Centrica plc
Interim Results for the six months to 30 June 2005

15 September 2005

Roger Carr, Chairman

1. Opening remarks

Good morning ladies and gentlemen, and in this vast auditorium welcome to the presentation of Centrica's 2005 Interim Results. In spite of the best efforts of the newspapers over the last two or three days you will be pleased to know that there is indeed some new information this morning which will hopefully make it worth your while coming.

As usual Sir Roy and Phil will make the main presentation, after which we'll have plenty of time for questions. And in addition to Roy and Phil we've also got some of the team here this morning, Mark Clare; Jake Ulrich; Derek King who you're all familiar with; and for the first time Chris Weston who is looking after the home services business.

Before the presentation I'd like just to make a few opening remarks.

1.1 Succession Plans

Firstly I want to comment on our succession plans. You will have seen our announcement this morning that Roy is joining the board of Compass and will retire from Centrica within the next 12 months to take up the role of non-executive Chairman of Compass in summer 2006.

Clearly the lead time to effect this change will enable us to conduct a thorough and exhaustive appraisal of both internal and external candidates. An executive search consultancy will be used to ensure we select the right person for this important role in a timescale that provides a reasonable period of handover to effect a seamless transition.

Roy will remain at the helm until next summer with my unqualified support, the board's total confidence and his personal resolve and commitment to deliver on our business plan in the year ahead.

1.2 Review of the first half

I'll now make some observations on the last six months performance.

Overall the results are good. Financially it was a successful first half delivered against an industry background that continued to be particularly challenging.

Strategically we have demonstrated patience in the pursuit of asset acquisition and prudence in purchasing assets that show early and earnings enhancing pay back. We have also made some longer term measured investments in energy exploration with a view to providing a value creative hedge in the future. We will continue to apply these capital disciplines whilst seeking opportunity to strengthen our flexible upstream portfolio. Additionally we've deepened our involvement in continental Europe through further acquisitions in the Netherlands and Belgium, and our aim remains to broaden our involvement here when opportunity permits.

Reflecting the strength and focus of the group on energy and related services we have decided to commence a process for disposal of Onetel, enabling us to fully focus our capital and resources on our continued development as an international energy company.

Operationally the team have attacked the cost base with vigour through the development of new IT systems, increasing our offshore commitment in selected service areas and driving efficiencies in our back office business processes. Customer attrition is being addressed with more innovative propositions and stronger selling and marketing campaigns.

Our pricing policy is to fully recover wholesale costs from our customers but respecting both the level and volatility in the forward curve and the competitive dynamics of the market. On this occasion we have chosen to extend the time over which we will recover our wholesale costs believing that the curve will soften and in the knowledge that we have the opportunity to revisit our pricing again in the coming year.

Managerially Roy has reorganised the team responsibilities to ensure appropriate focus on the delivery of cost reduction, IT systems conversion, home service growth, efficient asset management and the opportunity in continental Europe and as part of these changes the title of Deputy CEO was dissolved. At board level we've appointed Andrew Mackenzie as a non-executive Director who brings considerable upstream operational experience from senior management responsibilities he has held at British Petroleum and more recently at Rio Tinto.

1.3 Returns to shareholders

Finally in keeping with our commitment to shareholder value we are increasing returns to shareholders through our buyback programmes and increased dividend. It is the board's intention to grow annual dividends per share in real terms in 2006 and thereafter.

1.4 Outlook

Finally while much has been done there remains more to do. There is no doubt that the business faces a difficult second half and that 2006 will be equally challenging for the management team. I would emphasis however, that I and the Board are confident that the fundamentals of the business are strong and that the management will be robust in meeting these challenges.

I'll now hand over to Phil who's going to give you a review of our financial performance.

Phil Bentley, Group Finance Director

2. Financial Review

Thanks Roger and good morning everyone. As usual I'll take you through the headline figures for the Group and then go through the key movements in our main businesses.

Note that this is our first set of results under IFRS. We've described before in detail the main IFRS impacts – which are listed for the record on the slide – so I'm not going to go through them now. I do want to stress though, as I said in May, IFRS does not change the way we make decisions in Centrica. Neither does it affect the underlying drivers of value, cash generation or indeed the overall direction of our strategy at Centrica. For these reasons we've chosen to present our income statement in a three column format and in discussing our results will concentrate on the underlying business performances i.e. after stripping the IAS32 and IAS39 mark-to-market move.

2.1 Financial Highlights

So turning to our headline figures, turnover rose by 16% to £6.8 billion due largely to a 68% increase in turnover in North America and strong growth in British Gas business and in our home services businesses. We generated nearly £1 billion of operating profit in the first half, up 19% on a continuing basis principally due to high gas prices driving strong profit in our upstream business. Remember that the absolute quantum of operating profit in both 2005 and the prior year is now much higher under IFRS due to PRT and the tolling fees now being charged after operating profit.

This explains why growth in earnings therefore is lower compared with the growth in operating profits. Earnings from continuing businesses were up only 6% year-on-year due to those higher PRT and CT charges on our upstream assets. But EPS grew by 10% benefiting from the share consolidation in the latter part of last year and the share repurchase programme.

Cash generation remains a key Centrica strength with after tax net cash inflow before CAPEX and acquisitions of £878 million up some 18%. Our 24% increase in the interim dividend reflects our commitment to a higher payout ratio this year.

So overall a good first six months but as everyone recognises – and as Roy will touch on – the outlook for the second half looks more difficult.

