Roy Gardner:

OK, well, good morning ladies & gentlemen and welcome to our half year results presentation.

We've had a very strong first half and this morning I'm going to talk about some of the highlights, and Phil Bentley will take you through the financials, after which I'll conclude with a few remarks about the business outlook and then I'll open the meeting to questions. Financially we continued to build on the strong performance we achieved last year and we're very pleased with our progress. Turnover, excluding Accord trading, was up by 7% compared with the same period of 2001. Before exceptionals and goodwill we achieved £627 million of operation profit across the group, representing a 43% increase on last year. And earnings were up by 30%. And as a result of this performance the Board had proposed an interim dividend of 1.4 pence. And this represents a 17% increase over last year, and signals our confidence in the future, which I'll touch on later. Obviously Phil will cover the details behind the financials, but I want to emphasise a few points. We've increased our UK energy operating profit by 31%. And 49% of total UK operating profit derived from customer facing activities reflecting the progress of our strategy. And I'll come back to that shortly. We're making good progress in the provision of service to the UK commercial sector, and we've launched Centrica Business Services. Including our acquisitions of Enron Direct, and Electricity Direct, we now have around 26% of the UK commercial energy market. We've doubled our operating profit in this market, and we've improved our margins. We've achieved strong growth across the AA. We now have over twelve and a half million roadside members. Up by 8% year on year. And both loans and insurance are performing at record levels. In telecoms we've achieved significant cost savings and we've halved our losses. Our switched call routing model means we've been able to take advantage of the excess wholesale capacity in the market and negotiate improved terms with the carriers. In North America we're active in the newly opened markets in Texas and Ontario. We are also cross-selling energy with home services. And overall, we've increased our group operating margin from 9% to 12%. So despite a tough competitive environment and economic uncertainty in world markets we've continued to make good progress. In February we said that 2001 had given us a strong foundation for future growth and it's clear that that's been the case.

I'm going to talk a bit more now about how we are seeing the application of our strategy being demonstrated in our results. We talked before about customer product relationships and we're continuing to work towards our targets we've previously set ourselves. Increasing the number of customer relationships provides us with the scale and platform against which we apply these strategic imperatives to create value. And it's the combination of these imperatives that makes Centrica unique. The first strategic imperative is to continue to develop deeper customer insights. This means understanding for example key demographic information. How consumers trade off quality and price. And how that is affected by their brand perceptions. What sort of products they might want in the future, for example their desire for peace-of-mind products and interest in product bundles. Deeper insights enabling us to highlight valuable customer segments and focus our decision-making and actions on customer needs and behaviours. And we can link our targets to customer lifetime values. Our CRM investments across the group are important enablers for the development of deeper insights, and this year we've made good progress in enhancing our ability to collect, store and analyse data more effectively. And to give you an example of how we're using customer insights today, the AA's Just Ask campaign was developed from understanding that customers trusted us to look after them in situations where they were in

difficulty or felt vulnerable. So that insight has been used as the basis for promoting the wider range of AA products and services. Our launch of Centrica Business Services is another example. We've ascertained that consumers in this market are interested in a range of products and services from one source, provided they are appropriately bundled and priced. And that's the basis on which we are looking to expand beyond energy in this market.

Our second strategy imperative is product innovation and cross-selling. Using our insights we are focusing on developing unique and tailored products, pricing them appropriately, getting them to market quickly, and selling them using the most cost-effective channel and promotion. We've made good progress with both innovation and cross-selling. We have increased the reach of our new home services products into the market, and in the last 12 months we have increased by 48% the number of customers taking our plumbing and drains cover product, and we've sold over a quarter of a million electrical cover contracts. Compared with a year ago, we've increased the products per customer in British Gas by 6%. In telecoms, we've launched the One-Tel mobile service, and the One-Tel broadband internet service, both of which are extremely competitive offering. And in Goldfish, we've launched amongst other things an internet-based savings account and loans product, and both are already appearing in the Best Buy tables. Our aim is to sell more products per customer and so increase customer value and loyalty. And the output measures will include reduced cost per acquisition and increased targets for cross-selling. In highly competitive markets, customer service can be a key differentiator. This doesn't mean delivering a gold-plated service to every customer. It means delivering appropriate service relative to their needs and perception of value, using our insights to understand and develop those elements of service that *really* make a difference to the customer. And backing it up by delivering on our promises. And there's a clear link to customer satisfaction. In the AA for example we won the JD power award for the third time in four years and we did it because we've worked very hard to improve the things that customers told us were important. Providing the appropriate service standards will earn the right to a brand premium, and increased customer loyalty. And will ensure that cost to serve is more closely linked to customer value.

So to sum up these customer-led strategic imperatives, more data gives us the chance to develop greater insights, which means we can deliver more relevant propositions and services. So we increase sales per customer. And that gives us more opportunities for customer contact which in turn increases the amount of data we have. In effect, a virtuous circle.

