <sup>(ii)</sup>	24	5	(5)	24
	36	14	(17)	33

Potential unrecognised deferred corporation tax assets amounted to £29 million (2001: £10 million).

- (i) The pension cost provision includes the difference between charges to the profit and loss account and the contributions paid to the pension schemes in respect of retirement pensions and other related benefits.  
(ii) Other provisions principally represents estimated liabilities for restructuring, outstanding litigation and National Insurance in respect of long term incentive scheme liabilities. The National Insurance provision was based on a share price of 171 pence at 31 December 2002 (2001: 222 pence).  
(iii) Explanation of the restatement is given in note 34(iv).

	Share premium account £m	Profit and loss account <sup>(i)</sup> £m	Total £m
<b>40 Reserves</b>			
1 January 2002	62	1,263	1,325
Retained loss for the year <sup>(i)</sup>	–	(200)	(200)
Exchange translation differences <sup>(ii)</sup>	–	(6)	(6)
Shares to be issued under long term incentive scheme <sup>(iii)</sup>	–	2	2
Issue of ordinary share capital (note 20)	475	–	475
<b>31 December 2002</b>	<b>537</b>	<b>1,059</b>	<b>1,596</b>

- (i) As permitted by section 230(3) of the Companies Act 1985, no profit and loss account is presented. The company's loss for the financial year was £28 million (2001: £11 million profit).
- (ii) Exchange gains of £84 million (2001: £18 million) on foreign currency borrowings have been offset in reserves against exchange losses, of £90 million (2001: £18 million), on the cost of investments in overseas undertakings.
- (iii) The company intends to fund certain of its long term incentive schemes through the issue of new shares when these schemes vest. The amount shown represents the expected value of the shares to be issued using the market price at the date allocations were granted.

	2002 £m	2001 £m
<b>41 Movement in shareholders' funds</b>		
1 January	1,548	1,644
(Loss)/profit attributable to the company	(28)	11
Dividends	(172)	(124)
Exchange translation differences	(6)	–
Issue of shares net of issue costs	488	17
Shares to be issued under long term incentive scheme	2	–
Net movement in shareholders' funds for the financial year	284	(96)
<b>31 December</b>	<b>1,832</b>	<b>1,548</b>

#### 42 Commitments and contingencies

##### a) Capital expenditure

At 31 December 2002, the company had placed contracts for capital expenditure amounting to £5 million (2001: £1 million).

##### b) Lease commitments

At 31 December 2002, there were £1 million of land and building operating lease commitments in relation to non-cancellable operating leases for the company (2001: £2 million). The company has guaranteed operating commitments of a subsidiary undertaking at 31 December 2002 of £8 million (2001: £4 million) in respect of land and buildings.

There were no commitments at 31 December 2002 under finance leases entered into, but for which inception occurs after 31 December 2002 (2001: £nil) for the company.

##### c) Guarantees and indemnities

Refer to note 27(f).



## Gas and liquids reserves

The group has estimated proven and probable gas reserves in the UK and North America and estimated proven and probable liquid reserves in the UK. Estimates are made by management.

The principal fields in the UK are South Morecambe, North Morecambe, Galleon and Armada. The principal fields in North America are Medicine Hat and Entice.

<b>Estimated net proven and probable reserves of gas (billion cubic feet)</b>	UK	North America	Total
1 January 2002 (as restated) <sup>(i)</sup>	2,786	446	3,232
Revisions of previous estimates	(14)	(6)	(20)
Purchases of reserves in place	134	1	135
Production	(399)	(37)	(436)
Sales of reserves in place	(65)	–	(65)
<b>31 December 2002</b>	<b>2,442</b>	<b>404</b>	<b>2,846</b>

(i) Estimated net proven and probable reserves of gas at 1 January 2002 have been restated to include non-producing assets which were previously excluded. The impact of the restatement is to increase net proven and probable gas reserves in the UK by 55 billion cubic feet.