2.2 Operating Profit Analysis

So let's first look back on the key drivers of profitability in the first half. As I said, in total operating profit was up 19% and against the current background of extreme volatility in commodity markets our upstream business provides a hedge to the impact of our commodity prices on our downstream businesses and looking at the UK energy operation as a whole, we saw a 16% increase in total operating profit.

In the longer term we continue to expect our downstream businesses to make a standalone economic return and we're getting our costs down to make sure that that happens. At the same time we expect our upstream business to deliver the profits commensurate with the level of shareholder capital employed in those assets.

Beyond UK energy Home Services and North America both had a good first half which I'll touch on shortly.

2.3 British Gas Residential Energy

Turning to the UK in more detail starting with British Gas Residential Energy.

Operating profits here of £165 million were down 24% on the same period last year. Our price increase in September '04 gave us an additional £374 million of gross margin which more than offset the £341 million at higher commodity and transportation costs. This over-recovery is a first half effect only and won't be replicated in the second half. Whilst we'd originally envisaged an inflation level price rise in '05, commodity prices have continued to rise and for the fourth quarter now are over 40% higher than they were at the time of last year's price rise hence the need for the 14.2% announced last week.

Our energy efficiency commitment of £62 million in the first half continues to increase, up £24 million from the same period last year.

Lower customer numbers have reduced gross margin by £53 million combined with a reduction in average consumption per customer, mainly due to the adverse weather mix which has reduced margins by a further £31 million. We are beginning to deliver on our cost savings; a net £23 million positive year-on-year, despite the first half sales and marketing activities.

2.4 Centrica Energy

Moving on to Centrica Energy which turned in a very strong performance, primarily due to the 40% increase in gas production profit. Higher selling prices at Morecambe generated £172 million of additional margin, although this was partially offset to the tune of some £82 million by lower production volumes, down 17%, in line with the previous guidance that we've given.

Production from equity fields other than Morecambe, for example Goldeneye, Horne and Wren and Rose was actually up 25% and along with the contribution from Statfjord generated an additional £65 million of profit.

In our industrial and wholesale segment we lost £20 million, some £45 million adverse to last year. Although the average sales price of the industrial contracts were beginning to rise now up 11%, this still lagged the 27% increase in input cost. And the outlook for the second half therefore is for increasing losses.

Finally Accord increased its operating profit by £13 million, as a result of the trading opportunity arising from the higher levels of market volatility.

2.5 Other Businesses

In our other businesses, Home Services continued to deliver strong results with operating profit up by 44% to £59 million and turnover 10% higher. The improvement in margins reflects the contribution of Dyno-Rod which we acquired in the second half of '04 and the faster pace of growth in the higher margin products of plumbing and drains and home electrical care, supported by continued growth in central heating products.

British Gas Business also had a good first half, with operating profit up 20% to £55 million, despite the continued rise in wholesale prices. Even after increasing the average selling price to customers for gas by 23% British Gas Business still managed to grow its gas customer base. And it also held its operating costs broadly flat. But as with British Gas Residential though, this business will face a more difficult second half due to the higher commodity costs.

The results of Centrica Storage demonstrate the value of our 2002 acquisition. The average SBU price in the first six months was 53% higher than in the first half of '04 and the second half will be up again, as SBU prices for the '05/06 storage year are up a further 33%. The increase in SBU prices is largely driven by the widening winter/summer differential which has gone from around 7 pence per therm when we acquired the field to around 28 pence today.

But we've also increased the operational reliability from our investment in the asset which increases the price customers are willing to pay for this certainty.

The underlying profitability of Onetel is good but it suffered an overall loss of £2 million in the first half due to higher acquisition costs which supported the accelerated 29% growth in fixed line customers and the one off restructuring costs from moving operations to India. In all an adverse year-on-year variance of some £12 million. We believe that Onetel's 1.7 million customer base, combined with its low operating cost model will be attractive to potential buyers of this business

And finally North America increased its operating profit by 38% to £87 million driven by 9% customer growth in Texas and the year-on-year effect of the 2004 industry true-up. Retail prices were higher but were partially offset by higher commodity costs as well as increased customer acquisition costs in business markets which delivered a 94% turnover growth.

2.6 Returns to shareholders

In his opening remarks, Roger referred to our commitment to shareholder value and to increasing shareholder returns. We've almost completed our first £500 million share buy-back program and have increased the program by a further £500 to £1 billion. We've increased our interim dividend by 24% and we'll deliver a full year dividend in line with our commitment to an increased pay out ratio this year. Finally, reflecting our confidence in future performance, it is the board's intention to grow annual dividends per share in real terms in 2006 onwards.

2.7 Summary

So in summary, financially it will be a year of two halves. We had a strong first half but there are significant challenges for us in the second half.

Although we continue to believe that the forward curve is still overbought, even on our view of the curve and after our latest retail price increase, full year operating margins in British Gas will be lower than last year. And we currently expect earnings per share to be towards the lower end of market expectations, as we announced last Friday.

The higher proportion of upstream profits will increase our effective corporation tax to around 35%, up some 6 percentage points on the full year last year. And including the higher PRT charge the total effective tax take in 2005 will be close to 55%.

Cash generation will remain a key Centrica feature and we're confident of our financial strength to deal with these extreme wholesale energy prices in the short term. And we remain committed to maintaining our single A credit rating and to the strict financial disciplines that have characterised our investments in the past.