We're also focusing on the creation of additional value by realising synergies and sharing best practice across Centrica. With the leverage across our business model Centrica is worth more than the sum of the parts. But, how do we capture this substantial prize? And how are we structured to deliver it? And that's what this strategic imperative addresses. We have a brand unit structure which enables us to deliver within brand synergies. In addition, our group operations team has the remit to look at all potential areas of synergy and capability building across the group. And I operate a philosophy whereby any brand unit which believes there are no cross Centrica synergies puts itself up as a candidate for disposal. Where activities can be combined, they will be. For example, our procurement and IT functions are already combined as group activities. And we run a finance shared service. And we're in the process of combining our HR services across the group. And another area we're investigating is credit management and debt collection. And we are also applying a more rigorous approach to the implementation of best practice ensuring that we deliver the maximum value for the whole group. For example,

our CRM investment is being rolled out initially within the British Gas brand. But we're already applying the lessons we're learning from it to similar developments within the AA and Goldfish. Successful implementation of this imperative will be demonstrated through reduced group-wide costs to acquire and serve.

Turning now to the final key strategic imperative: our upstream asset activity. We still aim to source around 25% of our downstream gas and electricity requirements from our own supplies. We're continuing to invest in Morcambe, to increase deliverability and prolong its useful economic life. And we're doing experimental drilling, to find the most cost-effective way of accessing additional reserves. And we're also pursuing other opportunities to replace Morcambe's contribution to our supplies, by adding to our upstream gas assets and interests. Our gas purchase deals with Gasunie and Statoil will secure enough supplies to meet around 30% of our demand at prices linked to the gas market. With low wholesale prices of electricity, it's a good time to buy generation assets, so we're continuing to look for suitable opportunities. For example, at £155 per kilowatt our acquisition of Brigg represents the cheapest CCGT transaction yet seen in the UK. Our energy management skills mean we can exploit opportunities when we arise, for example when the interconnector was out of action we were able to turn down production of Morcambe and take advantage of availability of cheap gas. We've also got significant skills in risk management, and a very strong control framework which Phil will talk about shortly. The only point *I* will make is that it's possible we will want to increase our asset hedge over the *medium* term, in North America and the UK, given our growth targets.

So having talked about our strategic imperatives, how are we seeing them reflected in the results we're presenting today? Well in the UK we've seen a re-balancing of our profit mix. In the first half of the year, 49% of UK operating profit came from customer facing activities, compared with just 16% in the same period last year. British Gas, the AA and One-Tel are all contributing to this improvement, and I expect Goldfish to follow.

Now I want to spend just a few moments on the subject of our UK residential energy customer numbers. And two significant factors have impacted these numbers this year. Firstly, the after effects of our gas price increase. You are aware that average gas costs had increased significantly over a two-year period, so we've had to increase our prices in order to restore margins. And we achieved what we set out to do. And although as we expected it did have an immediate impact on our gas customer numbers, the net loss in customers over the first half was less than that seen in the same period last year. As consumers have become used to buying gas and electricity from the same supplier, inevitably there's been some impact on our rate of electricity growth. Now the second factor is the publicity there's been about sales tactics in the energy market. We've taken a number of actions to ensure that the quality and value of the sales we make remains high. And these actions include a temporary slowdown in sales activity as we focused on ensuring that all our sales agents comply with our strict guidelines and focus on value customers. It's also worth just noting that although we've been losing gas customers, we've continued to add electricity customers, which earn us a higher gross margin. Broadly, our numbers have shown a recovery over the first half, and we're currently back to a positive net weekly movement. Looking externally for a moment, as the UK energy markets continue to develop, we've seen further consolidation taking place, which we believe will lead to a more stable and sustainable margin environment. The AA's core market has become increasingly competitive with a number of new entrants offering breakdown services. But new markets are

opening up. For example, the market for new car warranty repair. And the AA is in good shape to compete. In telecoms, you know we've been frustrated by the lack of a level playing field. We've argued very strongly for change, and I am delighted that our efforts are now starting to have an effect. Wholesale line rental and carrier pre-selection will make a significant difference to our ability to grow this business. We're also very pleased to see the strong push coming from Government on the wider roll-out of broadband. Outside the UK, the Barcelona summit in March gave us some encouragement that there's a growing momentum behind energy market liberalisation in Europe. Prospects look good for SME market across most of Europe by 2004. Overall our external environments are still very tough and there remain a number of challenges. But we're much encouraged by the positive movements that we've seen so far this year.

Turning now to North America, the Ontario and Texas electricity markets have opened this year as planned and we're very active in both. We're now servicing around 20% of the energy market in Ontario, and by the end of the year we'll have around 15% of the electricity market in Texas. We've also got active marketing programs underway in other key states such as Ohio, Michigan, Georgia and Pennsylvania. Our acquisition of Embridge Services was completed in May and through that business we're beginning to bundle and cross-sell. For example we're selling energy through Embridge retail stores and we're also selling home services products alongside energy. But the landscape in North America has changed quite considerably from when we first set out our strategy. Progress on deregulation is variable on a state by state basis and we recognise that organic growth is likely to be slower than we'd originally planned. But as a counterbalance the economic and business environment in North America and the financial distress facing some of our competitors, has created more opportunities to add value through acquisitions. We have the financial flexibility and the management capability to move quickly to take advantage of opportunities as they arise. Where markets are fully open, we'll pursue organic growth, supplemented with the acquisition of customer blocks where we believe we can gain and add value. And as we've done, in acquiring over 850,000 customers in Texas from AEP. We have the unique combination of both energy industry experience and retail customer focus, so where the markets aren't yet deregulated we'll continue to look critically at other acquisition opportunities, including those where it isn't possible to decouple customers and assets. We're looking for sustainable and profitable growth, so as we've done before we'll walk away from deals that we don't believe add value. One issue for us in North America is the inability of some of the regulators to maintain incumbent pricing levels which allow sufficient and stable profit headroom to attract committed new entrants. So in summary we continue to believe that the North American market represents a significant value opportunity. We're confident we have the strategy and capabilities to realise that value and we're still on track for our targets.

