

Centrica AGM – 19 May 2006

Sir Roy Gardner – Chief Executive

Good morning ladies and gentlemen.

As Roger mentioned this is my last AGM having served as your Chief Executive for over nine years.

Many of you have been shareholders for just as long and were with the company at its creation. You'll recall the difficult early years. Few thought we'd survive . . . let alone prosper.

Back in 1997 competition in the gas market was just starting and we were saddled with uncompetitive purchase contracts. Our services business was making a loss. We had no electricity customers, nor a presence in Europe or America. And we didn't pay a dividend.

Well almost 10 years on all that's changed.

The early years were spent fixing the basics.

We then used our marketing skills and customer insights to expand the business into new products and services. We bought the AA and created huge value for shareholders before concentrating exclusively on energy and related services.

So today as an energy company we're worth close to £10 billion having also distributed around £2 billion to shareholders. We're the largest domestic electricity supplier in the UK, we own a fleet of power stations and a wider portfolio of gas assets.

We're the largest unregulated supplier in North America and have businesses in Spain, Belgium and the Netherlands.

Last year was another successful step in this journey. And a successful step in very difficult market circumstances.

In terms of the headline numbers turnover rose by 18% primarily as a result of the continued growth in our North American business. Operating profit was up 11% at £1.5 billion.

Of the major businesses only British Gas Residential Energy failed to increase profits. Here, despite increasing domestic prices, we were unable to recover the full £824m increase in energy and transportation costs.

As Roger said, in such a tough, uncompromising competitive environment, we must do everything we can to lower our costs. Last year we reduced the operating costs in British Gas Residential Energy by £138 million.

Looking forward, we have a commitment to deliver a cost base in 2007 that's at least £180m lower than in 2004. And I'm confident we can do better.

It must remain our aim to restore and improve our down stream margins. And that means as well as controlling our own costs, we must also ensure that we recover the costs of the energy we buy. Last year we had to increase prices and we've had to do so again this year.

We're not alone in this - it's an industry wide issue. But we're the brand leader, so the focus is on us.

It's inevitable that in such an environment we'll see customer losses but we must do everything to minimise them and then return to growth. And we've introduced more innovative products, marketed in a more creative way. We improved our sales performance.

Last year we sold 1 million fixed price contracts, giving customers certainty in an uncertain world. Whilst we lost 670,000 energy accounts in all, in the second half of the year we grew our electricity business again.

But I'm under no illusion: the battle for customers will continue and will intensify. We have to be even more responsive to customers needs. We have to give loyal customers every reason to stay with us. And give new customers every reason to join us.

Our upstream performance was once again very strong. Gas production from Morecambe declined, but the rest of the portfolio increased production by a quarter.

We've continued our prudent investment plan with the acquisition of Kerr Macgee, which is proving to be a particularly good investment.

Now as UK gas reserves decline, we're widening our search for reserves to supply our customers. Gas supplies will come from further a field and last year we gained the rights to drill for gas in Nigeria.

To facilitate the importation of gas to the UK we've bought capacity at the Isle of Grain liquefied natural gas terminal.

We've also become a partner in the planned construction of another LNG terminal at Canvey Island. If permission is granted then it would be able to process 5% of the entire UK's gas needs.

There's nothing short of a revolution occurring in the way the nation meet its gas requirements and we're right at the forefront of these developments.

On the electricity side we bought the remaining 40% of the Humber power station - we now own 7 power plants in the UK. We've also produced our first green power from both onshore and offshore windfarms.

I'd now like to say a little more about our growth businesses - Storage, Services, North America and British Gas Business. Taken together these businesses contributed a third of our profits in 2005. And because of differential tax rates, at the earnings level it was closer to half.

Centrica Storage - the Rough field - achieved outstanding results. Operating profit increased to £154m - which is half the total price we paid for the asset in 2002. There was a 41% increase in the price of storage and during 2005 the field reached almost 100% reliability.

However, as a result of an explosion and subsequent fire in February the field is currently shut down. I'll update you on the repair work as part of the trading statement in a moment.

North America increased profits by 40% in a year that saw extreme weather and volatile wholesale markets. Texas performed well and we've also been successful in moving into new US markets.

We've got a strong platform for growth. And the diversity of the business has protected us from market risks such as Hurricane Katrina and government intervention in Canada.

British Gas Services continued its strong growth. It came of age as turnover topped £1billion with profits up 54%. We saw strong growth in new products - plumbing and drains, home electric care and kitchen appliance cover. Total products held by Services customers are now close to 7 million.

I'm absolutely convinced there are further opportunities for growth in this business. We're ready to exploit them. But we're also focusing hard on improving service levels.

Our British Gas Business division also had another successful year. Despite soaring commodity costs, profits are up to £77m. Customer retention is outstanding.

This is a difficult market segment with a number of other suppliers having financial difficulties. So it's a very creditable performance.

I'd now like to take you through the trading statement we made to the Stock Exchange earlier today. This gives a picture of the performance so far in 2006 and the outlook for the rest of the year.

The first two months of the year were particularly challenging with the financial benefit of the recent retail tariff increase in British Gas not being felt until March. Even after our pricing announcement, the wholesale cost of gas and electricity continued to escalate.

This adversely affected the large industrial contracts and the profitability of British Gas Residential Energy, which will be loss making in the first half. The relatively cold winter also placed exceptional demand on our engineers within British Gas Services and the additional costs reduced profitability in the period.