So with that let me hand over to Roy to go through the details.

Sir Roy Gardner, Chief Executive

3. Chief Executive's Review & Outlook

Thanks very much Phil and good morning everyone. Phil's taken you through the financial results in some detail and I'm now going to give you my perspective on the things that the business has achieved during the first half. And I'll also make some comments on the outlook for the second half.

Now as both Roger and Phil have said there's no doubt that financially it was a very good first half. Although it's been a very challenging period with the continued volatility in wholesale markets and high levels of customer churn.

In February I set out our management agenda for 2005, so this morning I thought I'd report back to you on how we're doing against those agenda items. Whilst recognizing that there's still a lot to do and the challenges aren't getting any easier I'm very encouraged by what we've achieved so far this year.

3.1 Leveraging the value of scale

We said our aim was to leverage the value of scale and let me remind you why we think scale is important. It enables us to drive down our costs to serve, it gives us greater strength in upstream negotiations and it also gives us significant cross-selling opportunity. And our strategy is to focus on energy and related services, to defend our UK energy position and to grow in Home Services, to grow in Europe and to continue to build on our position in North America.

The chart shows that we've been steadily growing. We now have around 34 million customer relationships across energy and related services, an increase of 12% in three years. Growth elsewhere has offset the recent erosion in our UK energy base.

3.2 Disposal of Onetel

As part of our focus on energy let me now touch on our planned disposal of Onetel.

We've built Onetel into a strong business that's a serious competitor to BT. We're now starting to see some of the regulatory changes that we've lobbied for and these will open up opportunities for Onetel going forward.

However in the past two years we've increasingly moved towards an absolute focus on energy and related services and successfully divested both Goldfish and the AA. Whilst telecoms is still an important part of our overall product offering, having established ourselves as a credible alternative provider we now no longer need to own the business in order to provide the product to our energy customers. We've reviewed our options and concluded that our capital and resources are better deployed in pursuit of our focused strategic aims. We have therefore commenced a process which is likely to lead to the disposal of the business.

3.3 Getting back to growth in British Gas

Turning back to the 2005 agenda, we started out the year with a strong action plan to get us back towards growth in British Gas, and we've delivered good results with positive trends in both sales and churn.

Since April we've been consistently selling over 50,000 new energy contracts each week, as high a level of sales as we've ever seen. It reflects not only our increased efforts on the phones and the doorsteps but also the benefits of our cross-selling system and the success of the products we launched earlier in the year. For example, a million customers took up our capped energy contracts. A quarter of a million customer signed up for our free evening and weekend calls offer. And over 60,000 customers have taken advantage of our on-call assistance product, with a conversion rate of over 75% to a central heating care contract.

The disappointment is that it's taken longer than we'd anticipated to turn round our losses, but in electricity we've had nearly three months of net gains, and over the last few weeks, we've grown overall in energy.

Last week we announced a retail price rise. On this occasion we've followed rather than led, but obviously we expect to see an impact on sales and withdrawals. Our experience from last year has helped us develop our action plan for managing the increase. We've launched new propositions and have higher profile marketing. We're already selling our new fixed price contract and there are other products ready to go - and here you can see examples of some of our new marketing materials.

3.4 Reducing costs

Now in the first half, we've also made progress on taking costs out of the business. We've re-engineered many of our processes and that's enabled us to remove roles from across the Group. Last year, as you know, we identified 1,500 jobs we could remove from the organization, and earlier this year earmarked another 2,000 to come out from British Gas. And across the Group there are other cuts on our radar, with the simplification of the Group structure following the sale of the AA and Goldfish, and the planned sale of Onetel, we've identified areas of our support functions that can be reduced. This is something that I'm personally going to be driving through.

You'll have seen our announcement that we intend to move a significant amount of our back office work to India, although our customer facing staff will remain in the UK.

In total, we've told staff that we're closing five offices, which will bring some very real savings in the future.

Our new billing system pilot has begun on schedule, with 50,000 customers now live. And we've also sent out our first dual-fuel bill - a major milestone for us. We'll take the pilot through a full billing cycle and we'll evaluate the results ahead of the main customer migration which we expect to start around the turn of the year.

In Home Services we've rolled out our new deployment system to over 5,000 engineers and we're confident that the benefits that were delivered in the pilot will be delivered on a national scale once the system is fully in place.

The British Gas transformation programme is delivering its benefits. We're taking costs out. However it's increasingly difficult for us to ring fence the savings directly attributable to the transformation programme and to demonstrate to you that the benefits are being delivered. So let me make it simple: In 2007 Mark Clare and his team are committed to delivering a cost base for British Gas energy, that's at least £150 million lower than the base of £1.05 billion in 2004. Allowing for the effect of inflation and rising energy efficiency commitments that's a reduction of more than £200 million over that time period. That's a simple commitment, and we can't be any clearer about the level of focus that cost efficiency its getting within Centrica.

3.5 Growing Home Services

Turning now to Home Services which is a continuing good story. In the first half we grew all our product lines, turnover was up by 10%, profits by 44%, and margins by 3 percentage points. This remains a key area of competitive advantage for our energy business, and it's a market with big potential. In the areas of interest to us, we believe there's an addressable market of around £6 billion and it's growing. We've built a skilled national workforce that we're very proud of and are continuing to invest in. We'll keep working hard to retain our market leadership position and ensure we're well placed to exploit the continuing growth opportunity.

