



ANNUAL GENERAL MEETING 2005

ADDRESS BY MARK JOHNSON CHAIRMAN THE AUSTRALIAN GAS LIGHT COMPANY (AGL)

18 OCTOBER 2005

Introduction

Good morning Ladies and Gentlemen. Welcome to AGL's Annual General Meeting (AGM) of Shareholders.

I am assured that the necessary quorum is present and I have much pleasure in declaring open the 166th Annual General Meeting of The Australian Gas Light Company. My name is Mark Johnson and I am your Chairman. I would like to welcome you all here today.

For those Shareholders who are attending this Annual General Meeting for the first time, I extend a particularly warm welcome and trust you find it informative and helpful. Your investment in AGL has seen the number of Shareholders increase to just under 115,000 of which around 96 per cent are Australian.

The Board of your Company, and its senior management, are here to report to you today on the state of your Company, its performance and accomplishments in the past year. I would also like to talk with you during this meeting about the opportunities and challenges before AGL.

In this year's Annual Report we have tried to give you comprehensive operating and financial information, which we hope you found sensible and relevant.

As you might remember from the last AGM, one of the tasks we gave ourselves was to improve our communication with you. We have asked some of our large Shareholders about their priorities, we have commissioned research and we have spoken with a range of our retail Shareholders.

Last year you gave us feedback about the AGM, Annual Report and the quality of Shareholder communications generally. Around 70 people who attended last year's AGM provided feedback about what they wanted to know and hear from the Board.

You told us that:

- You wanted to receive information from the Company that was comprehensible and relatively easy to follow.
- You wanted information on the internet to be more accessible and easier to find.
- You also wanted to receive more information at the AGM on issues such as the effect on the business of sustained retail competition, the impact of regulation, dividend payment policy and franking credit availability, renewable energy and Board succession planning. I will touch on these matters today.



In response to your ideas and feedback:

- We have started using something called "Open Briefings". These accompany important market announcements where more detailed information is given by the Managing Director in question and answer format. These are found on AGL's website. If you have had the opportunity to read these I trust you have found them informative and helpful.
- We have focused on improving the readability of all Shareholder communications. You might have noticed that we have made this year's Notice of Meeting more user friendly.
- We also enhanced our website functions during the year, particularly the ability to access and search the Annual Report.

Some of you have also provided us with questions you would like answered today. As your Board, we certainly appreciate the efforts of those who have raised questions with us. I will bring these to your attention as we progress through the meeting.

We also encourage your continued feedback and you will have been given on registration, like last year, a Shareholder Feedback Form. We would appreciate any comments you may give to us and will continue to improve the information we provide to Shareholders. You can place your feedback forms in boxes provided at the exit from the hall.

The Notice convening this Meeting has been sent to all registered Shareholders.

Your external auditors Deloitte Touche Tohmatsu are also here this morning. The senior audit partner Greg Couttas is available to answer any questions on the audit should you wish to ask later in the meeting.

The Annual Report of the Company, the Independent Audit Report and the Concise Financial Report for the 12 months ended 30 June 2005 were posted to you on 14 September. A copy of the Concise Annual Report was given to you on registration.

You will also have been given a copy of AGL's second Sustainability Report. In it we report on our performance against 2004/2005 goals as well as setting new goals for ourselves. We are ambitious for AGL and will continue to strive for excellence in our business activities and the way we work with our stakeholders.

At this time last year we said to you that we expected to continue to reinvest in the Company, defend and grow our existing core businesses, and plan how to add new revenue over a five year period. We said that we would do this by extending our existing businesses and examining industry trends, determining our strategic response to them.

I would like to report to you on overall Company performance for the year, some of the key achievements and challenges we faced, and what we see as the key matters for AGL as we look ahead.



Financial Performance

Operationally 2004-2005 was a solid year for AGL. At an underlying level, profit after income tax for the Group was \$386.8 million. Excluding significant items and outside equity interests, underlying profit increased by 6.9 per cent compared with the previous year. Earnings per share also increased by 6.5 per cent.

The Annual Report spells out the details of the adjustments to the reported profit which takes you to the underlying profit. The most significant of these were \$587.5 million after tax arising from the sale of AGL's interest in New Zealand company NGC Holdings Limited (NGC) and the write down of \$193.0 million, after tax, in the value of the Victorian electricity network.

