**Centrica Trading Update Conference Call**
**Friday 16th December 2005**
**08:00 UK Time**
Chaired By Phil Bentley

**Phil Bentley**

Morning everyone. I'm joined by Kath Kyle here in Windsor today. If I just start by just ticking off some of the key highlights of the statement, then we'll turn it over to questions as normal.

As you can see we are confirming that full year group earnings will be in line with consensus. I think I'm right in saying the consensus is around £644m of earnings and about 17.5p earnings per share. You've seen obviously gas prices remains a key issue for us and we've given guidance there around our WACOG which will be around 37% higher than '04. Just to put it in context, the market is up about 50% and that will equate to a WACOG for us around 35p per therm. In electricity WACOE will be up about 30%, which will be just under £38 per megawatt hour, and again the market is up 43%. So that gives you some sense of some of the hedges that we've put in place. But obviously we are flagging that BGRE, whilst it will be profitable in '05, will be less profitable than it was in '04. Just to put that in context we made £242m in '04, £165m in 1H so obviously we will be looking at losses in the second half of the year but obviously it's still a profit in the full 12-month period.

Costs are a key issue for us and we're announcing today not specific numbers around job reductions, but we have been reviewing our corporate and support activities. Just to give you a sense, I mean at our headquarters we're looking to reduce numbers by about 40% by the end of 2006 and we are actually in the middle of that and people I'm afraid, are being told at this time that their roles will no longer be required. But the upside if you like is that we are more confident that we can increase the British Gas savings between '04 and '07, the op cost savings. We've increased £150m op cost savings now to £180m. There are obviously one off charges to cover both the 2000 job reductions in British Gas announced earlier and then the further corporate and support reductions. They're about £60m on a post tax basis. We do have other offsetting positives on exceptionals and I suspect that overall that'll more or less net out close to zero.

British Gas managing the sales activity, that's been absolutely critical. You saw with increased marketing and sales we probably added about £20 to £25 million of extra activity there. But we think it's been very successful. We are growing sales now. We're actually close to record sales ever in British Gas averaging over 70,000 gross sales a week. We've sold over a million of the 2010 fixed price products. That's the product that we launched only in September. It's been our best ever selling product and you can see the impact of that. We have actually grown electricity customers, which is very positive indeed. And actually overall we expect to lose net probably around 150-160,000 in the second half, and that compared with over 500,000 in the first half and 760,000 in the same period in 2004.

The billing system. We're on track there. Should be doing the first major migration as planned towards the end of the year.

Home Services. Good growth across the product range. Single digit growth in products and turnover. But that obviously, as we've said, before because of the operational leverage translates to a much bigger uplift in profitability. '04 profitability was £72m. Profitability in '05 will be materially up on that.

BGB, British Gas Business, performing pretty well actually. Second half flat on '04. We were about £22m in the second half of '04. But we will be up on the year as a whole. We did £68m in total. We tend to generate more profit in the first half than the second half, but what we look at is retention and selling, particularly around some of the autumn tenders that have got some of these large non-domestic customers. Some of the councils for example. We had a pretty successful round as bidding there and so churn is actually low single digits now in both gas and electric. Lower than last year and we are growing turnover. Not all that turnover flows through to profitability at the moment because as you know we are investing quite heavily on pulling together all our billing systems and process re-engineering so that frankly we won't see the full benefits of until the second half of '06, beginning of '07.

Production at Morecambe Bay. We've given guidance between 20-25%. It's definitely going to be down a little bit more than that. That's not operational issues or difficulties. That's simply because we've actually been shutting in production, certainly in the autumn period when we saw softer prices. So just as British Gas if you like has benefited from the lower cost of gas, particularly around September, October and even November, outturned out lower than we expected. It meant that we did shut in production and we even shut in production at the beginning of November when it was pretty mild. I know everyone thinks that the coldest snap is at the end of November but we were actually shutting in production. So that doesn't signal any real concerns for the field going forward. Obviously we are getting increased production from some other fields, but recognise that PRT chews away with the increased CT 75% of the profitability of Morecambe Bay.