3.6 Management changes in British Gas

In energy, it's mostly about customer retention and cost reduction. In Home Services, it's firmly about growth – two huge, but different challenges. To ensure they both receive the appropriate level of focus, I've chosen to separate the two parts of the business. Mark Clare, under whom British Gas has made remarkable progress this year, will now concentrate solely on energy supply whilst Chris Weston, who previously ran Centrica Business Services, will lead on Home Services. Mark and Chris will work side by side to ensure each business continues to support the other and that the synergies are delivered.

3.7 Upstream investment

3.7.1 Infrastructure Projects

Turning now to upstream. As we said before, total UK gas demand is around 105 BCM per year, and there are already import projects which by the end of 2007 will have a combined capacity of around 90 BCM. And we're pleased to see progress being made on a number of these projects. For example the first 8 BCM expansion of the existing Interconnector is now expected to be ready by the start of November, a month ahead of schedule. At Easington the onshore connection for the Langeled pipeline has now been built. And Isle of Grain took its first LNG shipment on 4th July. Beyond this timeframe, there's also the new plan for more LNG facilities to be built at the LPG terminal at Canvey Island.

It was encouraging to see the sharp drop in winter prices on the announcement that IUK would be early, reinforcing our view that there's still a lot of sentiment in the forward curve, and that as the additional capacity comes on stream, prices should start to come off.

3.7.2 Gas

Looking at what we've done this year, I'm pleased with the progress we've made on securing our upstream supplies, despite an overall difficult environment for asset acquisition.

We said before that securing the amount of gas we're looking for would require us to be innovative in the sort of opportunities we've considered. Our preferred geography is still the UK and Norwegian continental shelves but we're also looking further afield, for example to North and West Africa and to the former Soviet Union. Jake mentioned in February that we'd probably also go a bit further upstream and participate in some exploration. You'll be aware that recently we've been awarded two licensing blocks in Nigeria. And in the UKCS we plan to drill over the next 12 months, six new wells.

LNG will play an increasingly important part in UK gas supply, and as you know last year, we signed our first major LNG contract; the 15 year deal with Petronas, worth potentially around £4 billion. Since then our acquisition of re-gas capacity at Grain, plus the potential for us to gain capacity at Canvey has increased our attractiveness as a potential partner in further LNG deals.

3.7.3 Power

On power, we've still got the option to build at Langage, but we need more clarity on carbon allowances for new-build before we can finally make the decision.

We have now delivered our first green power into the grid from our onshore wind-farm in northern Scotland, and that's a 26 MW farm, enough to power around 20,000 homes. Offshore at Barrow, construction is well underway. The turbines will go up during the autumn, and we expect the farm to be generating by early 2006.

All in all we're making good progress.

3.8 Continental Europe

Now to look at growth in other business areas and really here we're talking about international expansion.

Firstly in continental Europe. Developments here are important to us. We want to access gas that has to flow across Europe, so we want free and open access to networks, and we want to be able to compete and grow scale in deregulating European energy markets. To date, progress has been frustratingly slow, but we're encouraged by the EU Competition inquiry into energy markets and the Transportation and Energy review, and we're making sure that the UK government understands the importance of raising energy up the agenda in Europe during their presidency of the EU.

In the first half of the year we increased our footprint in Europe. Our acquisition of SBU in partnership with Gaz de France has enabled us to secure both generation capacity and 20% of the retail market in Belgium. In the Netherlands we've acquired a good business with Oxxio which also gives us the opportunity to build a deeper understanding of the Dutch market.

In the short term we see the Benelux region as offering the best opportunities for us. It's likely that the Netherlands will make the fastest progress towards the industry structure that we find the most attractive - that is, full separation of regulated networks from energy supply and upstream assets. And we expect that to open up opportunities for us.

In addition to his role of Group Finance Director, Phil is now leading our European activity, to make sure we fully evaluate and take advantage of the opportunities.

We're confident that Europe will give us growth potential in the future, but we have to focus our efforts on it today.

3.9 North America

Looking at our other international business, North America. So far this year we've gained, organically, more customers in Texas than Reliant and TXU combined, and lost fewer customers than either of them in our incumbent areas. We've also successfully re-filed our Price to Beat in both areas, allowing us to raise customer bills by around 10% on average.

In Canada, the Ontario power market has now reopened and we're signing up new contracts, but the conditions for competition are still difficult. And in Alberta, the regulatory environment is making it difficult to switch customers to non-regulated tariffs.

But in Home Services, the business is growing well. And in business markets we've almost doubled our turnover year-on-year with rapid growth in all existing markets and entry into a number of other states. It's a very competitive market and margins are currently thin, but we continue to see it as an important growth area for our North American business.

In a short time Deryk and his team have created a scale business. Their focus now is on growing that business organically, supported where appropriate by small and well targeted acquisitions. And we expect to deliver over £3 billion of turnover from North America this year.

3.10 Outlook

Now I'll talk about the progress we've made in the first part of the year, but how does the second half of the year look? Well, clearly we're in uncharted waters, but one thing is clear; financially, it will be a lot tougher than the first half.

We've now priced for 2005 and the outlook for the remainder of the year is very dependant on what happens with commodity prices. The gas forward curve has historically been a poor predictor of outturn prices. For example, at one point last autumn the curve was forecasting around 80 pence per therm for January '05, but prices actually outturned on a month-ahead basis at 30 pence. The curve for the coming winter looks similar to the curve for last winter. Although we still believe it will outturn at a discount, the absolute level of that discount is likely to be less, due to both the recent convergence between UK and European prices and the continued rise in oil.