So to sum up, the first half of 2002 has been about building on the themes that characterised our progress in 2001. Profitable growth. Both organic and through value-enhancing acquisitions. Good defensive qualities, underpinning our growth platform. Brand strength, and corporate capabilities, enabling us to sustain a market leadership position in large and highly competitive markets. And financial scaleability, underpinning our performance. It's this mix of defensive and growth characteristics that makes Centrica a strong performer in an uncertain economic environment, and enables us to remain confident in our future progress. What I've done this morning is to give you a high level view of the business as a whole. We do want to talk to you in more detail about our brand units and how they're individually applying the Centrica strategy, but we can't do justice to it all this morning. We intend to do it through a series of seminars over

the coming months when you'll get an opportunity to meet more of our brand unit managers. Now I'm sure you're keen to hear more about the financials and to ask some questions so at this point I'm going to hand over to Phil.

Phil Bentley:

Thanks Roy and good morning everyone. I'd like to pick up where Roy left off focusing now on the financial highlights for the group over the half year. Turnover growth excluding Accord trading, was up 7% underpinned by organic growth particularly in electricity, home services and the AA, as well as by our recent acquisitions. Turnover growth would have been even higher, at 13%, were it not for the warm UK winter. We achieved a substantial improvement in growth and operating margins. Tax increased to £168 million due to higher taxes introduced in April on our upstream gas production. Earnings before exceptions and goodwill at £431 million grew by 30%. Turning now to the operating profit. I know that these reported segments reflect the divisions managing our day to day business, and there's a reconciliation at the back of the pack to last year's reported segments split. The slide shows the sources of our operating profit growth. British Gas residential reported the most significant increase. And I'll return to the drivers of this movement in a moment. Our new, sharper focus on the commercial energy sector also bore fruit, with profit more than doubling to 40 million, driven in part by the acquisition of Enron Direct. Profit for the Centrica energy management group was down 4% during the period, reflecting an 11% reduction in production volumes due to the warmer weather, offset by higher profits in industrial and wholesale. I'll return to the drivers of AA performance in a few minutes, suffice to say here that good underlying turnover and profit growth is being offset by strategic investment programs. One.Tel's contribution of £5 million reflects continuing growth and good cost control. Goldfish Bank's operating loss was £17 million, with increasing profitability of the core Goldfish card operations, partially offsetting our continuing banking platform investments. North America's contribution of £25 million was down by £4 million from last year, due mainly to increased marketing and market entry infrastructure costs, as I will highlight shortly.

So let me turn now to the movement in operating profit of British Gas Residential compared with the same period last year. As you can see, the impact of gas price increases of £173 million, was partially offset by a continuing rise in our average cost of gas. A 4% year on year reduction in customers, £21 million, and a 13% reduction in average consumption due to the weather, £44 million, further reduced our result, but we benefited from lower transportation costs. Our electricity improvement reflected our continuing growth in market share, while scaleability drove excellent progress within home services. Finally we have successfully brought down our cost base in our telecoms operations, British Gas Communications operating loss halved during the first half yielding a positive impact of some £26 million.

Within the AA, we saw good underlying profit growth across both roadside and personal finance. Within roadside, organic growth continued, as customer numbers grew by 8%, and we maintained a renewal rate of 83%, which together generated an increase of some £10 million in operating profit. Our personal finance business continued its solid growth as well. Insurance customers, and our loan book, grew by 10% and 62% respectively. Insurance renewal rates grew to over 80% which together yielded some £8 million of profit improvement. Our other AA units include both our service centres and a range of other start-up and smaller operations. To dwell on the service centres for a moment, with £21 million of turnover in 6 months, and the clear

synergies that we see with roadside, we believe that the economic value creation potential from this small acquisition, is actually quite significant. Offsetting this organic growth was 12 million of incremental investment in our Just AAsk marketing programs, and in our CRM infrastructure.

Turning now to North America. Gas supply profit was £21 million, benefiting from a larger customer base, higher pricing reflecting lagged higher wholesale prices, and higher average consumption, due to mix. In our electricity start-up business we incurred a loss of £20 million. We expensed £20 million in market entry costs relating to the opening of Texas and Ontario markets. Our Embridge services business contributed £6 million over two months, and is already performing ahead of the acquisition case. Production and trading profit was £17 million, gas production volumes grew by 12%, as we drilled and began production at double the sites, compared with a year earlier. But pricing fell by 29%. However the other side of our upstream production hedge is of course our downstream gas business, which as you saw enjoyed higher margins. This slide {Continuing margin improvement} shows the margin progress we're making across the group, the contribution from our restored residential gas margins was substantial, but by no means the whole story. Costs are being controlled relative to turnover growth, across the group, and this is taking place even as we pursue organic growth programs which are requiring significant marketing and systems expenditure above and beyond the natural run rate.