<b>Estimated net proven and probable reserves of liquids (million barrels)</b>	UK	North America	Total
1 January 2002	9	4	13
Revisions of previous estimates	2	–	2
Purchases of reserves in place	1	–	1
Production	(2)	–	(2)
Sales of reserves in place	(7)	–	(7)
<b>31 December 2002</b>	<b>3</b>	<b>4</b>	<b>7</b>

Liquid reserves includes condensate, propane, butane and oil.

## Five year summary

<b>Results</b>					
Year ended 31 December	1998 £m	1999 £m	2000 £m	2001 £m	2002 £m
Turnover	7,481	7,217	9,933	12,611	14,315
Operating profit/(loss) before exceptional charges and goodwill amortisation, including share of joint ventures and associates:					
British Gas residential			164	(46)	244
Centrica Business Services			36	44	65
Centrica energy management group (CEMG)			308	573	520
	262	476	508	571	829
The AA	–	3	19	72	73
Goldfish Bank	(12)	(14)	(15)	(32)	(40)
One.Tel	–	–	–	4	2
Centrica North America	–	–	8	68	63
Other operations	(37)	(41)	6	(4)	5
	213	424	526	679	932
Exceptional items	(85)	(136)	(14)	(80)	(35)
Goodwill amortisation	–	(13)	(60)	(88)	(123)
Profit attributable to the group	91	182	335	323	478
	Pence	Pence	Pence	Pence	Pence
Earnings per ordinary share	2.1	4.3	8.4	8.1	11.4
Adjusted earnings per ordinary share <sup>(i)</sup>	4.0	7.9	10.2	12.1	15.2
<b>Cash flows</b>					
Year ended 31 December	1998 £m	1999 £m	2000 £m	2001 £m	2002 £m
Cash inflow from operating activities before exceptional payments	870	1,453	1,139	869	733
Exceptional payments	(211)	(135)	(76)	(44)	(16)
Acquisitions and disposals	(101)	(1,162)	(590)	(607)	(935)
Cash inflow/(outflow) before use of liquid resources and financing	332	(690)	55	(342)	(918)
<b>Assets and liabilities</b>					
as at 31 December	1998 £m	1999 £m	2000 £m	2001 £m	2002 £m
Intangible fixed assets	10	992	1,309	1,524	1,813
Tangible fixed assets and fixed asset investments	1,937	1,913	1,993	2,225	2,865
Net current assets/(liabilities)	421	(346)	(469)	(397)	(108)
Long term creditors and provisions	(1,483)	(1,592)	(1,535)	(1,816)	(2,168)
Net assets	885	967	1,298	1,536	2,402
(Debt), net of cash and money market investments:					
Goldfish Bank	–	–	–	(610)	(430)
Other businesses – non-recourse debt	–	–	–	–	(196)
Other businesses – recourse debt	223	(127)	(117)	(433)	(529)
	223	(127)	(117)	(1,043)	(1,155)

Prior year numbers have been restated, as far as practicable, to reflect the revisions to the activities in the different segments that took place during the year, as disclosed in note 3 to the financial statements. The analysis between British Gas residential, Centrica Business Services and Centrica energy management group is not available for 1998 and 1999.

Prior years have been restated for changes in accounting policies. 1998 and 1999 were restated on implementation of FRS 12 Provisions, contingent liabilities and contingent assets in 1999. On implementation in 2001 of FRS 19 Deferred Tax and mark to market accounting for energy trading derivative financial instruments, values for 2000 were restated but not those for 1998 and 1999.

Goldfish Bank included certain financial service activities under the British Gas brand until 1 April 2000. From that date, the activities transferred to AA personal finance.

(i) Adjusted earnings per share exclude exceptional charges and goodwill amortisation.

