CENTRICA PLC
2006 INTERIM RESULTS PRESENTATION

27 JULY 2006

Chairman, Roger Carr

1.1 Introductory remarks

Well good morning everybody and welcome to the Centrica Interim Results presentation. It's my great pleasure this morning to introduce to you our new CEO, Sam Laidlaw, who's been in the role now for a whole four weeks and some of you of course will already know him from a previous existence.

Before I start my remarks, I'd like to make some comments on the process this morning. Recognising Sam's length of tenure and the fact that he played no part in the first half performance, we thought it'd be sensible to adjust our traditional format for these events. I'm going to make some opening remarks, including some specific thoughts on the first half; Phil will review the numbers and the performance in detail and finally Sam will give you his initial observations on the business and an indication of his priorities, along with the outlook for the second half.

We've got a full operational executive team here today who will assist Phil and I in answering any questions you may have on the first half performance. We have Mark Clare who – fresh from interviews this morning – and as you know, sadly will be leaving us in September and Mark's been at Centrica since its formation and just while we're all together I'd just like to thank him for the strong contribution he made to the business and to wish him well in his new role.

We also have, in the front row, Jake Ulrich, Deryk King, Ian Peters, Chris Weston and Grant Dawson and we're also joined today by Mary Francis who was appointed the new senior non-executive director of the group, and Mary, I don't think, will be answering questions this morning.

Sam will be pleased to comment on the business and its future, but I am sure you'll understand that at this stage, these will only be first thoughts, rather than conclusive judgements.

1.2 H1 overview: Key issues

Reflecting on the first half, I do look forward to the time which I believe is getting closer, when I don't have to stand here and use words like "challenging" and "unprecedented" to

describe the wholesale energy markets, but it is clear that in the first half, our financial performance was undermined by significant wholesale price escalation in a period of high energy consumption. This materially increased our costs prior to the retail price increase being effective in March. The impact of this pricing lag and high wholesale costs in general was reflected in the significant operating losses of British Gas Residential Energy, reduced profits in British Gas Business and higher losses on our industrial and commercial contracts.

The cold weather which drove up energy demand also brought about an exceptional workload for our service engineers, resulting in higher costs and contributing to the erosion of profitability of British Gas Services in that period.

1.3 Retail pricing

It's clearly unacceptable for our residential energy business to continue to be loss-making. And the requirement for us to cover our costs and reintroduce some margin headroom was the key driver behind our decision to announce today a further price increase, with effect from September.

In the first part of this winter, we believe that the scope for a further significant fall in the gas curve is limited, given the uncertainty which will inevitably surround the substantial new infrastructure projects which are due for completion in the fourth quarter of this year. Consequently, we now believe it is prudent to base our short-term pricing decision on an assumption that market prices will out-turn. I should stress that this does not change our longer term prognosis for falling wholesale energy prices with the potential for retail price reductions, when this additional capacity eventually beds down.

This price increase will restore margin in British Gas Residential Energy in the second half although it is probable that this business may only be break-even for the year as a whole.

1.4 Cash management

Higher prices inevitably lead to higher working capital demands and cash management remains a priority.

The continuing suspension of the buyback program, operating cash flow discipline and prudent investment policies protect our balance sheet and preserve our commitment to continue to grow the ordinary dividend paid to shareholders.

Shareholder reward both in good times and in periods of short term squeeze, remains the priority of this Board.

1.5 Progress

Whilst the restoration of profitability in British Gas is essential to shareholders value and the UK security of supply, management continue to minimise the size of the price increases that we need to levy on our customers, by focusing on performance improvement within the company. The commitment of management to achieving the provision of high customer service levels at the lowest cost in the industry was evidenced in continued progress in the transformation of British Gas, with the successful transfer of over 11 million customers to the new billing system and the outsourcing of the back office processes to India.

Innovative product development and the efforts of our sales and marketing teams contained customer losses in competitive market conditions and enabled us to end the first half with several weeks of net growth in our electricity base. We believe our new *Fix and Fall* product which we announced today will support this position and indeed is a testament to our view of lower commodity prices in the medium term.

In British Gas Services the management team have implemented an internal restructuring which will enable them to better address the opportunities of the market.

Upstream, we increased profit despite the proactive shutdown of Morecambe Bay and the punitive legacy I&C contracts.

Similarly, the storage team returned the Rough facility to full injection capability with remarkable efficiency after the force majeure incident in February, in parallel with earning satisfactory returns.

Results in North America demonstrated the strength of geographic diversification, showing attractive growth in both sales and profits. Whilst in Europe, continued lobbying by Centrica for more open and transparent markets, showed encouraging signs of traction with the European authorities.

And finally, and most importantly, we have made the full and smooth transition to our new CEO.

The Board and I believe that the foundations laid in the first half, together with today's pricing decision and the ongoing quest for efficiencies across the business, will combine to provide a firm base on which management may successfully and profitably develop the business under new leadership.

I'll now hand over to Phil, who will review the financial performance in more detail.

Group Finance Director, Phil Bentley

2.1 Introductory remarks

Thanks Roger. Good morning everyone.

With our first retail pricing decision not taking effect until after the heavy loss-making months of January and February, and our announcement this morning of a second tariff increase, the key message is that with the measures we've put in place, our business is in a better position today to deliver a much stronger second half. But before talking about the outlook, let's look at what we've faced in the first six months.

2.2 Financial headlines

There's no question, the first half of 2006 has been our toughest so far. I say that because rising wholesale commodity prices once again really hit our profitability. UK gas prices were 86% above the same period last year and they wound up being 29% above where the forward market had predicted twelve months before.

