



Review confirms integrity of management processes & 2008 earnings guidance

17 December 2007

AGL Energy Limited (AGL) provides the following advice regarding outcomes of its internal review of business assumptions, systems and processes and the associated external, independent review conducted by Ernst & Young.

Summary

- Re-confirmation of FY2008 financial year guidance:
 - Underlying Net Profit After Tax (NPAT) \$330 to \$360 million,
 - Earnings Before Interest Tax Depreciation & Amortisation (EBITDA) \$830 to \$875 million and;
 - Total annual dividend 52 to 55 cents per share, fully franked.
- No material issues arising from results of either internal (AGL) or external Ernst & Young reviews:
 - The need to revise earnings resulted primarily from adopting overly optimistic budget assumptions, not a failure in budget systems.
 - Internal policies and procedures work effectively and as designed with all monthly financial reporting information issued in accordance with scheduled timeframes
- The practice of providing medium term guidance will be discontinued. However, as a transitional measure the following FY2009 guidance is provided:
 - Underlying NPAT \$360 to \$390 million,
 - EBITDA \$870 to \$915 million.
- Beyond this transitional arrangement, annual guidance will be provided at future Annual General Meetings.

Review of AGL internal business assumptions, systems and processes:

Re-confirmation of revised FY2008 guidance – Guidance for FY2008 remains \$330 to \$360¹ million underlying NPAT, equating to an Earnings Per Share (EPS) range of 76 to 83 cents². AGL also forecasts associated EBITDA for FY2008 in the range of \$830 to \$875 million.

FY2008 dividend guidance – The FY2008 dividend guidance remains unchanged in the range of 52 to 55 cents per share, fully franked. The indicative dividend pay out policy of approximately 60 percent of underlying earnings will apply from the 2009 financial year onward. This policy will ultimately be subject to AGL's capital requirements in relation to growth and development opportunities from time to time.

¹ Underlying net profit after tax excludes adjustments totalling \$35 million relating to significant items and customer amortisation costs relating to Powerdirect purchase. It also excludes fair value adjustments.

² Based on a weighted average number of shares on issue of 433.6 million.

Primary reasons for revision to prior FY2008 earnings guidance – The business assumptions, systems and processes review has concluded that the budget and forecasting systems were operating correctly. The original guidance was primarily driven by adopting assumptions that, in retrospect and when taken as a whole, were at the upper end of probable outcomes and therefore overly optimistic. Current guidance is based on assumptions that management believe are set at the mid-point of likely outcomes and this probability weighted approach will be used in future.

The review has confirmed all policies and procedures work as designed. Furthermore the review confirmed all information regarding monthly performance was issued within appropriate time frames. The Board and management remain satisfied with the integrity and robustness of internal governance procedures.

Key inputs for earnings forecasting – The review confirmed that the key inputs used in AGL's forecasting models are appropriate. Key inputs are: electricity and gas mass market price assumptions, weather volume variances (gas & electricity), retail mass market customer churn rates, underlying electricity pool price assumptions, extreme weather days causing electricity load flex, variations in physical generation, impact of AUD:USD exchange rate movements on PNG oil revenues (cash receipts as opposed to future oil prices which are substantially hedged), PNG oil production volume changes, Tapis premium variations and assumed interest rates against group debt.

Load and energy price forecasting systems / financial forecasting systems and processes (electricity hedge book) – The key processes and methodologies underlying the budget and reforecast were consistent and the impact to full year profitability from the expected costs of wholesale electricity between the budget and reforecast were shown to be immaterial.

Significant changes in the input assumption of pool price outcomes were observed, however:

- The methodology used for the development of the pool price forecast in the budget and reforecast were consistent and in both instances substantially based on an independent market view of average price outcomes; and
- Although the resulting pool payments or receipts changed materially they were substantially offset by changes in hedge payments or receipts. This indicates that the hedge portfolio is performing as expected.

Energy risk management systems and practices (electricity hedge book) - Within AGL, the procurement of electricity hedge contracts is conducted in accordance with a Board approved Wholesale Energy Risk Management Policy.

One key element of wholesale energy risk management is to ensure that the procurement of electricity hedge contracts is in line with retail load expectations and the extent of mismatch is within defined risk limits. The risk methodologies were reviewed and found to be appropriate. Another key element is the independent valuation of the electricity hedge book. It was confirmed that valuation is conducted independently of the trading group and that these valuations are in turn subjected to external financial audit or review every six months.

The internal review also confirmed that other key elements of the Risk Policy - a segregation of relevant functions as per industry best practice for corporate governance, and regular reporting to senior management of positions and market risks – were also observed.

Ernst & Young review:

As communicated at the AGL Annual General Meeting on 8 November, the scope of this review covered the areas of i) key assumptions driving future earnings, ii) load and energy price forecasting systems, iii) financial forecasting systems and processes and iv), energy risk management systems and practices. The findings of the Ernst & Young review are summarised in Attachment 1 and are consistent with the findings of AGL's internal review.