Having started 2006 with a period of customer growth in the residential market, as

anticipated, we experienced an increase in churn following the announcement in February of our price rise.

However, sales of energy accounts remained strong and recovered within 4 weeks to pre-price rise levels. Sales of our 2009 fixed price product were particularly strong with around 700,000 sold - that takes the total number of fixed price accounts to around 2.5 million.

In the year-to-date, we have experienced a net loss of 350,000 energy accounts. But over recent weeks net losses have slowed substantially.

In parallel with our increased sales activity, after a number of successful migrations British Gas now has over 6 million customer accounts on the new billing system. We remain confident of completing the migration by the end of the year.

All newly acquired energy accounts are also being placed directly on to the new system. We've also successfully started operations in India with the outsourcing of some non-customer-facing activities to our partners.

British Gas Business grew its customer base over the first few months of the year. Despite rising prices, the strong contract renewal rate has continued, coupled with improved electricity sales to small businesses.

Upstream businesses have performed well, with the high wholesale prices bringing a year-on-year increase in profit levels in gas production. In March we announced progress on our upstream investment plans with the acquisition of a further stake in the Staffjord oil and gas field.

Earlier in the month, we announced that we were going to bring forward and extend the maintenance period at South Morecambe to carry out remedial work on the cooler units. We currently expect overall gas production volumes in 2006 to be down by around 15% on 2005.

As I mentioned earlier, Centrica Storage operations at Rough suffered a major interruption in February. Our investment in new emergency shutdown systems and prompt management action mitigated the damage to ensure no loss of life.

We've now completed a full assessment of the work needed to restore operations. Taken together with our ongoing commitment to Centrica Storage's customers, we expect the direct cash cost of the incident will result in an exceptional charge of around £40 million. This will be recognised in the Interim results.

Even after this charge, the forecast full year results for Centrica Storage remain in line with market expectations. This is due to increased space availability and higher storage prices, which averaged 65.6p for 2006/7, up 74% on the prior year.

Internationally our North America operations performed well. We added to our position in Texas with the acquisition of a third power station and a small block of customers. We've also continued to grow our Business markets operation in all regions. Profits in the year-to-date have been above our expectations.

In Europe we saw signs of real progress in the regulatory landscape. The European Commission has started to take steps against several companies over the slow progress towards competition. And in the Netherlands, the lower house voted in favour of separating monopoly network assets from commercial supply and generation activities.

As anticipated, the higher retail pricing has led to a rise in absolute customer debt levels and contributed to increased working capital requirements within the group.

A restructuring of our upstream operations, completed in late 2005, should reduce our effective tax rate in the year from the previous estimate of 58% to a current estimate of 54%.

Through the remainder of the year, we'll benefit financially from the higher retail prices implemented in March, the continued effect of high wholesale prices on our upstream activities and a return to service of the Rough storage platform.

We'll also continue to reduce costs in the Residential Energy business, while promoting innovative products to stabilise market share and maximise value. The successful migration of all residential customers to our new billing system will also reduce costs and improve our customer service.

But these positive developments must be viewed against the background of record oil prices and continued high wholesale energy prices.

There is still considerable volatility in the forward cost curve. Wholesale gas prices in the fourth quarter are currently 17% higher than at the time of our last retail price announcement. At current retail tariff levels and without a drop in wholesale energy prices, British Gas Residential Energy would be loss-making in 2006.

As we said at the time of our last pricing announcement, whilst we'll endeavour to hold residential price levels during the year, we will not be immune from these external pressures. We remain committed to our policy of fully recovering costs over time to return the business to acceptable levels of profitability.

So it's been a tough start to the year and at the operating level the Group has to date traded below our expectations primarily as a result of the higher than expected commodity costs. This is partially offset at the earnings level by lower forecast tax charges.

These factors, combined with the one-off impacts of extending the South Morecambe maintenance period and the inability to withdraw gas from Rough, mean earnings for the year are forecast to be towards the lower end of market expectations.

However, operationally and strategically we've made progress. There's also been good progress towards bringing onstream further UK gas infrastructure - this should apply downward pressure on gas prices over the coming winters.

In the meantime, we'll continue to seek ways to mitigate the impact of the current high wholesale prices on our customers through rigorous operating cost control and innovative products.

So that brings you right up to date with the business.

Looking ahead there are enormous challenges. The UK energy market will continue to change and in Europe the process of liberalization will, I hope, develop momentum.

The current position where markets across the Continent remain closed to UK companies is simply unacceptable. We must **not** let it endure.

Before I finish I'd like to thank you all here today. You've shown me great loyalty - I hope I've been able to repay that support in terms of the financial returns and prospects for future growth.

So much of this success is down to our employees and managers who have supported me with skill, enterprise and determination. They are a credit to the organization.

Ladies and gentlemen, this is a great company. We have outstanding products. We have a highly skilled work force. And we have the chance to build the business in Europe and in North America.

It's been a great honour to serve as your Chief Executive. It's been a privilege to have led the company. I'll take with me many great memories of the people I've worked with and what we've achieved together.

Looking forward we have an outstanding Chairman, and in Sam Laidlaw, an excellent new Chief Executive - I wish them and the management team every success. The competitive environment will be difficult but I know that Centrica can - and will - continue to prosper.

Thank you very much.