On the positive side, first half turnover rose by 32% to £8.7 billion. That increase was primarily the result of high retail pricing in British Gas and the continued growth in the North American business, up 31% year-on-year.

But rising commodity costs and the colder winter brought operating profit down 29% to £692 million. Earnings were down 38% to £277 million and earnings per share at 7.6 pence per share were down by around the same.

We have, though, raised the interim dividend, in line with the guidance we gave you in February, to set the interim at 30%, as the prior full year's dividend and we will maintain our commitment to increase the full year dividend in real terms.

2.3 Wholesale prices

So what was the key factor in these results? Obviously the continued rise in wholesale commodity prices. This slide shows the movement in both gas and baseload power wholesale prices since the start of 2002. When you look at the more recent movements, it's pretty obvious why the whole retail industry is suffering. In the competitive market that we've been operating in, it's been impossible to pass these rises through to end customers quickly enough, and so maintain our downstream margins.

This slide illustrates the point further. In our industry, any retail price rise is usually set with reference to the forward commodity curve, but you can see that, over the past four years, the twelve month forward market has consistently under predicted prices. And that

underprediction shaded here has averaged over 15 pence per therm over the last twelve months; and on sales in British Gas of 4 billion therms, that's a material under-recovery.

So the clear message here, in the face of rapidly rising wholesale markets, is; don't confuse what is simply a lag in margin recovery with a lack of pricing power. The chart shows that there's clear evidence of rational pricing across the industry, with a similar time lag that we've experienced in British Gas and that's why I'm confident of the margin restoration looking forward into the second half and beyond.

2.4 Operating profit analysis

So what has this meant for our first half results? Well, here you can see the segmental break down of operating profits. The number which stands out is the loss of £143 million in British Gas Residential Energy; down over £300 million on the first half of 2005. British Gas business results also here to boost gas services, was impacted by the cold winter. But, Centrica Energy, Storage and North America all performed strongly in the first half, and with margins now being restored, there's no doubt the second half for the group be materially better.

2.5 British Gas Residential Energy

Let's look at why British Gas Residential Energy lost money in the first six months. Our weighted average cost of gas was up by some 66% and our weighted cost of electricity up by 65%. This meant that our overall cost of sourcing energy rose by £1.1 billion. Of that £1.1 billion, we estimate that around £75 million alone was due to the impact of one-off factors, such as the outage at Rough, and other third party fields.

Compared with the same period last year, average pricing to end customers rose 26% in gas and 28% in electricity, but that only brought an incremental £846 million of margin in the first half.

On the other hand, lower customer numbers only reduced our profitability by £22 million. Customer numbers were down by around 430,000 in the period. That was less than we expected, as our mitigation activities minimised the impact of the price rise in March. In fact, we even ended the first half with weekly growth in our electricity base.

The positive effects of colder weather on average consumption per customer in both fuels brought an additional £8 million of margin.

Now the operating cost base fell only slightly. Underlying cost reductions were offset by one-off costs of around £30 million, mostly associated with the March pricing decision, and systems dual running, and staff back-filling whilst training customer service agents on the new systems. For the full year, with these one-offs and the cost impact of implementing

the September price rise, we anticipate a modest increase in the cost base in 2006, but we remain firmly on track to deliver on our 2007 cost reduction target versus 2004, of over £200 million.

2.6 Centrica Energy

Now I'd like to turn to the upstream business in the UK, where operating profit here was some £579 million.

Morecambe production was down 42% in the period, and that was largely due to the decision to bring forward the summer maintenance period, to carry out work on the cooler units. This volume reduction impacted profits by £213 million, but we do expect the South Morecambe field to be back in production by September. Obviously a partial offset to the higher input costs for British Gas was the higher average selling price to the gas production from Morecambe and this brought in an extra £265 million. And the growing portfolio of gas and oil assets outside of Morecambe contributed an incremental £112 million year on year on absolute profits of some £184 million. For the year as a whole, I now expect total gas production volumes to be down by around 15%.

2.7 Industrial sales contracts

Now as we've flagged before, losses rose in our industrial sales contracts, generating a negative year on year movement in the I&W segment of some £112 million. That was on absolute losses of £132 million. Although volumes remain quite flat, we do expect volumes to fall, as some contracts expire in October, the start of the 06/07 gas year. And we currently forecast that the losses in these contracts in 2006 will be around £300 million, but recent movements in the curve mean that losses in 2007, based on our view of wholesale prices, could now be around £250 million. And we now expect break-even to be reached a year later than we'd previously forecast, i.e. in 2009.

Now these legacy I&C contracts are clearly a burden, but here I've tried to give some comfort on the falling volume profile. Not only have we got a narrowing of the spread between selling prices and input costs over the next few years; but you can see that the volumes will fall rapidly, generating a material positive earnings delta and that's particularly true between 2006 and 2009.

2.8 British Gas Services

Now our British Gas Services have continued to grow, with total customer contracts now around 7 million. But as we told you at the time of the AGM, operationally, we experienced a very challenging winter. The number of increased callouts, up by over 165,000 in the period, placed exceptional demands on our operations. The direct cost was some £8 million in excess labour and parts. But having restructured management, opened our new

National Distribution Centre, and fine-tuned the engineer deployment system, we're now better able to handle workload spikes going forward.

The installations business was down by £10 million in the first half, primarily because we had an unusually strong first half in 2005, when consumers replaced systems before new legislation requiring expensive condensing boilers came into effect.