I&W I'm afraid is still pretty painful for us. The weighted average selling price has gone up, but again the weighted average cost of gas has gone up even more. But volumes are beginning to fall now as some of those contracts run off. Volumes will be down about 15% that we're selling out.

Storage. Obviously a very good year. Good reliability during the injection period, and we've been able to maintain reservoir pressure and sell out some of the cushion gas, 30 million therms. We simply don't need that gas in the field now to continue deliverability given the improvements and investments that we've made. So that's 30 million at 70p. That's £20 million additional straightaway. But we will be significantly up in the second half. I mean we did £57m in the first half. We'll do materially more than that in the second half and obviously with prices higher than 2004 we will be materially above the £69m that we reported in 2004. So that frankly will be more than double profitability.

North America. We had the seminar the other week. Hopefully gave some sense of the growth opportunities there. We got through the hurricane season in Texas unscathed regarding our hedges, and we've successfully refiled now and overall we see profitability in the second half probably a touch higher than the first half. We did £87 million in the first half. We did £132 million in the whole of '04. So you'll see again significant uplift in North America.

Europe. You'll have read we're trying to be a little bit more vocal about transportation transparency amongst other things. When we saw UK prices a day ahead at £1.30 at the end of November there was gas in Holland and Germany at 40p that couldn't be shipped to the UK, and the interconnecter was running at a third capacity. And we need to put pressure on government to produce some more liberalisation initiatives so that gas can flow. Clearly that's important for us going further forward.

Onetel. Nothing much to say there. We're continuing discussions.

We're continuing the buyback second tranche. We spent about £87 million in the start of the second tranche. We would expect to do an irrevocable during close period as we've done before.

Dividends as we said we expected to increase materially in 2004 in line with our commitment to lift our payout ratio.

2006 obviously price again is a big issue there. If we look today at the prices for '06 versus '05 this is market not volume weighted. Electricity prices are some 52% higher '06 on '05. Gas prices are some 72% higher in '06 than '05. But obviously that's not the exposure that we have because obviously we've been hedging in throughout the period. But obviously I think we're all looking at suppliers to put pricing through. I think a number of our competitors have already hinted at it, and clearly our policy is to recover over time the wholesale price of energy. And that's an issue that obviously we're all going to have to grapple with as an industry in 2006.

Morecambe Production. We're giving guidance there. I think we'd said between 25-30%. Because we've produced less in '05 we can produce more in '06 and so we're expecting that to be down between 20-25% based on '05. And obviously incremental production we'd said offset close to half, but it'll be about 40% offset at that time. Obviously the Chancellor didn't do us any favours the other week. As I said we're effectively taxed now on our upstream to the tune net of 75%. We are looking at whether we can mitigate some of that and if we can we'll make announcements to that effect.

The rest of the progress in 2006 is going to be around cost. Driving home the cost reduction initiatives, going fully live with the British Gas systems, process re-engineering the back offices, and driving on to bring home that advantaged cost base in 2007. We are seeing growth outside of the UK core energy. We see growth as we say in North America, in Europe, in home services. I think we'll be more confident to give earnings guidance when we meet again in end of February at the prelims results when we'll have got through January, February and have a fairly good sense of how March is going to shape up and then again what our pricing plans potentially may well be. So those will be the key to the earnings delivery in '06.

At that point if I may hand back to the operator for questions. Thanks.

## Questions & Answers

**Iain Turner, Deutsche Bank**
Good morning Phil. In the statement you say that customer churn has been a bit less than you, much less than you'd expected. And I think it's probably fair to say that last year customer churn was a bit more than you were expecting in response to your two price rises last year. Have you got any idea what's sort of going on in, in customer's minds? Can you give us any colour on how you're thinking of it in terms of the way customers behave?