# Information for shareholders

## Financial calendar

Ex-dividend date for 2002 final dividend	30 April 2003
Record date for 2002 final dividend	2 May 2003
Annual general meeting, International Convention Centre, Birmingham	12 May 2003
Final dividend payment date	18 June 2003
2003 interim results announced	31 July 2003
Interim dividend payment date	12 November 2003

## Centrica shareholder helpline

Centrica's shareholder register is maintained on our behalf by Lloyds TSB Registrars who are responsible for making dividend payments and updating the register, including details of changes to shareholders' addresses and purchases or sales of Centrica shares. If you have a question about your shareholding in Centrica, you should contact:

Centrica shareholder helpline: 0870 600 3985  
Text phone: 0870 600 3950  
Write to: Lloyds TSB Registrars  
The Causeway, Worthing  
West Sussex BN99 6DA

## Frequent shareholder enquiries

### If you change your address

Please notify Lloyds TSB Registrars, in writing. If shares are held in joint names, the notification must be signed by the first named shareholder. The form is also available to download from our website.

### If you change your name

Please notify Lloyds TSB Registrars in writing and enclose a copy of your marriage certificate or change of name deed as evidence.

### Lost Centrica share certificate

If your share certificate is lost or stolen, you should call the Centrica shareholder helpline immediately. A letter of indemnity will be sent to you to sign. Lloyds TSB Registrars will charge for this service.

### Duplicate shareholder accounts

Shareholders who receive more than one copy of Centrica communications may have shares registered inadvertently in at least two accounts. This happens when the registration details of separate transactions differ slightly. If you wish to combine your accounts, call the Centrica shareholder helpline to request an account combination form. The form is also available to download from our website.

### Buying and selling shares in the UK

If you wish to trade in Centrica shares, you will need to use a stockbroker or High Street bank which trades on the London Stock Exchange. There are many telephone and online services available. If you are selling, you will need to present your share certificate at the time of sale.

### Transferring Centrica shares

Transferring shares to someone else requires the completion of a stock transfer form. This form, and details of the procedure you need to follow, are available from the Centrica shareholder helpline. Stamp duty is not normally payable if the transfer is to a relative or if there is no money being paid in exchange for the shares.

## Direct dividend payments

The two dividends each year (see Financial calendar) can be paid automatically into your bank or building society account. This service has a number of benefits:

- there is no risk of the dividend cheque going missing in the post;
- the dividend payment is received more quickly as the cash is paid directly into the account on the payment date without the need to pay in the cheque and wait for it to clear; and
- a single consolidated tax voucher is issued at the end of the tax year in March, in time for your self-assessment tax return.

Arranging your dividend payment in this way also helps Centrica improve its efficiency by reducing postage and cheque clearance costs. If you wish to register for this service, call the Centrica shareholder helpline to request a direct dividend payment form. The form is also available to download from our website.

## The Centrica website

The Centrica website at [www.centrica.com](http://www.centrica.com) provides news and details of the company's activities, plus information on the share price and links to our brand sites.

The investor information section of the website contains up-to-date information for shareholders including the company's latest results and key dates such as dividend payment dates. It also holds details such as past dividend payment dates and amounts, and a comprehensive share price information section. Visit [www.centrica.com/investors](http://www.centrica.com/investors).

## Electronic communications

Shareholders who prefer to receive communications from Centrica electronically are encouraged to register their email address via the investor section of our website. The company's annual report is available on the Centrica website and, by registering, shareholders will receive an electronic notification when the company's annual reports and notices of general meetings become available. Shareholders are also able to complete and return voting papers for the company's AGM electronically. Registration is free and easy to complete. All that is required for registration is the shareholder reference number which is shown on your tax vouchers and share certificates. Once you are registered, you may also look up a range of information including the number of Centrica shares you hold, the registered name and address details and information held for dividend payment instructions.

## Share price information

The Centrica share price, and historical details, may be viewed on our website. Shareholders can find share prices listed in most national newspapers. Ceefax and Teletext pages also display share prices that are updated regularly throughout the trading day. For an accurate buying or selling price, you should contact a stockbroker or High Street bank.