However, ongoing product growth and pricing increases, reflecting better targeted risk-based pricing, contributed an extra £27 million.

Operating costs here also rose by £24 million in the period. That increase reflects additional IT costs; higher pension contributions and the structural separation from the residential energy business. But the growth opportunity that we see for home services thoroughly justifies this cost investment.

And as we build our platform for future growth, 2006 is a transition year for this business. However, we still expect that the second half of the year will be better than both the first half just gone, and last year's second half.

2.9 British Gas Business

Financially it was also a tough year for British Gas Business. Just like in the residential business, January and February brought a sharp uplift in input costs.

Now around 40% of the customer base of BGB are not on fixed price contracts and our ability to change retail prices has traditionally been linked, and restricted by the link with the British Gas residential billing system. Now that link will be removed late in 2006, when BGR's new billing system is complete. And the pricing flexibility will be further enhanced in BGB, with completion of their own gas billing system, early in 2007.

The remainder of BGB sales, i.e. the contract book, suffered higher Q1 losses, due to the high level of gas prices. Now that book is fully hedged, and the contracts are profitable across the year as a whole, but the margin profile changes during the year, and the unusual peak in gas input prices in Q1 06, compared with the more flat annual selling price, leads to losses in the period.

However, an underlying measure of the good health of this business is customer churn. Churn in the tariff customer base has now reduced to around 5%, and our renewal levels amongst fixed contract customers have remained at well over 90%.

And so the second half will be much more encouraging. We'll see the effects of both the March and September price increases and, as I said, the improving profitability of the

contract customers. And that should ensure that we will deliver expectations for the full year of 2006.

2.10 Centrica Storage

In Centrica Storage, from a profit perspective at least, it was a very strong first half. Operating profits, before exceptionals, was up 63% to £93 million. We also completed the sale of all storage units for the 06/07 storage year at an average price of 65.6 pence and that's some 74% higher than in the previous year.

The £42 million exceptional cash cost to the group of the fire and explosion includes the repair costs and the partial reimbursement of storage fees payable under the contract. Now the field has restarted injection in June and is currently 75% full. We expect to fill the field by the traditional end of the injection season, and be ready to produce by the beginning of October, as per normal. And we've already sold over 50% of the third party space for the 07/08 storage year – again, at higher prices - which shows real confidence in the field's stability.

2.11 North America

Now North America had an excellent first half. And the overall operating profit was up almost 40%, at £121 million. Our result was enhanced by a one-off gain of £7 million from selling our remaining shareholding in the Consumers Waterheater Income Fund; and £8 million from FX gains, but the underlying result was still a healthy 22% growth.

Now the expected fall in profit in the Canadian retail business, due to the expiry of the MPMA rebates, was then exacerbated by lower gas demand, due to the very warm weather in the first two months of the year in Canada.

However, this was more than offset by a strong performance in Texas, where we also acquired a third power station and a block of another 100,000 customers. And overall, profit here rose £39 million to £64 million.

Profit also rose by £4 million in our Other US business segment. We've got growth in customer numbers and an improved midstream capability.

Home Services business is showing the positive impact of an improved management structure. We also generated continued products and price growth in our core HVAC offering in Canada.

The negative delta in Business Markets masks the encouraging underlying growth in that business. We entered several new states, including New York, Maine and Delaware. But the near doubling of turnover in Business Markets causes a short term worsening of the

financial reported results and that's due to the immediate expensing of customer acquisition costs and our selling of mainly three year fixed price contracts on backwardated curves, where the profit comes later in the contract period.

So overall, an excellent first half in North America, which supports our guidance of a 20% rise in EBIT for the full year.

2.12 Tax

Now tax take has continued to be over 50% of our pre-tax earnings. This year alone, we've seen the ten percentage point increase in the supplementary tax charge on offshore production; and there have been legislation changes which affected us in the 2006 Finance Bill.

Our restructuring in the upstream business at the end of 2005 gave a £46 million benefit in the first half, but the Finance Bill has nullified any benefits going forward. Note that the benefits came through the consolidated accounts as a higher interest charge of £57 million, offset by a greater reduction in CT of £103 million.

PRT was down 27% year on year, largely due to our lower production volumes.

Overall, the H1 tax rate was up marginally, to 51%, and we expect the full year ETR to be around 58%. The H1 restructuring benefit will not be repeated in H2, as I said, and we get a full winter season's production from the higher tax paying Morecambe field.

But longer term, we do expect our effective tax rate to drop materially, as our profit mix changes and as the percentage of gas production from PRT paying fields falls.

2.13 Cash flow

Now net debt, excluding the non-recourse debt from the Waterheater Fund, has increased to just over £2 billion. The key drivers of our higher debt are; first, an £819 million working capital outflow; and second, an increase of £187 million in Capex and acquisition spend in the period.

Now just over £300 million of the working capital increase was due to the outflow of previous margin cash that we'd been holding at the year end, where a proportion of the contracts have now been delivered, together with a reduction in the positive mark to market position of existing contracts that are still to be delivered. The other £500 million of extra working capital, which is higher than forecast, is primarily due to the price rise in British Gas, which raises both billed customer debt, as well as our estimate of unbilled consumption.

As we adjust our customers' direct debits to take account of the new pricing, part of this working capital requirement should reverse and combined with a stronger second half EBITDA, we do expect to see underlying debt fall by the year end.

2.14 H2 financial outlook

So to wrap up, a tough first half, but we feel we have weathered the storm, and are well placed to see a stronger second half, and you'll hear more about that from Sam, in a second.