Ultimately wholesale energy costs will be passed through to customers. However, even on our own lower view of the curve the scale of price increase which would be required to fully recover wholesale profit in this financial year, would be completely unpalatable, and would potentially destroy long term values. This is simply a timing issue. There's always a time lag between commodity movement and retail price response. And in a rapidly rising market, that leads to a short term squeeze on margin. Over time commodity costs will be fully recovered and margins should expand as prices start to fall. In our recent pricing decision therefore, we've chosen to protect our customer base in the short term. And as a result in British Gas residential energy full year margins will be lower than 2004 and at a level we consider commercially unacceptable in the long term.

We'll continue to seek to expand margins through cost reductions and, in the remainder of the year, we'll be making further progress on our cost initiatives. Alongside that, we'll manage the impact of our latest price rise. We'll thoroughly test our billing system ready for full migration during 2006. And we'll continue to look for opportunities to expand our upstream portfolio.

It's also important that whilst we're addressing the near term challenges, we don't lose our focus on the longer term. Building and strengthening the business foundations, is key to delivering a future value. Centrica is a strong business and its prospects for growth are sound.

3.11 Conclusion

Now in conclusion, I want to emphasise the following. Although I've announced my retirement, I'm still here until next summer and for me it's absolutely business as usual. I'm personally going to be pushing the team to deliver on customer retention, cost reduction, implementation of our IT system and delivery of value adding upstream acquisitions. I remain committed to disciplined management of capital and continued delivery of shareholder value. These have been hallmarks of Centrica since 1997 and there's no change now.

I'm not under-estimating the scale of the challenge ahead, but I'm confident that we've got the right strategy, the right model and a management team that can and will deliver. Thank you.

Questions & Answers

Q1. Bobby Chada, Morgan Stanley

You talked a lot about cost reductions and I think the figures you gave were £150 million cost savings '04 through '07 and in nominal terms. I'm just trying to put that in the context of the previous numbers that you've shown, as the benefits of the British Gas transformation programme. It seems to me that is not a change from your previous targets for '05 and '08. Could you confirm that?

Sir Roy Gardner

I think it's slightly better. As I said, it's very difficult to be precise about where the benefits are coming from, but the impact on the cost base will be slightly more than we said. We always said that the benefits from transformation would be in the range of £150-200 million by the end of that year. And the way things are going, we'll be towards the top end of that. We've identified a few more savings and that's why we made that statement this morning. We've identified more savings that we can make across the group within the support functions and that will be a little bit more to come. So I just think this is confirmation plus a little bit more.

Bobby Chada
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And does this reduction exclude any potential increases in things like marketing costs, depreciation, EEC etc. or is it the total cost figure?

Sir Roy Gardner

The cost base will reduce by that number so any increase of costs in these areas are taken into account.

Q2. Martin Brough, Dresdner

It's just a follow up to that one. Could you just clarify – if you look at say the cost per customer on 2003 to 2007 will there actually be a reduction per customer over that period?

Sir Roy Gardner

Absolutely, yes.

Mark Clare, MD British Gas Residential Energy

Firstly on the transformation programme, you'**l** remember that some of the elements of the benefits are shown in margin, so lower churn as a result of the CRM systems, the metering programme which has delivered substantially low cost of metering cost to the business. So transformation goes a little wider than that. In terms of cost to serve, our real focus is to drive our cost to serve down below all of our competitors and we're probably in the back with one or two outliners at the moment, so we've got a real challenge. So we are focussing on that key cost to serve piece and we are taking account that customer numbers, unfortunately, are likely to fall, given the volatile environment we have. So we're looking for real savings in cost of sales across that period as well.

Q3. Andrew Wright, UBS

I know it's fairly early days but are you able to give any indication yet as to the customer reaction post the price increases announced recently and also to the new fixed price products you've put forward.

Sir Roy Gardner

It's very early days. Last Friday we announced the price rise. I can tell you that the 2010 product is getting a lot of interest which we expected too to so do. But it is far too early to say. Call volumes are pretty much the same. There's nothing abnormal.

Q4. Philip Green, Merrill Lynch

Just one further follow up on the CRM. In terms of capex, are we down on that or are you facing any further significant hurdles; including software upgradea and stuff like that on the SAP systems.

And secondly, just on Morecambe in terms of production can you just confirm the production decline range that you were suggesting before - I think its down 17% in the first half for this year - and also what your expectation is for 2006 for Morecambe's production decline? And associated with that what flex, if any do you have to improve on the headline situation through perhaps further capex?

Sir Roy Gardner

Well on CRM we're through all the capital spend. The largest part which we were working on, now the billing system is totally built. It's been through user testing and we're into the pilot. So there is no further software work to do unless we get any significant issues with the pilot which we've so far not seen. It's all about migration now to our customer base and training our staff to use the new system.

Morecambe the reduction this year will be in the range of 15-20% and next year 25-30%.

Jake Ulrich, MD Centrica Energy

The upper end of that range for the total year for this year and the lower end of that range for next year. I mean we're going to shut in I think part of next year depending on summer pricing and that's incorporated. So those are still correct.

Q5. Jason Steed, Lehman Brothers

A couple of questions. Firstly what is your open commodity position for the remainder of 2005?