I'd like to touch now on our cashflow drivers during the first half. Our EBITDA of £830 million was up over £200million, as a result of the underlying profit growth. Gas transportation prepayments, royalty and PRT tax payments, which will peak in 2002, and other net increases in working capital, all absorbed cash during the period. Our capex doubled, due largely to increases in CRM investments and the Goldfish banking platform, and our acquisition payments resulted from the purchase of Embridge Services in Canada, and the Brigg power station here in the UK.

Let me turn now to accounting controls, where we've placed particular emphasis on ensuring that our reported results are disclosed in accordance with best practice. For example we have had written confirmations from each of our businesses that our turnover is accurately reported, and does not include any so-called wash trades. On marking to market conventions, which we apply only to our trading activities, we use forward curves quoted on recognised public exchanges, and to the extent that most of our positions are short term, there is no management overview of those forward prices. In our Accord trading activities, we applied defined value at risk limits, which we have detailed in the interim statement. The group's financial and risk management committee meet monthly to review all our risk positions, and strict rules are applied to this activity.

Acquisitions form a major part of the Centrica strategy, and we apply great rigour to this M&A process. All acquisitions are subsequently reviewed, together with impairment tests, to assess performance against the base case. Let me also turn to the subject of pensions, and we include a reconciliation between SSAP24 and FRS 17 treatment, in the interim statement. Some key points to note about the specific Centrica pension position. Firstly we have a 10% surplus based on the last actuarial valuation. The FRS net asset valuation at the period end, and the shortfall thereof, is less than 10% of our pension liabilities, and less than 10% of the group's net assets. The duration of our accrued liabilities of 23 years is very long, and reflects the small proportion of pensioners compared with active members. Based on simulations we have concluded that a high equity weighting best fits our liability profile. And finally we are cash funding the scheme

well in excess of charges. So we believe we have the appropriate asset management strategy for Centrica's pension fund, and we are now turning our attention to opportunities to manage the liability accrual as well.

I want to turn now to our cashflow outlook. We've stated that we believe sustainable UK energy supplied margins ought to be near 5%, with British Gas earning a brand premium above that, after our CRM efficiencies come through. Whilst our residential gas margin has reached this level, we believe our electricity margin still has some way to go, as we grow further towards a mature position. Centrica Business Service is expecting substantial customer growth, with scaling benefits. The AA, One-Tel and Goldfish should all achieve good EBITDA growth rates, driven by product innovation, and cross-selling success. And we have similar expectations for North America, subject to the pace of effective deregulation. On working capital, we believe our total incremental working capital requirements over the next three years will be less than £600 million. Per customer peak working capital is shown here, and obviously varies by each business, for example in the AA and home services, we actually absorb little working capital, as most customers pay in advance. For Goldfish, our banking operations may require additional capital of around £100 million beyond the use of specific asset-backed funding facilities. And that will depend on the bounds between asset and liability based products. In respect of our tax outlook, we expect our overall effective tax rate to remain slightly less than 30% in the medium term, due to the gradual recognition of off balance sheet deferred tax assets, which at the end of 2001 as you know stood at £198 million pounds.

For capex and acquisitions. In British Gas we are well into our CRM investment plans, of which approximately £250 million is expected to be capitalised. We still have approximately some 50 million of additional capex investment therefore to make, in 2003 and 2004 together. For our energy management activities, we expect to spend around a £1billion over the next 10 years on UK gas field purchases, to maintain our asset hedge, and we will also look as Roy said to acquire additional electricity generation in the UK. For the AA, we expect CRM investments of approximately £80 million, through to 2004, whilst for Goldfish our banking platform investments will be largely complete by 2003. In North America, given current market opportunities, over 50% of our growth in customer relationships is now likely to stem from acquisitions, and we expect to invest approximately a further £50 million for CRM and other infrastructure costs over the next two years.

We're also reviewing as Roy said our upstream asset hedge requirements for North America, and would expect to spend a similar amount to the UK on both gas fields and electricity generation.

In summary, these factors taken together lead to our positive outlook for growth in the Group's free cashflow over the medium term, and we expect dividend growth going forward to be determined in conjunction with these earnings, and these cashflow drivers. However, I would emphasise that we are maintaining our primary focus on the range of growth opportunities available to the Group. Success in achieving our growth targets, together with the implementation of cost synergies and the benefits of scale, will be the key to Centrica's economic value creation. We still have much to do but the business is in good shape with a strong financial position to face the future. So now back to Roy.

Roy Gardner:

Thank you Phil. Well to sum up the first half, 43% growth in operating profit with a more balanced profit mix in the UK. A 25% growth in earnings per share and operating margin up to 12%. I am very pleased to be able to present such a strong set of results building on our excellent performance we achieved in 2001. We have a strong outlook for cashflow. It's this confidence that has enabled us both to lift our interim dividend by 17% and to commit to future dividend growth more closely linked to earnings and cashflow growth. Since I became Chief Executive, we've evolved from a simple gas supplier, with volatile earnings, to a more stable and stronger organisation. Profitable growth is still at the forefront of our strategy, but it is growth from a much broader base, and hence it's appropriate now to signal the next stage in evolving our dividend policy. We recognise that there's still a backdrop of economic uncertainty, and that our markets remain highly competitive, so we're in no way complacent about the challenges ahead. Our targets are as demanding as they have always been and we won't slacken the pace at all. The remainder of 2002 will be about continuing the strong performance we've seen so far. I'm confident we can look forward to continued underlying growth in our businesses and increasing profitability of our operations.