This last item was a result of a tightening regulatory environment, declining market values achieved for recent sales of regulated energy assets in Victoria and a disappointing draft decision from the regulator. AGL continues to challenge this and a decision from the Essential Services Commission is expected tomorrow. If we are still unhappy and we believe there are grounds for appeal we will consider that option seriously.

Following the sale of NGC, a three-part capital management program was implemented. You will recall that a special dividend of 30 cents per share, franked to 90 per cent was paid on 24 March 2005 and a capital return of 50 cents per share was approved by Shareholders and paid on 29 April 2005. We have commenced the last stage of the program, a share buy-back of \$150 million. This program is underway.

So far we have had a good start to this year. Our results for the first quarter are slightly ahead of our expectations.

Dividends

Some AGL Shareholders have asked about the Company's dividend payment policy and availability of franking credits.

By now, you should all have received the final dividend of 32 cents a share, 100 per cent franked, which was paid on 23 September 2005.

When this is added to the interim dividend of 31 cents, the total ordinary dividend for the year was 63 cents, franked to 60 cents (95.2 per cent). That compares with 60 cents per share franked to 45 cents (75 per cent) for the previous year. Including the special dividend, the total dividend per share was 93 cents franked to 87 cents (93.6 per cent).

Looking ahead this year, we indicated at the Company's full-year results announcements that we expected to at least maintain the current ordinary dividend of 63 cents per share. We also indicated dividends would be 100 per cent franked. Tax efficiency for Shareholders is a very important consideration and we will continue to focus on value for AGL Shareholders in future deliberations on dividend payments and franking credit availability.

The Dividend Reinvestment Plan remains suspended and I will talk further about the Company's ongoing capital structure shortly.



Towards a National Energy Market

You also asked about regulatory complexity and the impact on the business. In fundamental ways AGL, as with other energy market companies, operates in a difficult market environment.

AGL must deliver lowest cost efficient services to customers where, in Victoria and South Australia, about one in five households are either signing a market contract or changing retailers. These are unprecedented levels of competition. However we operate in a market that is a patchwork of inefficient and different State based rules and regulations. It increases both cost and risk, reduces efficiency and can result in less than optimal market behaviour.

In addition, both Queensland and New South Wales have been contemplating reform for several years, with Queensland only recently announcing that it intends to open the retail electricity market to competition from 2007. Whilst this is good news, it does not detract from the reality that State ownership policies and State based regulations frequently distort or ignore market signals. The resulting irrational market behaviour is highly undesirable.

Your Board has a strong view about these matters. Australia must have a national energy market. Energy fuels all economic activity in Australia and affects the price and competitive situation of every product and service we use or which we export.

The largest possible market is required for economies of scale, particularly to allow risks to be spread and managed. A small number of participants cannot average or spread their risks as well as a large number, the premium for risk is greater and costs to consumers end up being higher. Because higher risks mean higher costs, investment in required new capacity may be deferred.

AGL supports the efforts of the Commonwealth Government and the Ministerial Council on Energy to implement a cohesive national energy market. Several important milestones have been reached but significant work remains including the national regulatory framework for retail and distribution.

This is an opportunity to deliver efficiencies and reduce costs that will give confidence to the industry to invest in the necessary infrastructure. It places all energy market participants on a level and rational footing and will produce sensible results for energy consumers.

Competition and the Retail Market

AGL believes that dynamic and strong competition is good for customers and for the energy industry. For customers it leads to innovation in products and offers, competitive prices as well as improved customer service. For the energy industry, competition makes players more robust and more conscious of efficiency and effectiveness.



Last year AGL responded strongly in the market and maintained market share. We worked very hard to keep existing customers and win new ones. Given the intense market competition it is important that we defend market share and endeavour to protect margin. If we do not do this we will see our market share and gross margins erode unacceptably.

In this context AGL strives to be the lowest cost and most efficient energy company in Australia. It is essential that this ambition for cost leadership is combined with excellent customer service standards. We continue to invest in improving our systems and processes and the development of our customer service staff to reach this goal.