**Phil Bentley**
That's obviously the key question. I think what is certain is that customers believe that the days of cheap energy are over and therefore there has been certainly a push to locking in on fixed price deals as we see evidence by the million products that we sell there. I think there's a view that if I switch to another supplier they're only going to put their prices up aren't they? So I just think that we're getting the message that is pricing is driven fundamentally by wholesale markets. This is a commodity offer and frankly there isn't a lot to choose over the long run in pricing because we all face the same wholesale prices. So I think maybe there's some fatigue there as well, I switched before and actually they put my price up. Why bother? And actually if you've got good offers, we've got the best fixed price. We're the only ones offering out to 2010. Those are certainly attractive to customers.

We're all raising prices. I think SSE have hinted they will need price rises again in '06. Powergen, when they raised prices last year said they need to put prices up. We think they put prices through to new customers 12% in the last week. It's never on the front pages unfortunately when they do it, but we're pretty certain they've put prices up 12% again and that's after the September price rise they announced. So price rises are already filtering through. The SSE one is now effective in January. So people are raising prices.

**Bobby Chada, Morgan Stanley**
Morning. I had a couple of questions if possible? Could you say if you've seen any significant impact in terms of volumes? Say the weather was milder than you expected so has there been a subsequent volume issue from that? And could you also give some feel for how you see industrial and wholesale developing in 2006?

**Phil Bentley**
It has been again on average a warm year. November we had that cold snap. November I think averaged about two degrees colder than SNT. Was warmer at the beginning and much colder at the back. And now with the low SNT we're above in temperature terms SNT again looking forward over the next ten day forecast. So generally volume I think will be down. And obviously in some ways we don't mind that at this stage because quite frankly these, the wholesale prices that we're seeing at the moment at the margin incremental volume is loss making for us given you know given where the market has moved. So volume will be down.

I&W. Without giving absolute numbers I think volumes will be down slightly again. But the price differential is still lagging and therefore overall losses will be up again.

**Monica Echwe, AFX News**
Oh hi. Good morning Phil. Just to clarify your statement about the job losses at the headquarters, can you give me a specific number please? How many people how many people will actually go as part of this second wave of, next wave of job reductions?

**Phil Bentley**
We haven't come out with an absolute number. This is something that we work on over time. For example, in finance we've put in new SAP systems that are integrating ERP with HR and procurement. And so jobs drop out over time as these systems are put in place. We've got some efficiencies around corporate affairs. We've got efficiencies around IS. We've been letting a number of contractors go for example, and it's just an ongoing programme of driving efficiencies. So there isn't a hard number that we've come out with.

**Monica Echwe**
Contracts… I'm sorry. Just to clarify you said that 30% of those numbers at your headquarters. So how many people do you have in your headquarters right now? And how many of them…? I mean just to give me an idea what the figures will be like.

**Phil Bentley**
As I said, that was over a period that will take us through to the end of 2006 and it depends what you include in the number. If I include all our shared services activities for HR and finance and systems then it's over 1000 people. But it depends what you include in the number. As I said we haven't given a full number.

**Ian Mitchell, JP Morgan**
Thanks. Morning Phil. Just a very quick couple of numbers questions. Given some of the movements we've had obviously in the upstream production forecasts, could you give us some guidance as to what you expect for the tax rate this year and, and next if possible? And then also on the extra £30m of savings, which you talked about? Obviously good news. Can you give us a bit of a view on the timing of when those will feed through? Thanks.

**Phil Bentley**
We're always looking at tax planning there, and I think you know we've given guidance this year for around 55%. Overall it may come in at a tad lower than that. Maybe 51-52%. But obviously we're going to be close to that 55% again next year because effectively the extra 10% post PRT calculates out at an extra 5 percentage points uplift. So I think if you're around 55% next year with the tax plan that we've got in place you'll be in the right sort of ballpark.

The £150-£180 to be honest you'll see more of that in '07 than '06. We've got the costs of getting headcount out and as I was saying earlier in that previous question that phased over a period of time. So you really won't get the clean run rate probably towards the end of '06 and therefore you'll get a full year benefit in '07.