FY2009 guidance:

The practice of providing medium term earnings guidance will be discontinued. As a transitional measure, FY2009 guidance is provided with underlying NPAT in the range of \$360 to \$390 million and EBITDA in the range of \$870 to \$915 million. AGL has added EBITDA guidance to NPAT guidance as it believes EBITDA is a clear measure of operational business performance and cash generation.

Beyond this transitional FY2009 arrangement, annual guidance will be provided at future Annual General Meetings.

Project Phoenix Update

Retail efficiency initiatives are on track with the first deployment of the SAP (Phoenix) customer billing and management system being successfully executed during the week ending 15 December 2007. This involved the transfer of approximately 1.2 million mass market customers to the new systems with no material issues arising. Consequently Project Phoenix remains on budget and schedule with two further releases planned for 2008.

Conclusion

Both internal and external reviews have confirmed the robustness of AGL's internal systems and processes. AGL remains committed to growing shareholder value through the ongoing, disciplined execution of its existing integrated strategy, as shown by recent initiatives such as the divestment of the AlintaAGL stake, the decision to build the second Hallett Wind Farm, the acquisition of the Enertrade assets in Queensland, the signing of an off-take agreement with QGC's Condamine Power Station and the Heads Of Agreement to explore development of the Macarthur Wind Farm.

Timing of 2008 interim result release:

AGL currently anticipates release of its interim results for the six months ending 31 December 2007 on the morning of Friday, 29 February 2008. Further event details will be provided closer to this date.

Paul McWilliams
Company Secretary

A brief presentation will be spoken to via conference call today (no webcast). The presentation will be released to the ASX shortly before the call commences and subsequently available from the AGL website: Time: 1030hrs (Australian Eastern Daylight Time)

Dial-in numbers: Freecall Australia 1800 505 083
International +61 2 9423 1645

A replay of the call including the Q&A session will be available from the AGL website following the close of business today: <http://www.aglinvestor.com>

14 December 2007

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The Board of Directors
AGL Energy Ltd
72 Christie St
ST LEONARDS NSW 2065

To the Board

Independent Assurance over the September Reforecast Process for the earnings of AGL Energy Ltd's Merchant Power Wholesale Electricity Unit

Background

The AGL Energy Ltd ("AGL") Board of Directors has requested Ernst & Young to evaluate AGL management's process for reforecasting the earnings of AGL's Merchant Power Wholesale Electricity Unit for the remainder of the 2007/08 financial year. The reforecast was undertaken in September 2007.

Forecasting the future in any field of endeavour is problematic. Australian electricity prices are highly volatile and affected by supply and demand which in turn is directly affected by weather. Hence the accurate forecasting of profitability in the industry is necessarily reliant on a number of unpredictable variables including weather and price outcomes.

Scope

AGL has a process for establishing the annual earnings budget for the Merchant Power Wholesale Electricity Unit. Ernst & Young was requested to provide limited assurance that the process used to reforecast was consistent with the process used in the original budget in the following respects:

1. the application of the key assumptions driving earnings
2. load and energy price forecasting systems
3. financial forecasting systems and processes
4. energy risk management systems and practices

Our Approach

We used the findings from an agreed-upon-procedures engagement as the basis to form a negative assurance opinion in relation to the consistency of the reforecasting process with the budgeting process. The reference point for our work was the budgeting process undertaken in April 2007.

Our Conclusions

Based on the work undertaken in the agreed-upon-procedures engagement and subject to the limitations below, nothing has come to our attention that causes us to believe that:

- the key assumptions are not consistent across budget and reforecast numbers
- there are significant differences in the overall load and price forecasting processes except for timing differences affecting reforecast outcomes. Timing differences appeared to be due to:

- movements in prices and load between the timing of the budget and reforecast numbers
 - the treatment of extreme price days
 - the method of including recent generator and retailer acquisitions
- the annual budget process and the reforecasting process are not operating on a consistent basis
- the energy risk management systems and practices had materially changed, except for the fact that the database administrators within the outsourced IT services provider that manages AGL's key energy trading IT systems, can make changes to source code in the production environment without approval or review. As audit logging had not been enabled on these systems, no system-generated evidence is available to comprehensively list all changes made to the relevant systems.

Limitations

Without detailed knowledge of the above areas of AGL's Merchant Power Wholesale Electricity Unit's budgeting process, readers should not rely on the findings of this report.

This engagement used findings from an agreed-upon-procedures engagement. The responsibility for determining the adequacy or otherwise of the budgeting process and the agreed-procedures was that of AGL's management. Data and information was provided by AGL. Ernst & Young was responsible for executing the procedures and forming an opinion based on the findings of the procedures undertaken. Some findings involved management representations.

Our work did not include an evaluation of the reasonableness of the budget or reforecast assumptions.

The procedures we performed did not constitute an audit in accordance with Australian Auditing Standards or a review made in accordance with Australian Auditing Standards applicable to review engagements. Our engagement was conducted in accordance with Australian Auditing Standard ASAE 3000 'Assurance Engagements other than Audits or Reviews of Historical Financial Information'.

Ernst & Young

Melbourne

14 December 2007