The second's on Langage. When do you expect clarity from the government with regards to the second phase of emissions trading and what degree of clarity do you need in order to go ahead with making your decision to build or not?

Sir Roy Gardner

The first part of your question, you wouldn't expect us to tell you how open we are for the rest of the year, but we do have an open position, and that's commercially sensitive.

On Langage we would expect the government to come through with some confirmation in the position within the next couple of months.

Jason Steed

And that would be sufficient to make the final decision?

Sir Roy Gardner

They know what we need in order to make our decision, and if they don't come through with a sensible allocation of allowances in the next phase then there's going to be little investment in new power generation. So they know what they have to do.

Q6. Bobby Chada, Morgan Stanley

On the Kerr McGee acquisition, have any of the other owners of various stakes opted to exercise their pre-emption rights or should we assume that's going through smoothly.

And could you perhaps add a little bit of colour to the potential investment in Nigeria: next steps, what sort of activity will be undertaken, potential capex. I think you have a partner on that as well.

Sir Roy Gardner

On Kerr McGee that was a good transaction for us. There has been an pre-emption yes, on one small block.

Jake Ulrich

The pre-emption – one of the small sub-areas of exploration, again it's a relatively small piece we're talking certainly less than a million dollars in value. And that would probably go through. And we've had a pre-emption on one other piece, on Andrew, and we're going to contest that one - we believe it's on technical and financial grounds so we will contest that. Again, not the major portion of it which is on Skene and Buckland and Brae which were the pieces we were most interested in. But I think all in all we're still okay there.

On Nigeria, it's early days. We've committed to pay signature bonuses of US$5 million on each of those blocks and that's contingent, of course that we have a production sharing arrangement negotiated some time in the near future and we're well aware these things can drag out for some time. We've committed a spend over the next 12-18 months in each of those blocks of around £20 million for initial seismic and a few exploration wells. So it's pretty early days at this point. We have a pretty good team down looking at that now.

The interesting part of that is we've had quite a bit of interest from other players in joining into those blocks or trading into some other pieces. So on block 14 which is the offshore block the team has already started talking to at least one other European major about some swaps. And then on the onshore piece there are some other national oil companies, two of them that are interested in participating with us. So it's opened up a little bit of our "horse trading" opportunity here to see if we can get into some other areas, not only Nigeria.

Q7. Edmund Reid, Cazenove

I have two questions. The first one is on taxation for 2006, how would you expect it to evolve? I know its early days, but would you expect it to be going up – as upstream profits rise?

Phil Bentley

Yes, obviously the effective tax rate is increasing because there's a PRT take and the CT. Just to be clear, PRT is charging 50% of income and then on top of that you've got 40% on upstream profits, so those fields that are taxed in PRT - and South Morecambe's the biggest - effectively has a tax take of 50% plus 40% of another 50%, so 70%. So a lot will depend on whether that will go up any further will depend on the forward curve. Clearly with the forward curve in '06 being higher than '05 we'd expect upstream profits as a proportion of total, probably just to edge up a little bit again. Therefore the tax rate will just probably push up slightly again.

Edmund Reid

My second question was just on whether you've seen any demand response in terms of higher prices? I think you talked about the weather being an impact in terms of average consumption being down in H1 2005 on 2004. So I just wondered whether people are sort of switching on their heating a bit later – anything like that.

Sir Roy Gardner

We're not seeing anything like that.

Mark Clare

Nothing detectable. The big changes should be around energy efficiency – there's a lot of money being pumped in on that, but even there we're not seeing consumption figures falling. Certainly not detectable anyway.

Q8. Maurizio Carulli, AXA Investment Managers

Yes, two questions, if I may. The first one regarding the billing system pilot. When do you expect that to be rolled over, if you can give a bit more precision in your statement.

And second, before, Sir Roy was commenting about the forward curve for gas prices and was saying, if I've understood correctly, that the forward curve looks to have an element of over pricing and that that may well be disappearing over time during the next few months. However, we should not expect lowering prices as much as past but here,again, if I've understood correctly. Do you want to develop a bit more on that,on the reasons for that sort of analyses?

Sir Roy Gardner

On the billing system the migration will start just after Christmas and it will carry through in phases and will complete during the second half of the year. Just in the summer.

Jake Ulrich

I think you'll be aware we have a fairly sophisticated modelling system and it is primarily driven by long term supply and demand, but that's not the only input. A major input is the oil price and it's the Troll price and how that feeds into European prices. And last year, if you look and even last December oil prices were down around $40 a barrel as opposed to $65. So you can't expect the same drop-off. So last year we saw the curve, I mean extremely overcooked and we mention that it's still a bit frothy, but the differential's nowhere near as great as last year. And of course weather in the short term will drive that.

Q9. Andrew Mead, Goldman Sachs

Outside the UK, you've made some growth expansion in both Europe and the US. I just wanted to know whether or not your capital commitments, particularly on your need to vertically integrate, have changed as a result of that and developments of the last 6-12 months. And secondly, the priorities as to where you see the greatest need for vertical integration in the near term, whether it's more in European expansion or your North American expansion.

Phil Bentley (MD Europe)

I think we've always recognized that each market is different and it depends on how our competition is fixed up, regarding their own degree of vertical integration. When it came to Belgium we were effectively, as Luminus, having to buy from Electrabel our supplies or part of our supplies from our major competitor. So the opportunity to get generation that fully matched our supply needs was an opportunity we couldn't pass up. So in Belgium we've got full vertical integration.