**Kate McKenzie, Financial Times**
Oh hello. Have you had any more expressions of interest about Onetel?

**Phil Bentley**
Well we're right in the middle of the process at the moment Kate. So it would be totally inappropriate for me to comment on it. We're in a process. We'll let you know when we're at the end of it.

**Kate McKenzie**
Okay. You're discussing with the existing one bidder though or have there been any signs of interest from anyone else?

**Phil Bentley**
I certainly have never commented on how many bidders we have. We're in the middle of a process and certainly where I worked before we'd never comment during the process.

**Andrew Wright, UBS**
Morning. Just a couple of questions. First of all could you give your diagnosis of what's happening in European gas markets at the moment? Why gas isn't flowing from central Europe to Zeebrugge? And do you think it's active anti-competitive behaviour, do you think it's just that the markets aren't functioning very well to do with transport? I'd be interested to know what your interpretation is. Also just looking forward on gas markets. The expansion of the interconnector has been a bit disappointing and it's been backed on lowering prices, and we've got several bits of new infrastructure coming in hopefully before the start of next winter such as the BBL pipeline, Langeled and further interconnector expansion. Are you more confident that this infrastructure investment will be more effective in getting some of the cheaper central European gas over into the UK? And just a last question on tax again. You mentioned potential mitigation. I mean how firm is that? And you know what sort of things are you thinking of doing, and what sort of effect might you have on your tax bill from those mitigation activities?

**Phil Bentley**
Okay. European flows… it's quite difficult because we don't see the transparency in terms of capacity flowing, particularly from Bunde and Emden which is the if you like the Midal North German pipeline that comes in at the top of Holland, where there is capacity constraints. And also Eynatten as well, which is the, the Belgian/German border that gets the southern Megal line through from Russia at the bottom. We don't see… We just do not know you know where some of those bottlenecks are and exactly how much capacity is available, and what is flowing. We don't know whether it's full. We suspect it isn't. We suspect that storage is being kept topped up in both France and Germany in particular, and that's why gas isn't flowing. Now, I guess in Holland it's quite… You know there are bottlenecks between Holland and Zeebrugge there that don't necessarily help us at the moment, and there needs to be some more capacity expansion there to flow.

So I think the point you make is a good one on Europe is that the inter-connector will, flows will be dependent on bottlenecks and monopoly companies' behaviour around supplier of last resort pressures in local countries. So that won't go away overnight and we'd agree with that. And that's why we're pushing hard for use it or lose it regulations across pipeline transparency of capacity availability etc. And that's why we're pushing Europe for that.

The other point then about the new infrastructure and again we've got a good line of sight on both BBL and Ormen Lange because we're an off taker on those, and reception services are coming into Bacton and to Easington. We think there'll be more volume coming down those pipes. We are looking, as you know they're oversized and whether it makes sense for us to contract more capacity. But from what we understand both the producers Statoil and Gasunie are pretty confident the gas is there and will be ready. Now, that's not gas that otherwise would go somewhere else once it's contracted. So I do think that's different. Gas from a field, which should have a different effect than gas through the inter-connector on site.

On the mitigation. On PRT we had put some plans in place because it was something that we were concerned of a risk about. But until we know that the plans have been effective then really it's not really appropriate for me to comment at the moment. But perhaps as we look in through '06 we may be able to give more, we'll have more comfort around the mitigation. Some of the mitigation. I mean it's not going to be, all of it by any means. But maybe you know there's potential for say 25% to 50% mitigation if we're successful in our planning and if we are we'll let the market know.

**Peter Atherton, Citigroup**
Morning Phil. Just want to try and pin you down a little bit on the philosophy of the '06 pricing. If Q1 turns out to be quite bloody, presumably your sort of earliest you'll think of putting prices up is sort of the late spring. Will it be your intention to claw back the impact of whatever the outturn in Q1 is? Or will you sort of book that as a hit and then do your prices to protect yourselves for the rest of '06 into '07?