Clearly, the effect of the price rises in British Gas will improve margins, although, if the forward commodity curve stays where it is, British Gas Residential Energy, for the full year, as Roger said, is still likely only to be at break-even. But British Gas Business, British Gas Services, will both have much stronger second halves. And gas production profits will be up year on year, on the back of higher prices as well as South Morecambe coming back into production. Overall second half production volumes will be higher than the H2 2005. And those businesses which have posted strong financials in the first half, will do so again in the second half.

So we're through a challenging first half, and we remain confident that we will deliver full year guidance, even at the high Q4 higher wholesale prices we're currently seeing.

With that, let me hand over to Sam.

Chief Executive, Sam Laidlaw

3.1 Introductory remarks

Thank you, Phil. Good morning, everyone.

As Roger said earlier, I've been in the job for a little less than four weeks, so I'm still getting around the company and learning to know a little bit about it, but I think you'd be disappointed if I had no opinion either on the priorities, or on the potential of the business that I've joined. As the new Chief Executive, I'd like to set out my clear aims; some first impressions; and what I see as the immediate priorities. But before I do that, I'd like to quickly look ahead at what the second half of this year has in store.

3.2 H2 business outlook

Today's price increase will be effective before the winter, and will re-establish a level of profitability in British Gas. It also underpins our earnings guidance, even in the face of the

current market commodity curve. But clearly, today's price increase will delay a return to customer growth.

We will complete the implementation of the long-awaited billing system in British Gas and that will provide the basis of a new customer experience, and introduce a range of efficiencies. But cost reduction doesn't stop at British Gas Residential. We will pursue cost reduction across every area of our business.

Upstream, South Morecambe will be back into full production by the beginning of September and we've now refilled over 75% of the Rough Storage field, ready for customers to withdraw gas by the start of the winter.

North America will continue to grow in the second half. We're forecasting full year operating profit growth at around 20%.

Overall, I'm pleased to report that our near term earnings guidance remains in place even if we don't see fourth quarter prices falling.

3.3 Business principles

Now I'd like to give you some of the wider thoughts that I promised at the start: My clear vision is to create superior shareholder returns. I fully endorse the vision of being a leading integrated energy company and we will remain focused on our key markets of the UK, Europe and North America.

In order to drive superior shareholder returns we will need to significantly improve the operational, financial and customer service performance levels in our core business. We're going to be focused and we're going to be selective in the growth options that we pursue. We will pursue value not volume, nor size for size's sake. We will be disciplined in our capital allocation, particularly at this point in the cycle. And we will be relentless in our acute focus on costs.

3.4 First impressions

During my first few weeks with the company I've been meeting with the people and visiting the operations to assess the capabilities of the organisation. I've been evaluating both the current and prospective returns of the portfolio and I've been identifying the current challenges and opportunities for profitable growth. Let me give you some first impressions:

- In British Gas Residential Energy, the customer base remains strong and the brand, even if we are under constant media barrage, continues to command a premium. However, churn across the industry does remain high, primarily of course, as a result

of the tariff increases in recent years, but customer service levels need to improve. Determining the optimum future shape of this business will also be key to maximising its value. A very substantial investment has already been made in new systems. Costs overall are significantly higher than where they need to be and migrating our final customers, as you heard from Phil, onto the new system in the fourth quarter of this year, is a key enabler for cost reductions in 2007.

- Our British Gas Services business does have great growth potential. There's important work in progress to improve the delivery and the quality of the service. That will also enhance the value of this business. After a year of transition we believe there's good growth potential next year.

- British Gas Business has strong customer loyalty and earnings potential but, as you heard, the legacy systems have been impeding our ability to pass through rising input costs to the customers. That issue is being addressed through a new billing system and customer service solution which will also enable further cost reduction.

- Centrica Energy is addressing the clear challenge of declining Morecambe production. We've got to make sure that we have a focused strategy and disciplined processes to access new sources of gas. This is an area where I expect to be able to make an immediate contribution. We've also got to leverage the strength of our position in the market place to enhance our upstream assets and contractual position in both gas and power.

- And in Centrica Storage we have both a unique asset and a dedicated and highly skilled team delivering solid returns.

- In North America I'm impressed with the level of returns already being delivered and the strength of the business model. But this has been created during extremely volatile market conditions by a very strong management team. It's a sound growth platform for the future.

- In Europe things are at a much earlier stage but there are reasons for optimism. The European Commission is determined to create a properly functioning market and is now taking action and we will continue to support their efforts.

- As for the people and the organisation, I have to say I have been very impressed by both the quality of the Centrica people and by their commitment. I'm reviewing the organisational structure to ensure that we leverage our integrated capabilities and deliver on our strategic imperatives.

3.5 Business priorities

So, for me, the immediate priorities are clear:

- First, we've got to restore appropriate margins in retailing. Today's price announcement is a step in the right direction. We need to ensure that through innovative tariff structures, such as our new *Fix and Fall* product which we announced this morning, and through our increased marketing effort, we minimise further customer losses.

- Second, we need to reduce our exposure to the commodity price risk, both structurally and cyclically. We'll do that by finding new and appropriate long term sources of both gas and power and we'll be building on our recent successes at Langage, Drax and Statfjord.

- Third, we've got to deliver the cost efficiencies I've mentioned a couple of times. As Phil said, we are making progress, but we have to be single minded in our pursuit of further opportunities. Completing the roll out of the new billing system is clearly going to be a vital part of this.