## ShareGift

ShareGift is a charity share donation scheme for shareholders administered by the Orr Mackintosh Foundation. It is especially for those who may wish to dispose of a small parcel of shares whose value makes it uneconomic to sell on a commission basis. Further information can be obtained at [www.sharegift.org](http://www.sharegift.org) or from the Centrica shareholder helpline.

### Useful historical information

#### Demerger

Centrica plc traded on the London Stock Exchange for the first time on 17 February 1997, the date of demerger from British Gas plc. Shares were acquired in Centrica on the basis of one Centrica share for every British Gas plc share held at demerger. Shares in Centrica, acquired at demerger, are treated as having a base cost for Capital Gains Tax purposes (calculated in accordance with taxation legislation) of 64.25 pence each.

#### Share capital consolidation

On 10 May 1999, the ordinary share capital of Centrica was consolidated on the basis of nine new ordinary shares of 5<sup>2</sup>/<sub>3</sub> pence for every ten ordinary shares of 5 pence held on 7 May 1999. The consolidation was linked to the payment of a special dividend of 12 pence per share on 23 June 1999.

#### Shareholder benefits

A series of updated benefits on selected products and services from across the group has recently been introduced. Our major brands British Gas, Scottish Gas, The AA, Goldfish and One.Tel are all featured in these offers.

To request a brochure, please call the Centrica shareholder helpline or visit the shareholder benefits page of our website. If you have not previously registered, you will be asked to give your shareholder reference number in order to participate.

#### Overseas dividend payments

A service has been established to provide shareholders in over 30 countries worldwide with the opportunity to receive Centrica dividends in their local currency. For a small flat rate fee, shareholders can have their dividends automatically converted from Sterling and paid into their bank account, normally within five working days of the dividend payment date. For further details, please contact the Centrica shareholder helpline on +44 (0)121 415 7061.

#### American Depositary Receipts

Centrica has an American Depositary Receipt (ADR) programme. The ADRs, each of which is equivalent to 10 ordinary Centrica shares, trade under the symbol CNTCY. For enquiries, please contact:

ADR Depositary  
The Bank of New York  
Investor Relations  
PO Box 11258, Church Street Station  
New York, NY 10286-1258

email: [shareowner-svcs@bankofny.com](mailto:shareowner-svcs@bankofny.com)  
or via [www.stockbny.com](http://www.stockbny.com)

Telephone: 1 888 BNY ADRs in the US or 00 1 601 312 5315 from outside the US.

[www.adrbny.com](http://www.adrbny.com)

### Analysis of shareholders at 31 December 2002

Distribution of shares by the type of shareholder	Holdings	Shares
Nominees and institutional investors	13,164	3,690,106,609
Individuals	1,237,668	562,749,805
<b>Total</b>	<b>1,250,832</b>	<b>4,252,856,414</b>

Size of shareholding	Number of holdings	Shares
1 – 500	948,162	235,077,877
501 – 1,000	198,428	136,561,533
1,001 – 5,000	95,686	163,119,619
5,001 – 10,000	5,051	34,965,321
10,001 – 50,000	1,902	37,839,904
50,001 – 100,000	350	25,249,965
100,001 – 1,000,000	852	294,018,102
1,000,001 and above	401	3,326,024,093
<b>Total</b>	<b>1,250,832</b>	<b>4,252,856,414</b>