Now. To open the meeting for questions we've actually got a number of my management team here this morning and I'll try to bring them in to answer questions as appropriate. And as always when I come to you for a question please wait for the microphone and give your name and organisation before you ask your question. [10 second pause] Good, it really was a comprehensive statement ... oh, [laughs] ... Simon.

Simon:

Yeah, good morning, Simon Flowers at Merrill Lynch. Can I just say a word about the presentation of the results, because we got a lot more information in the release this morning, and although it does make it a bit harder initially to give a view on them, the group's transparency is very much to be welcomed. Now, a couple of questions on North America please. You mentioned that in one or two states there is, I think you said, slowing growth organically in the US because of lack of headroom in gross margins. Is that just Texas and the price to beat, or you seeing that in other states as well? And the second part, strategically, you've now developed a hub in Ontario with the acquisition of Embridge Services, you've got ... you seem to have critical mass there. And I assume that Texas with the acquisitions and the skill the opportunity there could become a hub. Will we see a concentration around these, or do you see further opportunities to create other hubs, in North America?

Roy:

Well the answer to the first part of your question is yes certainly we had a problem in Texas, with the regulator reducing the price to beat, but we've now seen a resolution of that issue, so we now have plenty of headroom to go in and secure customers at margins that we find acceptable. There are one or two other states - Derek, you might want to mention which they are - where we had a similar problem but, er, we'll endeavour to find a resolution there.

Derek:

OK. We've not had any problems with margins in Texas, the PUC has set prices to beat there in the regulated utilities which allow adequate headroom for us to compete profitably. The issue with utility behaviour has been principally in the gas markets, and particularly in the northern USA but also to some extent in Ontario, where the collapse in gas prices at the latter part of last year have led to very low pass through costs, er, we're competing against that based on a forward curve which is rising. And I'm pleased to say that situation appears to be repairing itself as the year goes on. And we've just been able to re-enter a couple of markets in the northern United States with profitable gas products. In terms of the question on hubs, yes Ontario is a hub, yes Texas is and will become a hub, er, we're developing another hub in the midwest, Ohio, and Michigan, particularly potentially Illinois, and, longer out, during the course of next year I'd expect to be looking at trying to achieve the same in the northeastern United States centred around New York and New England.

Andrew Mead:

Hallo, it's Andrew Mead from Deutschebank. Could I just ask on the gas profits, could you give an indication of what the, um, maybe what the gas production figure would have been without the 3 to 6 month lag in terms of the pricing because I think your price held up quite well over the last 6 months, in the gas production business. And just also in gas supply, you highlighted that you're benefiting from the lower Transco rate as they hand back some of the overall coverage[?] Does that, am I correct in assuming that ends as about now? And ...

Roy?:

Mm, yeah, the answer to that question is yes, it's ending.

Andrew:

Thankyou. And just lastly just on the home services, you talked about you said scaleability. And just looking at the numbers and customers numbers, the main ... as far as I can see the main growth over the last 6 months has been in the non traditional part of that business, but it still doesn't seem a very large customer base. I just wonder whey they're still trying to get to the sort of rather large increase in just over six months year on year.

Phil Bentley:

The answer to the question about what our prices would have been had we not had the contracts, I mean to be honest I don't have the answer to that, I mean we have lag in our contracts, er, pricing from Morcambe, um, that's the basis of our contract, if we had a different contract price there may well be lags in that as well, so, er, I think the important thing to note going forward, um, as you know is that we are moving away from the lag in that driven by the oil price, and replacing that more with the gas market related prices, the Gasunie and Statoil deals will be gas market related, and that's bringing down the amount of gas that we buy from the market that's related to oil price, and you can tell given in today's market with high oil prices and softer gas, you know, why we don't want to be caught out in that way and why strategically we've been

moving that, so by the end of this year less than a third of our slate if you like will be linked to oil prices. Yes the Transco business, er, Transco payments stopped the ... the recovery beginning of the year. On this issue about scaleability, I mean, it's about having the base of the customers which we start with three star cover, that gives us our base, and then can we add more product to that, can we add the plumbing cover, can we add the plumbing cover, er, can we add the electrical cover. So it's the scale of the base that allows us then to add these incremental products, at pretty good margins, and that's really what we mean by scaleability.

Roy Gardner:

And I don't think a 48% increase in the number of products sold in that area is unfavourable. 900,000 plus customers is a decent customer base. There was one at the back I missed the first time ...

Martin:

Hi, yeah, Martin Brough from Dresdner. I just had three questions. I just had three questions, one was on the UK energy supply customers. When you were showing your full year results in February, you seemed to indicate that you were zero net loss at the time of the presentation, whereas now it looks like you were losing net 20,000 throughout February. Could you just sort of reconcile those two. Also you were saying you'd signed up 600,000 customers in Ontario, whereas you now only seem to have 500,000. And finally could you just confirm that you made over 100% of your profits in North America in the first half of last year from upstream production.

