



**Who  
we are**

# Chairman's report

Dear Shareholder,

This is my first report to you since succeeding John Phillips as Chairman of your Company. It covers AGL's financial performance, some important events during the year and it describes conditions in some of the markets in which we operate. Particularly, I want to give you a sense of how your Board operates, how we see the risks and opportunities ahead for AGL, and how we assess the Company's capabilities to deal with these circumstances.

## Financial Performance

Profit attributable to Shareholders grew 18.5% to \$349.5 million, compared with \$295.0 million last year. Earnings per share grew by 9.5 cents, up from 67.3 cents in the previous year. The underlying profit after income tax for the Group of \$361.8 million, excluding significant items and the outside equity interests associated with those items, increased by 12.8% compared with the previous year.

Competition intensified in many of AGL's markets. Established electricity retailers tried to increase market share, particularly in Victoria and South Australia, and new entrants tried to obtain customers with aggressive price offers.

AGL's improved profit came from its existing portfolio of businesses. It was achieved from the strong market positions the Company has established and reflects the benefits of continued improvements in operating efficiencies, market analysis and service levels for our three million customers.

Balance sheet gearing increased by 2.1% to 40.6%, but this was within limits to maintain AGL's 'A' credit rating. The underlying physical assets are in good condition and appropriately insured. Operating cash flow grew by \$95.0 million to \$637.2 million. Interest cover improved from 4.1 times to 5.7 times.

The Board approved a final dividend of 31 cents a share, franked to 23 cents (74.2% of dividend). This will be paid to Shareholders on 24 September 2004 and will bring the total dividend for the year to 60 cents (45 cents franked).

The full-year dividend represents 78.3% of the year's profits, similar to the payout percentage for the last several years. We expect to continue to pay dividends in this range. There is a Foreign Dividend Account (FDA) credit of 8 cents attached to the final dividend for the year.

The Company's financial position and balance sheet are sound and can finance growth. The Shareholder base has expanded from 106,037 to 114,468 during the year and the shares are liquid, with annual turnover equivalent to 2.5 times the market value.



## Market Environment

The physical gas and electricity networks which cover the east coast of Australia are not perfect, but they are each a complete network carrying molecules of gas, and electricity from producers to consumers in pipes and wires across half the country. The regulatory and business dimensions which lie on top are much less coherent.

Each State has a different regime for regulating energy businesses. The electricity and gas industries in each State have different structures, ranging from Government ownership (Queensland and partly New South Wales) and regulation through to markets with competitive private sector companies in production, distribution and retailing (Victoria and South Australia). Each industry in each State is at a different stage of deregulation, so the single physical market is made

commercially imperfect, by the overlay of multiple regulations and inconsistent commercial incentives to the participants.

Doing business is more expensive, less efficient and more risky than it needs to be, or would be with one set of rules for everyone in the market. Energy is an input into every Australian cost and a material expense to every Australian household. For all these reasons, AGL strongly supports a national energy market, and we are working with the Federal and State Governments and industry bodies towards this outcome.

At the Federal level, AGL supports the Ministerial Council on Energy's national reform programme which will be implemented over the next two years and will cover governance, economic regulation, electricity transmission and gas market development. At the State level, AGL continues to advocate light-handed regulatory policies with safety nets for the disadvantaged.

While energy market conditions are difficult, inefficient and risky for all participants, they also offer opportunities for AGL. Regulation is likely to be with us always, and the Company

has a deep understanding of the regulatory issues and enjoys good working relationships and mutual respect with the regulatory bodies.

Reform, even if fitful, will continue through the energy industry and change is likely to be the constant. AGL has strong established positions and the technical, financial and human resources to build on the opportunities which will emerge as the industry finds a shape more suited to a progressive Australia.

#### Loy Yang Power Investment

AGL and its foundation partners, Tokyo Electric Power Company and Commonwealth Bank investors, contracted to buy Loy Yang Power in Victoria in July 2003. Following the Federal Court ruling that the ownership structure did not lessen competition in the electricity market, AGL completed its 32.5% investment for \$210 million in April 2004.

The purchase of the Loy Yang Power interest is also a very important step in expanding a new earnings stream for the Company. Loy Yang Power, which comprises the Loy Yang A power station and the adjacent coal mine,

represents the first investment in base load power by AGL and brings the direct and equity investment in power generation to over 1,000 MW, or about 2.6% of the national electricity market.