# Index

---

- Accounting policies **18, 35-37**
- Acquisitions and disposals **22, 50-53, 57**
- Auditors
  - appointment **23**
  - remuneration **40**
  - report to the members of Centrica plc **31**
- Automobile Association (the AA) **3, 4, 5, 6, 10-12**
- Balance sheets
  - company **64**
  - group **33**
- Board of directors **4, 21, 23**
- Borrowings **46, 66**
- British Gas **2, 4, 5, 7-9**
- Capital expenditure **54, 57, 67**
- Capital gains tax information **71**
- Cash flow
  - review **16-17**
  - statements **34**
  - notes **53-54**
- Centrica Business Services **2, 6, 9**
- Centrica energy management group **2, 9-10**
- Chairman's statement **4**
- Charitable and political donations **23**
- Chief executive's review **5**
- Combined Code on Corporate Governance **23, 25**
- Commitments and contingencies **57, 67**
- Committees **21, 23-24**
- Community **19-20**
- Consumers' Waterheater Income Fund **22, 63**
- Corporate governance **23-24**
- Corporate responsibility **4, 19-20, 23**
- Cost of sales **35, 40**
- Credit rating **17**
- Creditor payment policy **22**
- Creditors **47, 66**
- Current asset investments **46, 66**
- Customer service **5**
- Debtors **46, 66**
- Decommissioning costs **36, 47, 57**
- Deferred tax **47**
- Demerger **71**
- Depreciation and amortisation **44**
- Directors
  - biographies **21**
  - emoluments **27**
  - pensions **27-28**
  - re-election **23**
  - remuneration policy **25, 27**
  - service contracts **26**
  - share interests **28, 30**
- Directors' report **22**
- Directors' responsibilities statement **31**
- Dividend **4, 22, 43, 70**
- Earnings per ordinary share **1, 16, 32**
- Electricity **8, 9, 10**
- Employees
  - average number during the year **22, 41**
  - costs **41**
  - policies **6, 20, 22**
- Energy America **3**
- Energy trading **37**
- Environment **19**
- Europe **3, 4, 15**
- Exceptional charges **16, 40**
- Financial calendar **70**
- Financial instruments **37, 59-62**
- Financial review **16-18**
- Financial risk management **17-18**
- Fixed assets **17, 35-36, 44-45, 65**
- Five year summary **69**
- Gas production **9-10**
- Gas purchase contracts **58**
- Gas reserves **68**
- Goldfish Bank **3, 5, 6, 12-13, 17**
- Goodwill **16, 44**
- Group earnings **16**
- Guarantees and indemnities **57, 67**
- Health and safety **20**
- Interest **16, 32, 41**
- Internal control **24**
- Lease commitments **57, 67**
- Litigation **57**
- Movement in shareholders' funds **49, 67**
- Net debt **17**
- North America **3, 13-15**
- Operating costs **32, 40**
- Operating profit **1, 5, 16, 32**
- One.Tel **3, 12**
- Operating and financial review **7-15**
- Pensions **55-56**
- Petroleum Revenue Tax **6, 10, 16, 42, 47**
- Post balance sheet events **22, 62**
- Principal activities **22**
- Principal undertakings **62**
- Profit and loss account **32**
- Provisions for liabilities and charges **17, 47-48, 66**
- Related party transactions **58**
- Remuneration report **25-30**
- Reserves **49, 67**
- Restructuring costs **47**
- Sales contract loss & renegotiation provisions **48**
- Segmental analysis **38**
- Shares
  - analysis of shareholders **71**
  - called up share capital **48**
  - issue of share capital **17, 48**
  - material shareholdings **23**
  - prices **30**
- Shareholder information **70-71**
- Share schemes
  - All-employee **22-23, 35, 48**
  - Executive **25-26, 30, 48**
  - Long term incentive scheme **26, 28-29, 48**
- Statement of total recognised gains and losses **34**
- Stocks **36, 46**
- Strategy **4, 5-6**
- 'Take or Pay' contracts **36, 48**
- Taxation **16, 36, 42**
- Website **70**
- Working capital **17**





**If you would like this annual report in an appropriate alternative format, such as large print, Braille or cassette, please call us on 0870 600 3985. Alternatively if you have a text phone, please make your request on 0870 600 3950.**

**You may view a fully accessible online version of this annual report on our website [www.centrica.com](http://www.centrica.com) It can be customised to suit your own viewing preferences.**

Centrica plc  
Company registered  
in England and Wales No. 3033654

Registered office:  
Millstream  
Maidenhead Road  
Windsor  
Berkshire SL4 5GD

Tel: 01753 494000  
Fax: 01753 494001

[www.centrica.com](http://www.centrica.com)