Power Generation

Investment in power generation remains an important element of our Company strategy of integrating generation with our retail business. Investment in power generation assets is designed to better manage wholesale price volatility and control our wholesale electricity costs.

Ownership of generation plant is then combined in an overall portfolio approach with financial hedge contracts. This provides flexibility for our electricity traders to reduce AGL's exposure to the market spot price, smooths fluctuations in the wholesale electricity price, provides better matching of income when prices rise, and provides more predictable prices to customers.

AGL continues to evaluate additional renewable and gas-fired power generation opportunities including both existing and new plant across South Australia, Victoria, New South Wales and Queensland.

Upstream PNG Gas Project and PNG Pipeline

During the year AGL commenced the \$66 million front end engineering and design work (otherwise known as FEED) for the natural gas pipeline from Papua New Guinea to eastern Australian markets. Work has been progressing well to date and a decision to build is due in mid 2006.

In early July 2005 AGL announced an additional two-part involvement in the PNG Gas Project which, in turn, enhanced the prospects of the pipeline being built:

- First, AGL signed a \$4.5 billion conditional gas supply agreement with the PNG Gas Project producers for 1500 petajoules of natural gas over 20 years from 2009. This gas is priced below AGL's current average portfolio cost and will enable AGL to meet future customer demand in New South Wales, the ACT and South Australia on a very competitive basis. It underpins participation in the Queensland energy market and diversifies AGL's existing gas supply portfolio.
- Second, AGL signed a \$400 million conditional agreement with Oil Search Limited to acquire a 10 per cent equity interest in the upstream PNG Gas Project. Part of AGL's integration strategy is to create value through equity investments in upstream gas reserves at attractive entry prices. This transaction will be earnings per share accretive from day one.



These transactions are very important for AGL's future competitiveness. Whilst AGL does not want to be an oil and gas explorer, we do want greater control over how and when we sell wholesale energy into the market. The equity investment provides us with greater pricing flexibility and the opportunity to provide long-term returns to Shareholders.

Capital Structure

Some Shareholders have asked about the Company's ongoing capital requirements and some analysts and commentators have said that AGL is under geared. That may be correct if you take a snapshot; we are trying to achieve the most appropriate level of debt where opportunities and risks are changing rapidly.

Different business models have continued to emerge in the market for energy assets. These business models have different asset compositions and capital structures to AGL and provide returns to Shareholders differently.

The Board is looking at these matters, plus the continued examination of investment opportunities that was mentioned earlier, in the context of the current level of gearing of AGL's balance sheet. We will continue our consideration of how to optimise AGL's business assets and capital structure from a Shareholders' perspective. How AGL holds its investment in the PNG pipeline is also relevant for the Board in considering the Company's capital structure.

Corporate Governance

I would now like to discuss a number of matters that relate to the governance of your Company, in particular the operations and effectiveness of the Board of Directors.

Following the review we conducted of the performance and structure of the Board in 2004, we commenced the two to three year process of Board renewal. Last year I indicated that the Board intended to appoint four new Directors over the next four years.

We intended to be in a position where two new Directors would be presented to you today for election. David Craig is the new nominee. I will outline some particular skills he brings and you will hear from him later in the meeting.

I had hoped that we would also have another nominee with specific operational and business experience in the upstream gas sector to complement the existing skills of the Board. The Board People and Performance Committee has been working with search consultants to achieve this.

Some Shareholders have commented on the slower than expected pace of Board renewal and as Chairman of the People and Performance Committee I am responsible for the fact that we have not done what we said we would do. We will remedy this as soon as we believe we have a suitable candidate.



In doing this we will balance the value of corporate memory with the ideas and experience that new Directors bring. We believe it is very important that we allow new Directors to gain the necessary knowledge base without losing important corporate memory.

In this transitional period, Charles Allen has agreed to stand for re-election by Shareholders. Charles has very broad upstream oil and gas experience having worked for many years with Shell and subsequently as Managing Director of Woodside Petroleum.

David Craig, who is standing for election today, was appointed to fill a casual vacancy in May 2005. I will speak about his experience, accomplishments and performance so far on the Board a little later when the meeting deals formally with his election.