Phil Bentley:

The UK energy supply when we put the numbers up were all over the place, you know, we'd just announced the price rise in the first couple of weeks they were up then one week it was down, um, I'm sure the numbers are the same in terms of the chart that we put up, there's no reason why they shouldn't be. But there was undoubtedly a lot of noise just in the system if you like on the back of those price rises on the 1st of January. In terms of the issue about the US with ... um, this is in respect of the electricity customer numbers, we've been signing up customers for electricity based on a market opening, um, now originally we thought the market opening would be last year, it got delayed to this year, and finally opened in May. By the time the customers actually went on supply, compared with the customers we signed up, there was some leakage, we had some double counting of customers as we went through and actually looked at who came on supply, versus who we had signed up, and that explains why that number started, if you like, lower. The final point on US North American production, I mean you have to look at it as the ... as I'm trying to explain is the hedge in the, er, in the gas in the ground is similar to Morcambe Bay if you like. We own that gas in the ground, we've paid for it when we bought the business, we own it. Now we are selling fixed price deals to our customers. Now obviously the transfer price varies whether gas prices as Derek says are high, or whether they're low, because you are accounting for the transfer price at the ... for the segmentation analysis. So last year prices were high, so it looked like all that margin was made upstream, this year prices are lower so it looks like more the margins downstream. The fact is you've got to look at it as a whole, as the, you know, as looking at the gas in the ground providing the hedge for the fixed price contract.

Roy Gardner:

If I can just go back to your first point, just looking at the chart at the beginning of February I still think there's no net loss, but the net loss occurs towards the back of February and March and indeed we did lose net customers during the first half of the year, but as I said in my presentation, we're now seeing a positive movement each week, and looking forward that position is going to continue.

Derek:

I think just the other point to add, I mean, we lost less customers this first half than we lost in the last first half. And given that we raised prices more, you know, you could argue that we actually did pretty well, we're I think 10% less losses than last year. I don't want to sound complacent but we did put in a big price increase, we have added 173 million through that pricing increase to the British Gas numbers, so to have ended up losing less than we did a year ago I think is not a bad performance, and we know in the 2nd half of the year as we did have last year that our acquisition program kicks in, the noise from the price rise dies down, and we expect to see better performance in the 2nd half *this* year as we did *last* 2nd half.

Roy Gardner:

We'll take somebody in the middle here.

Simon:

Thank you, Simon Edrich from Schroder Salomon's. I'd like to echo really the greater disclosure which is going to be extremely useful going forwards. I've got two questions, the first concerning customers in North America, and in the past we've heard about contract periods of five years and three years, I wonder if you could just give a little bit more detail on what exactly that means if the contracts really are firmly signed in for five years, with, er, very difficult for them to get out. And the other is given the increased weighting going forwards in North America towards acquisitions, how you intend to fund those acquisitions going forwards.

Roy Gardner:

Well let me answer the 2nd part and then Derek you may want to pick up the first. I believe that there will be more of a bias towards acquiring customer blocks than we indicted when we set our original targets. And that's because there are much more opportunities now as a result of the economic environment in North America and the fragility of some of our competitors. We saw that coming and that's one of the reasons why we put the share placing through in the early part of this year, so we *have* the funding available to achieve the targets that we've set ourselves in North America.

Phil?:

Just, I mean cash flow is the answer, if you look through where the cashflow drivers are going in the business, the cashflow will finance those acquisitions going forward, I mean it's also over a longer period of time so when you run the model through of where the cashflow growth is coming, that will finance the acquisitions.

Roy Gardner:

Derek do you just want to pick up the point on the contracts.

Derek:

Yes. When we acquired Direct Energy they only had one product in the market place which was a five year fixed price contract for gas, er, and if customers wanted to terminate that contract they had to pay a cancellation charge. But nevertheless they could terminate on payment of the charge. Since then we've introduced a wide range of different types of products in our gas and electricity market so we have five year contracts, we have three year contracts, we're currently marketing a three year electricity contract in Ontario, with a one year free opt out for customers who are uncomfortable locking in for a three year period. So we're developing as time goes on a wide range of contracts to suit the particular market circumstances and competition in any state or province.

Simon:

Thank you. Could I follow that up, sorry, with one additional question. In terms of the hedging of these contracts, in the past my understanding has been they've been pretty completely hedged against changes in supply costs or wholesale costs. Is that the case?

Roy?:

Yes.

Simon:

That's still the case?

Derek?:

I mean there's always an issue about the back-end liquidity, you know, five years is not as liquid as the one-year market, so, I mean we look to have a duration hedge on that matches the sale contract.

Simon:

Thank you.

Roy Gardner:

In the middle here.

Andrew Wright:

Hi, it's Andrew Wright from UBS Warburg. Two questions, one on the tax rate. The tax charge has gone up by about 85% year on year. I understand the 40% rate of PRC but that's given the Morcambe profitability is slightly lower, that seems not enough to explain that difference, could you explain what else is going on there. And secondly on the rate of electricity customer gains, I mean inevitably there was a bit of an impact from the gas price increase around about January, but it seems that the ongoing level of electricity price gain, sorry, electricity customer gains, um, are significantly lower than, er, over ... over the six months in the second half of the year. Is that because of your own marketing actions or is it because of any change in the churn rates and activities in the rest of the market, could you give us a bit more colour on that please.