**Phil Bentley**
Do you want to know our pricing plans Peter? The fact is we don't have pricing plans at the moment that are absolutely locked down because we don't know, and that's the issue. Q1 is not our concern to be frank. We're well over 80% hedged in Q1 and then we get into the spring and the summer. Actually Q4 for us is a bigger concern quite frankly because we have a lower hedge position at that time. So I don't think, in terms of philosophy, if we had to take a hit in 1Q then we'd love to recover that as part of the overall pricing thinking. You know we don't plan to lose, run the business as British Gas and lose money. Frankly the margins in British Gas are very very thin at the moment and that's not our intention that that is a permanent feature of the downstream business. We've got to get our cost base down and we've got to see some of that wholesale price flow through to customers I'm afraid, and that's the plan.

**Elena Moya, Bloomberg**
Oh hi. I have actually two questions. Just to clarify, you said that your suspicion is that gas is being kept up in France and Germany and that's been the main reason why it isn't flowing to the UK. Just to clarify that. And secondly, there was a comment yesterday saying that gas is going to keep, be kept at its peak with these high prices until 2007. Do you foresee gas prices being kept at these levels for that long?

**Phil Bentley**
To be clear I said that storage we thought was pretty full in France and Germany and I said we didn't have transparency of capacity availability. I don't think I used the word suspicion because I don't think that's a very helpful word. The fact is we don't know. You know in terms of 2007 if I look at…

**Elena Moya**
Sorry. Sorry. But I think you said that you suspected that there is the idea that the storage was being kept up in France and Germany. That…

**Phil Bentley**
I'm saying I think it's pretty full, but we don't have the facts. We certainly believe it to be pretty full in those countries. In terms of the gas prices. If I look at the forward curve today prices for January are over 90 pence a therm. Winter '07 is 67. So I'm not sure what research you're referring to, but clearly the market thinks that prices in '07 are going to be on that reckoning 30% lower in '07.

**Elena Moya**
I see. And again following then my colleague if I may ask that question now about job cuts? Are you clearly saying that you were expecting this 40% cut and your headquarters you mean in Windsor? Right? And you didn't clarify how many people worked there.

**Phil Bentley**
Again it's not a helpful question because more than… Our shared services activities are not in Windsor, number one. And number two, at Windsor I think we have about 800 people. That includes people from British Gas home services and Centrica Energy.

**Martin Brough, Dresdner**
Hi. Yeah. I just wanted to ask about the CCGTs? just in terms of how they're running at the moment, or how you expect them to run next year? I noticed in the North American presentation you were showing spark spreads for the UK of about £20 per megawatt hour, which seems to be about double what I get. But if they are that high are you going to be running these stations quite hard? Do you expect to be a net buyer or seller of carbon next year?

**Phil Bentley**
I can't think of the chart you're referring to in, in the North American presentation Martin but no doubt you'll point it out. I don't recognise that 20 number for spark spreads for the UK. We're looking much more around the ten range here, I think we'll be running less than ideal load factors quite honestly and that's certainly what we've been doing in'05. I see no respite from that in '06 quite honestly.

**Martin Brough**
Okay. Do you know whether you're going to be a net buyer or seller of carbon on that basis, or roughly sort of neutral?

**Phil Bentley**
This year we ended up being a net seller. But I suspect it'll probably switch over. We may be a net buyer. It's on the cusp to be honest Martin.

**Andrew Mead, Goldman Sachs**
Oh hi. Just two questions… One, just for clarity the Morecambe volume added for next year. You're saying basically it's the same in absolute terms that you indicated before, and the change is merely measuring the percentages. And the second one was, did you say that the marketing

costs for 2005 inside British Gas are £20 to £25m higher? And if so what are you likely to see in 2006? But presumably given you said at H1 that you're still going to reduce your absolute cost base in '07 by £150 and now £180m. That all gets offset by the time you get to 2007?

**Phil Bentley**
It's because the decline is higher in '05. The relative decline in '06 in percentage terms is lower, but in volume terms it's about the same.