Graham Reaney who is Chairman of the Audit & Risk Management Committee is also standing for re-election. As I mentioned the Board is in a period of transition and that this must be conducted seamlessly and sensibly, particularly in relation to the position of Chairman of the Audit & Risk Management Committee. It is intended that Mr Reaney will work with a successor when that person is chosen by the Board.

As I indicated earlier Tony Daniels has decided to retire at this AGM. Tony has always made his skills and experience available to the Board and provided insights that were relevant, concise and constructive. We will miss his substantial contribution to the work of the Board and on your behalf we wish him well for the future.

We also introduced a process of review of individual Board members by their Board peers. This has provided feedback to individual Directors, allowed us to identify shared priorities, and identified areas for improvement in Board performance.

We believe the changes put in place last year, including more regular informal interactions between Board meetings, have improved the effectiveness of Board meetings. Systematic review of established policies and systems have enhanced the Company's awareness of the need to reconcile the most efficient and lowest-cost energy company with objectives of employee satisfaction and growth.

The Board continues to devote considerable time to strategy development.

Remuneration

One of the most important matters that the Board must consider is remuneration for all AGL employees. This sometimes gives us considerable challenges. We must balance Shareholders' interests with fair remuneration practices which motivate, reward, attract and retain employees.

This Board is keen for incentive plans to be based on share ownership. In our view this best aligns the short and long-term interests of senior management and Shareholders. The AGL remuneration arrangements have three components – a monetary cash component, a lump sum short-term



incentive and a long-term incentive payable in fully paid share rights that progressively vest over three years.

The granting of share rights is dependent on the extent to which the actual performance of AGL improves, measured by the three year average growth in economic profit. How economic profit is calculated is set out on page 44 of the Annual Report. Put simply, it is the gross earnings of the Group less the cost of capital. Cost of capital is what we need to pay you, the owners of the business, for allowing us to use your capital, and what we must pay lenders. If the Group earns more than the cost of capital there is an economic profit and, if it increases on a three year average, the long-term incentives apply.

This approach provides a basis for Shareholders to assess the way in which funds have been used to produce earnings at or above the cost of capital.

One of the beneficiaries of this scheme is the Managing Director, Greg Martin. The allocation of share rights to Greg has to be considered by the meeting because he is a Director. The 2003 Annual General Meeting first considered the allocation of shares to Greg under the Long-Term Incentive Plan. This means that this will be the third time a general meeting has considered allocating shares to him under the Plan.

The Board is aware that several Shareholders, including some institutions, have expressed well developed and strongly held views regarding the use of an alternative measure of Shareholder value creation, that being Total Shareholder Returns or TSR. Again, put simply, this is the sum of growth in market value of AGL shares, plus dividends, which an owner can view as the total return in their hands from holding AGL shares.

Their view is that TSR is a preferred proxy for Shareholder value creation and should be used in determining long-term incentive plan entitlements.

Over the past year AGL's Total Shareholder Return – increase in market value plus dividends - was 29 per cent. The compound annual growth rate in TSR over the past four years was 17 per cent. By comparison, the compound growth rate in economic profit over the same period was 14 per cent. Under either measure, AGL Shareholders have benefited and value has been created.

Nevertheless, the Board has listened carefully to this differing view and we intend to thoroughly review AGL's Long-Term Incentive Plan to ensure it continues to be aligned with Shareholders' interests.

As part of this review we will consider whether the use of Total Shareholder Returns as a measure of Shareholder value created is more appropriate and suitable for a company like AGL. We will also consider other market performance comparisons and other entitlement hurdles. We will report to you on our review.

This year all other eligible employees have received their entitlement to acquire share rights, which vest over the next three years. The Board believes they should also be allocated to Greg Martin under the existing plan.



Conclusion

It only remains for me, on behalf of the Board and, I hope, on behalf of all of you to thank everyone at AGL for the results achieved in 2004/2005.

On behalf of my colleagues, thank you for attending and demonstrating your interest in AGL by taking part in this meeting. I hope you will join us for light refreshments outside.

For those of you who wish to provide feedback to us about this AGM and other Shareholder communications, I encourage you to fill in the Shareholder Feedback Form. May I remind you that you can place them in the return boxes at the exit to the venue.

Mark Johnson
CHAIRMAN