- Fourth, we have to deliver the growth potential in British Gas Services. We may have had challenges in the early part of 2006, but the lessons we've learned will be invaluable in growing profit in the future.

- Fifth, we need to build on our position in Europe.

- And finally, in North America, we need to selectively infill in the existing markets with value enhancing opportunities.

So, as you can see, there's urgent work to do. We've got to sharpen our strategic focus, reshape the organisation, enhance our core profitability, improve our operational excellence, and identify profitable growth opportunities. I'm looking forward to that challenge and to communicating our progress on all these fronts to shareholders over the coming months.

Thank you.

Questions & Answers

4.1 Bobby Chada, Morgan Stanley: I had a question about the Residential Energy business. You highlight in your statement £90 million of excess energy costs incurred due to system operator kind of calculations. Last year it was £42 million. How should we think about that going forward? And is that all reflected in the WACOE that you show or is it in the opex? And then secondly, on your 07 cost savings target, do you expect to achieve all of that in 07 or by the end of 07 simply be at a run rate which is equivalent to achieving all of it?

Phil Bentley: Yes, what that's referring to is – the first point – is the imbalance and that's the difference between what Transco essentially deems as and what we're billing from our customers and there's a lot of work that Mark and the team are working on to get that imbalance down. It's reflected in our weighted average input cost, it's not in the opex numbers, to answer the question. I think the solutions there are partly data solutions and partly industry solutions in terms of just making sure that we can correctly meter read as an industry across the network. So that's the key point there.

The point about the 2007, no, that is an absolute saving in 2007, it's not a run rate. Obviously we'll exit the year at a stronger run rate if we're going to deliver 200 in the full year, but it's a £200 million full year target.

Sam Laidlaw: You also had a question on costs, whether they were going to be an annualised running rate or whether they were going to be down by the end of the year and the answer is those costs will be out in 2007.

4.2 Ian Mitchell, JP Morgan: You talk a bit about cyclical long term exposure to commodity costs, particularly on the generation side, I know Centrica have talked about new nuclear build and that it's not particularly interested in the long term. Is that something that's still open for review? It would seem like a reasonable way maybe of offsetting some of the gas price risk in the long term.

Sam Laidlaw: I'll offer an early view on it and that is that clearly we would like to diversify our sources of power generation. I think the economic case for nuclear remains to be proven and certainly for a company of our size and scale with the current expertise that we have. I think it's still an open question as to whether it's the right thing for us to invest in.

Ian Mitchell: So it's not ruled out?

Sam Laidlaw: I wouldn't rule it out but I don't think the economic case has yet been proven.

4.3 John Musk, Lehman Brothers: You talk about your view that the forward curve is now perhaps a realistic way of looking at what your expectations are for this winter. Where does that mean you are with your hedging for this winter and should we expect you to be fully hedged going into the winter?

Jake Ulrich: By the time we hit those months we will pretty much be fully hedged, but we do have some exposure at this stage for Q4. I think the important distinction to make here is what we think in the short term i.e. the rest of 06 and what we think about going on 07. Given the high oil prices, the numbers look pretty reasonable from now to the end of the year. I still think there's a premium in Q1 of next year and if we see all the infrastructure deliver then I would expect that to soften up given a constant oil price, but our curve has pretty much converged given that where the oil price is now for the rest of this year.

4.4 Philip Green, Merrill Lynch: Phil, I scribbled very, very quickly the comments on the working capital. Could you just perhaps repeat what's happening in the £300 million, what that's really all about, but also what are conditionalities for the £500 million to reverse? I think last year at the prelims you were saying if the forward curve moves down and other interactions, you would expect that perhaps to halve in amount, but clearly if certain other conditionalities arise then maybe that becomes quite sticky. So, it's really just a bit more flavour on the £800 million, thanks.

Phil Bentley: I think if we go back to the beginning of the year, we were forecasting a £500 million working capital outflow and clearly we're running at a higher level there and for the full year as I think we've said, it will likely to be more of the order of the £800 million level rather than the £500 million. Now the, obviously the higher prices and therefore flowing through to the unbilled and the debt levels is the key driver to that. The £300 million is essentially the margin cash that we hold from third parties who are contracted to deliver forward fixed price commodity and what happens obviously is, as the curve goes up, they pay margin to us but then when they actually deliver physically, not only do we have to pay them for it, we also have to give them back the margin cash and that's why that's the £300 million and it's flowed out. A lot of that is in North America.

Now, second half, there's probably a lot less of margin cash to come out. We are working hard as I said in the script, to reset the direct debits in British Gas and that should help to soften if you like, the impact on debtors and of course, you've got a much stronger second half in EBITDA terms which is why I think, when you add all that up, we're reasonably confident that debt levels net-net will be lower by the end of the year.

4.5 Andrew Wright, UBS: I just wanted to ask a question about the Industrial and Commercial business and you've given us a fairly good idea of what's happening with the legacy contracts there. Could you tell us what you're doing in that business now? Are you still trying to sell gas to industrial and commercial customers? If so, are you doing them

under terms that ensure that you protect yourself against similar events in the future or are you still signing up long term contracts with industrial customers?

Jake Ulrich: Yes, I mean the Legacy contracts long term fixed price, clearly we're not in that business right now. In the industrial sector we are doing one year contracts. They are hedged fully and so we're not taking a risk. It is a margin business.

4.6 Andrew Mead, Goldman Sachs: Could I just ask, on the British Gas Residential Energy business and in particular with regards your comments I think in several of the slides about appropriate margins within that business, if we were to look at the forward curve for 2007, would you need further tariff increases to get to those appropriate returns on margins?