I think if you looked at the Spanish market and maybe the Dutch market, again there may be some opportunities there to add some degree of vertical integration given what is potentially happening there vis-a-vis further concentration, consolidation and corporate activity in both markets.

So I think you're probably right to say over time, just as we're seeing a decline in the capex because we're spending less, if you like in British Gas now that the lion's share of the spend on the IT system is completed, yu'll probably see a little bit more maintenance capex going into those assets.

Derek King, MD North America

On North America I don't think we see any need to change previous guidance on the likely upstream asset spend. On gas, upstream assets confer a modest benefit to our downstream business, and so our approach tends to be opportunistic but the market is very frothy right now and we're not looking at acquiring major gas assets while prices are at their current peak levels. On power, in Texas that's our primary focus for upstream assets. You'll recall we have 1,000 MW of gas-based mid-merit plan now. We've just signed a large total offtake deal with a 120 MW windfarm in Texas and we're actively seeking to expand our base load with mid-merit and peaking cover in Texas but within previous investment guidelines. I would like dearly to have some upstream asset cover in Ontario but under the current regulations with the dominance of the provincially owned OPG that's unlikely in the near term. In our growth markets, in the North East and Midwest US, we're looking at extremely liquid power markets, with long-term availability of power up to five years out. So there is no requirement to invest in upstream assets to support our business markets growth in that region. We're looking, however opportunistically and if reasonably priced, economic assets come on the market we will look at those.

Q10. Peter Atherton, Citigroup

Two questions around the Onetel sale. Can you clarify what your telecoms offering is going to be going forward once Onetel's been sold and how you will actually source that. And secondly, is Onetel the final non-core business now outside the energy focus. And does Home Service actually fit within an energy focus group?

Sir Roy Gardner

Home Services is very much a part of our core business. The engineers are effectively the ambassadors of the British Gas brand. So there's no way we'd even consider that. It has huge potential, it's very important for the supply business, aids retention of customers. It does everything we want it to do. It's a great business. Onetel is also a good business but we've made our decision for the reasons I explained. Currently British Gas actually receives a service from Onetel so following the divestment nothing will change and that's the sort of arrangement we would like to negotiate with the new owner. And it's been working very well, free evening and weekend calls have gone down exceptionally well and it's the reason why Onetel's growth has been quite significant this year.

Peter Atherton:

So your intention is to market Onetel with a contract inclusive of British Gas.

Sir Roy Gardner:

That's right.

Q11. Nigel Hawkins, Libertas Capital

Two issues, if I may. Getting back to what Peter was saying on Onetel, why with your much cherished 34 million customer relationships do you think Onetel has been so disappointing financially?

And secondly, I recently went to the E.ON meeting and as you probably know they're minting money on the back of some substantial price increases in the UK recently on electricity. How concerned are you that with this sort of publicity that the government may re-introduce electricity and gas price controls at the retail level, as currently exists in the water sector?

Sir Roy Gardner

I wouldn't exactly describe Onetel's performance as disappointing financially. It's a very profitable business. The fact that it hasn't reported a profit in the half year is because it's grown so quickly. And I think it's an excellent business and will be very attractive to potential enquirers?

Nigel Hawkins

Have you got an EBITDA figure on Onetel?

Phil Bentley

It's probably about the half year, probably about £6 million, of that order, positive. And I think the other way of looking at it, if you look at the return on invested capital in the business on a full year basis last year, on a ROIC basis last year was 13.6%. So I don't think anyone would say it's been a disappointing performance. We haven't invested a lot of money into the business. I think you'll see from the exit multiples that we hope to get that we have created real value from that investment just as we did with the AA.

Sir Roy Gardner

I don't know what E.ON is producing in terms of profit from its retail business. I don't think there's the same degree of transparency but we're not printing money. Life is tough in the energy supply business and I think the government know that and certainly the regulator knows that. So I would not expect or anticipate any further or future price regulations.

Nigel Hawkins

So you're not concerned about the possibility of price controls being reintroduced?

Sir Roy Gardner

No.

Q12. Richard Alderman, Merrill Lynch

Apologies for asking this question but I guess it's on everybody's minds. There's been a huge amount of speculation in the press about M&A activity concerning yourselves. Could I just ask you, in this calendar year has any company actually approached you, and if so, are any conversations or any discussions still going on?

Roger Carr

I should probably pick that up. If we'd had any sensible formal approaches then I think we'd have had to notify the market accordingly. We are watching all the turbulence with interest. Clearly it is not going to go away from the industry perspective. But the issue for the Board is that our job is to make sure that this company builds value in its own right. That's very much what we're focused on, that's the whole of Roy's agenda over the next twelve months. I would equally say to you that as you well know, neither Roy nor I are strangers to takeovers, whether it be in the football business or in the water industry. And we're well versed in managing our responsibilities to shareholders. So in the event that one received a sensible and thoughtful opportunity and offer then we would respect our commitment to shareholders and value creation. But we are running the business today as an independent, but that is our focus, that's exactly what we're doing.

Richard Alderman

And the second question, given the competition issues, can you rule yourselves out of being interested in looking at Scottish Power?

Roger Carr

I think you know one should never rule anything in or out at any time, but as I've said to you our interest and our focus is on running our own business and we'll watch what happens with interest in the market place.