Roy Gardner:I'll answer the 2nd part, Phil you pick up the tax charge. I said in the presentation that as we are selling dual fuel now there is inevitably going to be an impact on our electricity customer acquisition through gas price increases, and we certainly saw that. But, we are now acquiring at the same rate through our conscious decision to reduce our salesforce in the field whilst we ensure that our sales team adhere to the strict guidelines that we've got for door-to-door selling. We are now in the process of looking at the channels we'll use to acquire electricity customers from here on out, including doorstep selling, and we are starting to see an increase in the rate of acquisition, and looking out for the rest of the year, that will start to grow again.

Phil Bentley:

Yeah, on the tax, I don't want to go into the intricacies of FRS 90 the timing of which you recognise defer tax assets and bring them onto the balance sheet and then utilise them, drives what you see as an 80% increase. I mean I think you've got to look at what is the effective tax rate, post goodwill and exceptionals. And so before the increase in the upstream inside ringfence corporation tax which went from 30 to 40, which had an 11 million hit in the first 6 months, before that our effective tax rate had gone up from about 21 to 26, but that's still lower than the UK ... obviously the UK ... the UK rate. That's why we say now on the going forward 28% will be our, you know, approximate tax rate going forward.

Andrew Wright:

Is that 28% on post goodwill, post ...

Phil Bentley:

Yes.

Andrew Wright:

... um, exceptional?

Phil Bentley:

Yes. Yes.

Andrew Wright:

And is it still the case that you're not paying any tax on onshore UK?

Phil Bentley:

Correct.

Roy Gardner:

Second row here.

Caroline Randall:

Caroline Randall, J P Morgan. I've got two questions. First of all about the North America market entry cost, that £20 million that you talked about, is that the bulk of the entry cost now for Texas and Ontario going forward, and could you confirm whether this is going to be in addition to the 50 million pounds of the CRM spend that you talk about on page 27 of the presentation. And then next question, can we just have an update on the timing of the potential divestment of the water heater assets at Embridge.

Phil Bentley:

The 50 is on top of the 20, to answer your question about CRM there. In terms of timing for the water heater disposal, we look to have a transaction away before the end of the year. We would, you know, we have high hopes that we get a pretty good price for those assets. I don't want to sort of lead you to any conclusions but I think certainly the discussions we're having with the bank at the moment are pretty positive. In terms of the 20 million, Derek, do you want to ...

Derek:

Yeah, the £50 million CRM spend is all outside Texas ...

Phil?: [inaudible] UK.

Derek:

Texas systems are all fully in place and operational from scratch at the beginning of the year. The cost, the entry costs in Texas and Ontario for electricity are largely what that ... I would expect those costs to cover our entry per se, but of course as we acquire customers going forward in both Texas and Ontario for electricity, we will have customer acquisition costs. But in terms of the market entry I think we've sunk most of the costs that we will incur in those two markets.

Roy Gardner:

There was one just on the right, 2nd row, 3rd row ... down the front here.

Austin:

Austin Earl from Newman Ragazzi I have three questions that all pretty much relate to the cash flow. If I can just start on the capital expenditure, I wonder if you can give us a guidance for the capex for this year, the full year charge or expense and also for 2003?

Phil Bentley:I mean we'll probably end up spending a similar amount in the round, er, to last year probably a ... maybe a little bit more, may be a little bit more, er, 2003, um, similar level to this year. I'm not going to give you the number.

Roy Gardner:

You had two other questions.

Austin:

Yes, two other questions, um, on the working capital, you're saying you now expect an outflow of £600 million over the next three years, is that correct?

Phil Bentley:

Yeah, I think you've got to look at the growth, um, if you take business services for example, they do have those customers, heavier industrial customers absorb working capital, North America growth absorbs working capital, even One-Tel which has a small amount, but in terms of the targets that we're focusing on to deliver customer growth, absorb working capital in the short term. And you can do the maths of the customer numbers and the number that we put there on the chart for working capital per customer to get a broad range behind that.

Austin:

I guess what I'm trying to understand is what has changed from the last few years.

Phil Bentley:

I mean we've been taking a lot of inefficiency out of our business structure, that's what's been driving a lot of cash out of the business. There will still be plenty of cash coming through from the EBITDA growth.

Austin:

And shall I expect 200 million, I mean that 600 million you put in the slide, is that roughly 200 million a year?

Phil Bentley:

I think it's probably more back ended.

Austin:

And then lastly just on the provisions, you've made some provisions in the first half, I mean, should I expect a similar sort of number in the second half, or, will that maybe you actually reverse that in the 2nd half.

Phil?:

Provisions for debts you mean?

Austin:

No, in the, you've made a provision I think it's 215 million in the cashflow statement.

Phil Bentley:

That's the reduction in provisions based on PRT, I mean that's the PRT payments being ... we have to provide for PRT and then we pay ... we've been in what's called safeguard, so you don't pay cash PRT whilst you're building up the production platform and the production. When you start producing, you start paying out of that provision cash PRT, and we now in South Morcambe got the peak PRT payments at the moment, which is also coinciding with the highest royalty payments which are lagged from high gas prices last year, so it's all hitting us, that's what you see there in that provision move.

Austin:

So what shall I expect for the 2nd half?