Sam Laidlaw: I'll take a view on it. If we look at the forward curve, we don't believe we will, no.

Andrew Mead: So, you won't need a tariff increase to make the right returns?

Sam Laidlaw: We won't need tariff increases to make the right returns.

4.7 Mark Hives, Soc Gen: It's a follow-up question to Jake about his belief on quarter one gas prices for next year and the import projects which are coming into the UK at that point in time. Those import projects are primarily pipeline projects giving capacity rather than commodity. Does he believe there'd be any extra commodity coming into the UK at that point in time, particularly via the Langeled pipe. There is an industry view that, or there are various industry views that there may actually be no extra gas coming in via the Langeled; it could just be existing Vesterled gas and existing gas which comes from Norway via the Interconnector, so I'd be keen to get Jake's position on that.

Jake Ulrich: I don't think that's the Norwegian producer's views about what's going to happen. There is incremental supply. I can't say that the line will be full but I do believe there will be incremental supply. More importantly, though is the BBL line which is associated with a contract to deliver 8 million therms a day to us as soon as that line is operational and that is new incremental supply to the UK.

4.8 Bobby Chada, Morgan Stanley: Now that you've sold your remaining stake in the Waterheaters Fund, why is it that you still have to consolidate the profits? Do you receive any cash? I suspect the answer is no and how much did that contribute in this year, please?

Phil Bentley: It's a very good question Bobby. It's all down to IFRS accounting and due to the fact that essentially it is deemed that by virtue of the fact that we set the returns of that operation by the price that we charge in for servicing the water heaters that are in the

fund, it is determined by the accountants that we commercially have an interest in that business, even though from a borrowing perspective, there's total non-recourse to Centrica. I think it's probably in the sort of twenties, the contribution of the water heaters, probably a bit more than that.

Bobby: But there's no cash been received?

Phil Bentley: No, not anymore, we used to get cash when we were a 20% shareholder essentially from the dividend distribution but now we get nothing.

4.9 Colin Pollock, Credit Suisse: I've got two questions on the residential energy business. The chart on page twelve, the customer number, losses £22 million, does that mean that effectively those customers weren't profitable in the sense that losing them didn't have much impact on profitability?

Phil Bentley: Well, the short answer is yes, clearly, and it's a function of the margins in the period – it's as simple as that.

Mark Clare: Clearly the margins are much lower than they have been historically and will be in the future at the moment because of the high commodity prices, so our margins are low. Obviously, as Phil's already said, we've also done better in terms of retaining our customers so the actual hit is quite small. Obviously that's a yearly hit, I mean, there's a long term value to losing those customers but in the short term, the focus has to be on recovering margin and that's the priority we set.

Colin Pollock: You've just announced another price increase. Do you expect that to have a further impact on your customer numbers that you project in the business?

Mark Clare: Yes, clearly it's too early to tell what sort of effect it's going to have, but I'm sure that we will see initial numbers of customers who move away from us. I think the more that our competitors re-price - and we know that two have already done so, we think that Powergen and Npower will follow - we would expect the normal return of customers and that we will start to see our electricity business growing towards the end of this year, maybe early next. And then hopefully, as long as we don't have to move prices again and we can actually get back into the stride of growing our customer base.

Roger Carr: I mean, just to add to that, there is a very proactive marketing campaign which you've seen some evidence of this morning but the attitude of the team is to sell into the market, very positively, to make sure that we do stop customer attrition at the rate that could otherwise occur, but it's going to remain competitively challenging, there's no doubt, but the team are very much up for the challenge.

4.10 Jamie Tunnicliffe, ABN Amro: Just wanted to check on British Gas Services in terms of the outlook comments you made about 07 and 06 and just see that that's consistent with the sort of product growth and margin targets you've set out historically for that business looking out I think 08, etc - that you still very much have those in mind.

Chris Weston: Yes, I think we are still very optimistic about growth in 07/08. As the comments were made earlier, 06 is a bit of a transition year. There are a number of steps that we're taking; included in that is around improving the baseline service that we offer to our customers. I think it's mostly we know that our customers are great advocates of our service so we have to ensure that that base service is as it should be to continue that advocacy which supports the growth. We're also confident when we look at other areas of the market, where there are opportunities so in emergency repair, the on-demand side of the market, it's an area of the market we see growth and also as was mentioned, we're getting much slicker at risked-based pricing, so reflecting the risk of a boiler breaking down in the price that we charge to the customer and you've already seen some evidence of that and we would expect to see that continue. So we are confident about the growth going forward.

4.11 Andrew Wright, UBS: I was interested in your prognosis longer term for commodity prices being lower. I wondered, is that based on a view on where oil prices are likely to go medium term or is it based on a view about increased gas supply into the UK and the impact that may have. And just to clarify, would you expect UK gas prices to eventually trade at a discount to Continental European prices at some point?

Jake Ulrich: It's based on where the forecasters see oil prices going and the fact that there will be convergence between European and UK prices. With the BBL line, the Interconnector up to 24/25 bcm per annum, we have quite a bit of interconnectivity, certainly between North West Europe and Britain so we would expect prices to trade roughly the same versus the premium we now have here in the UK over North West Europe.