Q13. Peter Atherton, Citigroup

Can we just maybe squeeze a little bit more out of you on the dividend policy from '06 onwards? I mean "real growth" - it's not the most aggressive or detailed policy I've heard for a while.

Roger Carr

I think as a policy which is the important point to make we have made a material change in dividend policy over the last 12 or 18 months. Stepping it up and committing to further growth from that point on in real terms I think is very appropriate. I think it's absolutely in keeping with the nature of the company, but I do think it's a real demonstration of a very positive commitment to dividend growth from what was traditionally a low base, but which is now very much in accordance with peer group and which, if we can continue to grow it in real terms, will be a very good return for shareholders.

Phil Bentley

I think we're yielding above the average now, we yield about 4.2% and if you look at the 2001 to 2005, we're probably have a CAGR there of about 40%. So I don't think anyone would suggest we hadn't made big strides in dividends. I think what we're signalling into '06 is that don't expect these big jump-ups again. We're at the level where we need to be, and we'll make sure that we deliver some real growth on top of that, but it's not going to be the same level as the step-ups you've seen from a 21% payout ratio in 2001 to a 50% this year.

Peter Atherton

And just a follow-up question on the buyback programme. What's the timeframe you're envisaging?

Roger Carr

We've set the stall out to complete the first one and go into the second. The first one we completed over 12 months, and we would expect the same I think going forward.

Q14. Iain Turner, Deutsche Bank

Can I just ask you about the decision you made about putting up prices from last Friday, how you arrived at the level that you did decide to put them up? And why, given that you probably likely to provoke quite a lot of switching you haven't put them up by more, and what evidence you have that not putting them up by as much as you maybe could have done will actually help you retain customers in the longer term?

Sir Roy Gardner

Well that was an exercise that took us some time. Clearly we wanted on this occasion to bear in mind the lessons we learnt from the last price increase, where we disappointingly lost a million customers.

Mark Clare

Clearly we had two other companies already going, so we took notice of that. We looked at the cost of the commodity in 2005, so we obviously fed that into the equation. We have been carrying out research on what's likely to happen if we increase prices by more or less, and if you put all that into the melting pot, we concluded that we should be moving our prices by about 14-15% maximum. And obviously the proof of that will lie in the next 3-6 weeks I guess when we see the real reaction. But obviously it's a balance. What we are facing going forward of course, if commodity prices continue to stay high, is that obviously we may have some more decisions to make in 2006, and I think it gets more difficult then.

But we've learnt a lot from the previous price rise, and we've done a lot of things differently. You will see that we've been on the television the day of the price rise. We've gone very heavily with marketing investment as we put our prices up. We are much more reactive in terms of what our competitors are doing, and I think that we are in a good shape. We also have something like twice the sales capacity we had when we last put our prices up. So if you like, all of that is taken into the mix. It's no good assuming that we can simply ride this out and not put prices up. Clearly we have to, as the chairman just said, in the longer term we have to ensure that we recover our commodity costs. So that, if you like, is a given. The rest of it is really a decision we're making based on all of those various inputs, and when we next sit down I'm sure we'll be able to reflect on whether we got it right, but we think we have at this stage.

Q15. Jamie Tunnicliffe, ABN Amro

Just wanted to ask on your upstream capex programme that you've highlighted previously. Have you become more or less confident that you'll spend the sum that you've indicated to us in the past. And just if you could link that into your delivery of an efficient balance sheet, which is one of your key principles?

Sir Roy Gardner: Well, our investment programme of £5 billion was a five year programme and we're only just over a year into it. And I think we've made quite reasonable progress in that 12 month period and we see nothing to change our view on what we want to do going forward.

Phil Bentley

I think we've always said we would look to stay within the single-A rating, and the best way of leveraging up the balance sheet will be to make those value creating investments. Clearly we've got significant headroom today, but it certainly is our plan to stay within that single-A rating and the investments that we're planning to make will get us to a more efficient balance sheet than we're at today. So we agree the point you're making.

Clearly the buyback is helping as well, but we are generating a lot of cash. It's just a question of getting the timing right between opportunities that tend to come along only once and cash flow that's coming throughout the year. I think if we felt less confident now, we'd probably be doing more on the balance sheet, but I don't think we do feel any less confident. I think there are good opportunities to lay down capital for good returns.

Roger Carr

making that judgment remains a constant agenda item, you should be assured of that.

Q16. Andrew Wright, UBS

Just a follow-up question on the balance sheet issue. Would you or the credit rating agencies be more comfortable with higher levels of gearing if you had either a greater proportion of upstream hedge than you have today, or perhaps if the energy market was slightly less volatile? Are those important factors in considering the timing and extent of any increase in gearing in the balance sheet?

Phil Bentley

I think that's probably right Andrew. In the past when we only had intangible assets like the AA clearly there was probably less capacity for raising our gearing ratio there. But to be fair they are looking much more at cash flow generation as a key measure. S&P look at funds from ops over total recourse debt, and Moody's look at retained cash flow over adjusted debt. So the absolute. They are looking at cash flow and we are generating a lot of cash, and therefore I think we all agree we've got some capacity there.

Q17. Patrick Hughes, CSFB

On your commitment to single-A range, is that a range or are you committed to your current mid-single-A, because obviously a lowering would have implications on your short term rating?

Phil Bentley

Yes, no, I think it's a range. I think if we dropped a notch if we had to for the right deals, then clearly we would do. So no, we're not set in a mid-point.

ENDS