AGL sells electricity to around 1.5 million customers in Australia. The Company is exposed to considerable risk because the wholesale prices it pays to the generators, who make the electricity, can fluctuate or vary much more widely than the prices AGL can charge to its customers. Generators may charge as much as \$10,000 per megawatt hour in periods of extreme demand, compared with typical sale prices to business customers and retail customers in the range of \$60 and \$200 per megawatt hour.

AGL reduces this risk by contracting with generators for future delivery at fixed prices, but future demand cannot be precisely predicted so the Company cannot eliminate all risk in this manner. Risk can be minimised by being an electricity producer as well as a retailer, so the gains and losses from market imbalances are averaged across both production and consumption.

Our existing electricity generation peaking plants at Somerton in Victoria and Hallet in South Australia augment AGL's contract portfolio. AGL will work with its partners to manage the investment in Loy Yang Power consistent with our environmental principles.

#### Corporate Governance

AGL conforms with the Australian Stock Exchange (ASX) Corporate Governance Guidelines, and we have included most of the requirements of the CLERP 9 legislation in this report although they are not required until next year. In particular, a Remuneration Report is included as part of the Directors' Report.

During the year the Board conducted a review of its performance. We have made a number of changes to our processes as a result. We are reshaping our priorities and procedures to allow more time to consider and debate strategic matters, which we think is particularly important for an industry in transition. We are putting more time into reviewing our policies for our people, succession planning, environmental issues and health and safety to ensure AGL has a sound

#### The Board



**Mark Johnson**  
Chairman



**Greg Martin**  
Managing Director



**Sir Ronald Brierley**



**Graham Reaney**

framework for growth. We have reviewed information technology and architecture, and we continue to devote considerable time and effort to risk management.

The review indicated that the Board works well with the executive team, coherently and efficiently with one another, and conducts its business in a frank and open atmosphere. Greg Martin's review of operations will demonstrate that the Company is not losing sight of the day-to-day issues of running a customer focused organisation.

The Board is also conscious of the need to bring new Directors into AGL, to provide new attitudes and skills, and to create an orderly succession process. We will try to ensure a transition of the valuable knowledge base in the existing Board to its new members. To do this, we expect to recruit a new Director over each of the next four years. New Directors will have term limits of ten years and will not nominate for new terms when they pass the age of 70.

For many years, AGL has had a Shareholder approved plan providing deferred benefits to Directors on retirement. Directors' retirement plans

are not consistent with current corporate governance standards, and the Board has terminated the plan. Existing Directors have decided to invest their entitlements in AGL shares. New Directors will receive fees only.

### Board Changes

In December 2003, John Phillips AO retired as Chairman after a twelve year tenure on the AGL Board, seven of which he served as Chairman. His stewardship and his counsel were valued by all his colleagues and, as I hope this report demonstrates, he left AGL in good condition. We wish him well for the future.

In January 2004, Max Ould was appointed to the Board. He is the former CEO of National Foods and of Peters Foods Australia. He brings executive experience as well as particular competence and interest in marketing, brand management and the needs of consumers.

### People

During the year the Board reviewed AGL's procedures and policies for recruiting, training and development, and succession planning. We concluded that the Company has a depth of skilled and highly motivated people,

and a work environment to maintain their commitment and increase their individual contributions.

The Board believes the Company has strong ethical standards, high safety and environmental standards, and a culture in which AGL's people genuinely support these commitments. AGL's people are a great asset and form the basis for the Company's continued prosperity.

Greg Martin and his excellent senior management team have led the AGL community in the hard work that has brought good results for Shareholders this year. Over 98% of eligible employees under AGL Share Plans, hold shares in the Company and collectively employees rank as the 11th largest Shareholder. We are proud of this alignment of employee and Shareholder interests.

### Outlook

Since year end the Board has decided to sell AGL's interest in NGC Holdings Limited. From AGL's perspective, market conditions in New Zealand provide an opportunity to realise value for our Shareholders by selling rather than continuing to hold this investment.

The Board of AGL expects that the Company will continue to advance its position as Australia's leading domestic energy company for the financial benefit of its Shareholders. We will do this in a manner that recognises that our community is a wide one, with many stakeholders. Most of the advances we make will be small and incremental – doing a thousand little things better or more effectively – as goes on in any competitive and well-managed business. A few of the advances may be major new investments, which we will make only if they fit within our risk framework and add substantially to AGL's earnings streams.

I hope this report demonstrates that AGL has the human, technical and financial resources to achieve these advances on your behalf.



**Mark Johnson**  
Chairman

**26 August 2004**



**Charles Allen AO**



**Carolyn Hewson**



**Tony Daniels OAM**