Phil Bentley:

Um, you ... we've paid quite a fair bit out this first half, you should expect less than we've paid out in the 2nd half.

Austin:Great.

Thank you very much.

Angelos:

Angelos Anastasiou from Williams De Broe. Just in the statement you mentioned that the customer relationship management, um, implementation will impact on margin at British Gas to the end of 2004. I was just wondering if you could expand on that, how much we should be expecting the impact to be.

Roy Gardner:

Well it will be the balance of the 340 million less the 250 million capital. Just as simple as that.

Richard Alderman:

Richard Alderman, Merrill Lynch. Can I just ask you a few questions about Accord. The strategy. I'd just be interested in terms of the strategy of Accord going forward, the growth in turnover of the last four of five years has been quite spectacular, it's something like 9 to 10 times what it was in 97, 98. And the profitability obviously has swung from small loss to small profit. How do you see that going forward in terms of the strategy, in terms of turnover growth, that was the first question. Secondly I'm just slightly confused by, in all this breakdown of extra data you've got a big number for electricity gigawatt as traded, 37,000. But no comparable number from previous year. Is that because you've merged together purchasing ...

Roy Gardner:

We didn't have any electricity trading the previous year. Relatively new.

Richard Alderman:

You didn't trade anything all for a risk R[?] position last year.

Roy Gardner:

No.

Richard Alderman:

Nothing. OK. And in terms of that position now, so you're trading 10 to 11 times physical generation from your own stations. Are you comfortable with that level of risk? And just in terms of the mark to market accounting you talked about earlier, have you actually changed any accounting policies in that book in the last 2 or 3 years?

Roy Gardner:

Well, Jake will pick up the first two parts of that, and Phil the last bit.

Jake:

I'll go back to the first. Accord strategy or Accord turnover, I would expect that Accord turnover in the UK will not grow significantly from where we are. There are a couple of things happening as you are aware, a number of players that have left the market, so we see fairly good liquidity right now as those players exit and close out their positions. But in the intermediate to longer term there are fewer counter parties and we see, you know, less liquid market in the longer term.

And I don't know whether any players will come and pick up that slack or not, but I certainly don't see the huge growth in turnover over the next few years. What was the 2nd question?

Roy:

9 times trading, I mean that's ... go on, Jake.

Jake:

Yeah well that's based on our own generation but if you look at it as a multiple of our demand it's less than 2 times the physical demand that we have on the customer side, which is similar in gas, it's between one and two times the physical demand overall. So it's really irrespective of our own equity production, it's really more a function of the demand we have on the retail side. So yeah we are comfortable with that number.

Roy Gardner:

Do you want to pick up the last question?

Phil Bentley:

Yeah, just on the strategy point, before the accounting. I mean, there was all this speculation about would we withdraw from Accord, Accord trading, the real point there is that we have underlying demands to fulfil, we are short the market and will always be buying for British Gas to underpin our customers. So we have that flow. Now if we were only ever buying from the market and never selling to the market then obviously the bid-offer spread if British Gas got on the phone would be adjusted, so the whole point is that we have the flow required, er, the underlying flow, we also have the data because we have close contacts with the field producers, we know what's happening with the weather patterns and forecast load demand, and so we trade that data as well and apply that to our trading position, so we will always want a small trading book, um, around our underlying procurement needs, but I think and I say the right measure is, what proportion of that is of the whole of our needs, not of our needs what is it we generate or produce ourselves. On the accounting FRS 18 which was introduced the end of last year, required us to mark to market, um, unrealised gains in Accord at the end of last year and then we restated 2000 and we went through that at the time. It's simply that you had to use the appropriate valuation mechanism, so we've restated 2000 when we did 2001 under FRS 18, and then, we haven't changed this year, we still report under FRS 18.

Roy Gardner:

I think we have time for one more question. I think you had your hand up.

Jason Goddard:

Thank you, it's Jason Goddard at CSFB. I just wanted to ask about Goldfish and what you expect to spend on creating the Goldfish bank. What profitability we have at the credit card

business that underlies this, and what your targets might be for the new businesses as you build out.

Roy Gardner:

Well that gives me a chance to bring in Ian Peters who is our new managing director of Goldfish.

Ian Peters:

Thank you. What we've seen over the last 12 months is an improvement in margins through the credit card, primarily through a reduction of funding costs. We are moving through the movement from the former JFC joint venture partner, and, the credit card platform will be the foundation for the growth of Goldfish going forward. As was said in the presentation we are similarly now about half way through the investment in the banking infrastructure, which we're due to complete at the end of 2003. Primary use of that will be on our savings and loans operations both of the new products there went live in the last week, with full marketing, and the early signs from there are encouraging. In terms of forecasts, our aspiration is unchanged to achieve break-even in Goldfish around the end of 2003, and the longterm profit targets I'm not going to get into now, but the loan product will be a substantial driver of that over the next 2 to 3 years.

Jason Goddard: Do you have a sense of EBIT at Goldfish credit card?

Ian Peters:

What we've said before to the market is that we expect a return on equity between 15 and 20 percent and that hasn't changed. That's a longterm return on equity.

Jason Goddard:

Thank you.

Roy Gardner:

OK well I'm gonna have to call a halt to this session, but I will ask my colleagues to stick around for a little while so if there are any other questions you may want to ask of them, please feel free. Thank you very much.