4.12 Maurizio Carulli, AXA Investment Managers: The focus of today has been mainly on residential business, on cash management, working capital and net debt and rightly so because it's the more pressing issue at the moment. However, one of the challenges that Centrica is facing long term is the replacement of the declining Morecambe field and one of the reasons for which Sam has been chosen by the Board as the Chief Executive I believe, is also because of his previous experience in the upstream business. Can you give us an idea, a sense, of what your strategies will be regarding addressing the issue of investments in the upstream and in terms of what sort of assets, what sort of geographical exposure, what sort of purchase policy, if you wish, regarding assets you are going to have once this, assuming for a moment that this issue of the cash management will be successfully addressed.

Sam Laidlaw: Well, it will be careful and I think we do, as I said in my remarks, we are at the top of the cycle so we have to be very disciplined about it. We will be looking not just for sources of supply that involve buying the asset but also new contractual arrangements as we've done with Statoil and Gasunie and Petronas and clearly diversity of supply is going to be important. In terms of the exploration and production opportunities that we will pursue, they will all be linked to supply gas to the UK market, either piped gas or LNG, so I think there will be clearly a regional focus and it will be a balance of near term development opportunities and current production.

Roger Carr: I think just to add to that, one of the great things when Sam joined, is that the principles that we've had as a Board which is, you know, not size for its own sake, to invest prudently and thoughtfully, are very much where Sam is and the opportunity I think of broadening the network of contact we have to find sources of supply will come through Sam over a period. But financial discipline remains absolutely core. And reflecting back to the nuclear question, just as Sam said, one can rule out nothing in this life but the economics of nuclear, let alone the experience that you need to be in nuclear, would suggest that it won't be very high on the Board's priorities.

4.13 Ajay Patel, DrKW: Two questions; firstly, could you give us an indication to maybe the quality of your customers that you're losing; are we talking a larger loss on the direct debit side or further up the value chain, or are we talking sort of the lower end, that you're losing customers from? Secondly, in the US, in Texas, it seems to be more of a rotation of generation portfolio from TXU from gas to lower cost coal and NRG with their nuclear. I'm just wondering if, what you believe the impacts are going to the residential competition end of things, do you see them pricing more on a cost plus methodology or do you still see forward there will be sufficient competition in that market to be wholesale price plus a margin going forward?

Mark Clare: On quality of customers we obviously measure the customer base across a number of segments and, as each price rise has been made, we've carefully watched to see what has happened. The rise that we made in September, after that we were losing slightly below average value customers which was obviously quite positive. I have to say that the 22% rise earlier this year, we saw some of our higher value customers moving away, so we saw that reverse. But as soon as we got through that period, then we get back to a situation where it stabilises. One of the great opportunities we have, as mentioned earlier, we have a very significant sales machine; we are able to direct that sales machine very carefully both with our new systems because as you know we're able to use that segmental information in our acquisition strategies there and with our field sales and outbound calling, so we can actually focus on the higher value segments. And that's something that we will certainly be doing as we get past this next price rise.

Deryk King: In Texas there has been a considerable speculation about new build and in particular new build of coal plants and the fact remains that today the only new plants that

are being built are gas-fired. But TXU has made a large pre-emptive announcement that it will build over 10,000 megawatts of new coal plant. That has caused a political and environmental furore because the proposed technology is classic supercritical coal technology, none of the new technological innovations. So in my mind it's somewhat doubtful whether we'll ever see that capacity built.

As to whether TXU, if it did build that capacity, would use it to subsidies their retail margins, well I can only take the evidence of the past two years where TXU and other baseload generators have been making extraordinary profits upstream. We have seen no evidence whatsoever that any of those producers subsidising the downstream retail business and as we approach the end of Price to Beat, it appears that there is significant market discipline in Texas which we expect we'll see maintained through the end of year transition into the future.

4.14 Edmund Reid, Cazenove: Two questions: the first one is if you can give us an idea of the marketing cost of price rises, just roughly how much?

Mark Clare: Well if you just take the marketing cost alone, it's probably around £20 million, but then of course you've got all the operational costs; we have to backfill the call centres, do all the mailing and obviously the interaction with customers. So I guess you'd probably be looking at about £35-40 million in total, of which £20 million is pure marketing.

Edmund Reid: And my second question was on Sam's presentation. You mentioned a lot integrated. That is a quite common term which is slightly different from the message we saw four or five years ago. I think in 2004 the Board gave guidance in terms of what they were looking for on gas and electricity in terms of integration. Has that changed and do you take a slightly different view?

Sam Laidlaw: When I use the word "integrated" I'm not talking about necessarily a complete - the hedge position, I'm actually talking about the way the company is managed and the way we actually use our brand and our marketing presence also to secure upstream positions, and the way we actually manage the commodity risk through the value chain. So I think there is a lot to do in terms of process and in terms of organisational structure to make Centrica more integrated. The second sort of supplementary part of your question is, have our targets for hedging the production and power generation changed and the answer to that is we don't have new targets in that area at this point in time.

4.15 Richard Alderman, Merrill Lynch: Just a couple of extra questions on British Gas Services if I may; the £24 million you mentioned in terms of increased costs, is that the lion's share of what we should expect for the full year. And a broader, more strategic question – you talked obviously about those costs involving a significant amount of tidying up of the IT, pensions and structural separation of the business. What's the Board's

attitude to the long-term future of that business. Are there ways that value could be crystallized by looking at it as a partial separation, possible listing. Indeed there's been some speculation in the market that you've received unsolicited offers for that business, could you confirm whether that's the case or not?