The marketing I think we would say that in these high price environments we're going to have to bake this sort of number in to our planning as we're going forward, and that's certainly what we've done in '06. We're not looking to reduce… We don't make the numbers up by cutting marketing. Let me put it that way. We make the numbers from £150 say to £180m by taking costs out. Not marketing and sales.

**Andrew Mead**
But the £20- £25 million is a full year number?

**Phil Bentley**
Yes.

**Phillip Green, Merrill Lynch**
Quick update on CRM. I know that you'll carry out your 50,000 trial, I think obviously plan to cut over a lot more from I think it's Christmas holidays onwards. Just a quick update there if you can? Secondly, we talked about 2007 a little bit in terms of cost benefits. But in terms of the British Energy contract I wondered if you applied the forward curve, what sort of additional hits one might see there from, from basically re-contracting at market? And thirdly just on the fixed price offers, are you saying that these are NPV positive, neutral or negative on the gas costs that you've got such that if you signed up the customer on that basis is it actually incrementally making you money at the moment? Or is the payback sometime out in the future on the assumption that the gas curve falls? Thanks.

**Phil Bentley**
On the pilot Phillip we are through that testing. We are close to making the go/no-go for the first major migration, which will be over a million customers. And the plan, if all goes well, would be to have done that at the turn of the year. So we'll be able to confirm that in the February update. But my expectation is that we will have done that by then clearly.

The BE. It's commercially sensitive what the terms are and the volumes. I think some people have got a fairly good sense of it and I think the '07 hit, if you like is material. I don't think there's any question about that. But at the same time we would expect for example, to see the I&W losses coming down in '07. So you can't just pick one thing in isolation you know and not look at some of the other pieces to that.

Fixed price offers. We've effectively hedged out the first three of a five-year deal. So there is an exposure at the back end when we do think that the market will fall, but in terms of margin contributions today it is making positive contributions. So they are strongly NPV positive. There is more NPV in the years four and five, but there is a positive spread today.

**Edmund Reid,Cazenove**
Hi Phil. It's Ed. Two questions. The first one was just on the fixed price product. You said a million customers. I just wanted clarity on whether that was a million customers or a million customer accounts? And then the second question was just on the sort of magnitude of price rises that you're looking at in 2006 given the current forward curve. Obviously I don't expect you to give any exact numbers, but would you expect it to be substantially higher than you've seen previously?

**Phil Bentley**
On the second question we're going to have to see what 1Q looks like and what 4Q is shaping up like. So it would be wrong for me to comment on that.

The first answer. Yes, that is customer accounts. So it's a dual fuel offer. So 50% is gas and 50% is electricity to answer your question.

**Ingo Becker, Kepler Equities**
Morning. It's on your gas production. You said that the Morecambe Bay will be 20-25% down but 40% will be offset by incremental production. Do you expect to be able to maintain the rate of incremental production, or are you running other fields harder in the current high gas price environment and you have to sacrifice that then in '07 or '08?

**Phil Bentley**
It's a good question. We are running the fields as hard as we can at the moment for sure. '07 and '08 will depend on the extent to which we have been able to if you like top up the portfolio with some other assets. We are looking at assets. We are finding them expensive at the moment and we're being patient. But I would hope that by '07 and '08 we've been able to add to the portfolio, which has always been our plan as you know.

**Bobby Chada, Morgan Stanley**
Hi. Again it's just for clarification really on some things you've said about gas prices previously. You said that your 80% hedged for Q1. Is that both in price and volume, or just on volume terms? And are you able to give us any feel for where you think WACOG may shape up either in the first half of next year, or the full year?

**Phil Bentley**
The first answer Bobby is clearly that's price and volume. If it's only volume it's not hedge as far as I'm concerned. But that's price as well as volume. We generally have plenty of volume. That isn't our issue. It's fixed price volume is what we need. On the WACOG I'm not… I'm just looking here as to what the market assumptions are. I think I'm right in saying it's close to 50p. You know we may come in under that but that's certainly where the market would calculate it out to be.

**Ends**