Roger Carr: Well I'll give you the sort of overall Board commentary as at today. The position is that we clearly drive the business for shareholder value. It is front and centre in the Board's activity. When we look at the business, we do see that the Service business and the brand value that the Service business brings to the overall offering we have, is both valuable and material, and it's also got headroom for growth as has already been made clear. So we think the combination of the service offering, as well as the commodity product offering, is a strong combination, and we think it adds glue to the customer proposition. And as a result of that, it seems sensible to us to keep the two together, and to build value in the totality of the group, by actually leveraging the quality of that business, as we are doing under the management now, to get growth from it. So that's the sort of broad policy position. Now all of this, of course, is where the business is today, but we think that's a sound start.

Chris Weston: With regard to the operating costs, there is obviously a full year impact of separating the two businesses, and there will be some additional costs there. On the IS side, we have invested a bit more in the work management system; not a great deal, but there's also had to be some investment in the underlying infrastructure and applications that that system sits on. That amounts to about £4½ million this year, and that's the full year cost. There will probably have to be some incremental capital expenditure in future years, but of that kind of magnitude, not larger.

4.16 Richard Gray, Credit Suisse: Just two very quick questions: First of all, perhaps just for Jake. Could you just give us an indication of how the market looks as you're contracting upstream, and just give us an idea for what sort of proportion of volumes are still linked to oil prices, and what the sort of duration is – i.e., you know, looking forward, will it really be the end of the decade, or is it more likely to be the end of the next decade before we start to see oil prices and gas prices de-linking?

And secondly, obviously we're all aware of your upstream credentials. Clearly, as you've indicated, there isn't really much of a change in strategy, really, from the strategy laid down a couple of years ago. The other crucial element is cost cutting. Could you just give us an example of your cost cutting credentials from previous employ?

Jake Ulrich: I think that's a relatively difficult call to make, and it really depends on how much gas shows up in Europe over the next few years. I don't see a strong de-linkage move in the next two or three years, especially with these oil prices where they are now. I mean, there's going to be quite a lot of resistance from the producers. As soon as there's some change though, you will see some move towards a gas indexation. So, anyway, it's

a slow process. Most of our oil linked contracts will be rolling off here, both on the industrial side, sales, and the few purchased ones that are linked to products, so…

Richard Gray: You are signatory to pretty much every single major….or contract underlying all the major infrastructure developments that have been taking place. Can you just give an indication of what….you know, how much there is a link to oil, and over what sort of duration, just so we get a better feel? I mean, are we talking about at least 50% of the price is oil related and that's going to last for ten years? Because that's going to give us a pretty good indication.

Jake Ulrich: I don't think anyone could tell you that, to be honest. But if you look at the contracts that are being signed, the ones we've signed, as we've said before, there's no oil linkage per se in the contracts we've signed around the BBL and around Langeled. But is there a correlation of oil because there's a linkage to Continental prices? Yes. And it's the contracts that are indirectly influencing that – it's the ones that…you know, EON/Ruhrgas, Gaz de France, the Norwegians and Gazprom; those things are re-negotiated every several years. I can't tell you how that is going to go directionally.

Sam Laidlaw: I think there's another element to that part of the question, too, which is the introduction of LNG. Jake has been speaking very much to piped gas, but as we start to see LNG coming in, which is priced in very different ways, then some of that oil linkage will start to fall away.

The second part of the question, I think, on costs, I mean, how long have you got? There's plenty of track record, and whether it's putting place SAP systems upstream and downstream, which I did at, you know, Amerada Hess ten years ago; or whether it's sort of more recent experience at Enterprise; I think the cost came out pretty quickly there, although I wasn't there very long, and I think if you talk to anybody who was there they would agree with that. So, I don't think that's a concern. The issue is making sure that you really do proper process re-design, so that you're not just taking permanent establishment and employees and substituting them with contractors. And that, I think, is the opportunity at Centrica, is to really do end to end process re-design.

Roger Carr: And I can absolutely reassure you, that in the first four weeks of Sam's involvement, the focus on where we can save money has been absolutely ruthless so I've got no doubt that's going to be reflected in his tenure here in this business.

4.17 Bobby Chada, Morgan Stanley: I just wonder have any of your customers actually received a dual bill yet? Or will that not happen until sort of later in the year? And if they have, when they get this bill that's kind of double what the other two were, roughly, what's the reaction been?

Mark Clare: Well, the good news is, a lot of our customers have received the new SAP bill, but we have held off of sending out dual fuel bills in great volumes. I mean, we thought about, if you like, having to opt out, so unless you opted out, you would actually receive a dual fuel bill, but what we want to do, obviously, our priority is to get the system in completely and as soon as we've done that, then we will start to actually offer the benefits of dual fuel bills to our customers.

Bobby Chada: So, in simple terms, no-one's received on yet?

Mark Clare: Very, very few, yes.

4.18 Ajay Patel, DrKW: I'm just trying to understand the term "appropriate margin". So, we were here three years ago we were talking about an 8% margin, target before this unprecedented rise in wholesale prices. What I'm trying to understand is, ok, bills have gone up, so obviously the margin that you talk about from British Gas residential would have to go down, but has your viewpoint of the appropriate margin changed over that period, then, has that decreased? In terms of profit rather than a percentage?

Sam Laidlaw: I'll make a comment on that. Clearly the recent margins and obviously the first half year is completely unsatisfactory, but I think industry commentators have said, you know, that a 5% margin on this business might be acceptable. My personal view is that with the economies of scale, that we should have the brand strength that we should have, we clearly need to do better than that. I think to get double digit returns in this type of business is unlikely, but we certainly need to be well north of 5 and that's where I think, over time, a combination of cost reductions, service delivery and our pricing power, needs to get us.

Roger Carr: Well, thank you all very much for coming this morning. Thank you.

ENDS