



AGL is well placed to play a leading role in supplying Australia's future energy needs. We have the assets and the people for AGL to continue to be successful in the coming years.

**Mark
Johnson**

Chairman

Strategy and capital management

AGL must have a strong balance sheet and an investment grade credit rating to operate efficiently in national energy markets. Financial strength was important last year and has continued to be so this year. Apart from the effects of higher interest rate margins on the cost of borrowing, AGL has been little affected by conditions in financial markets.

Financial results for the year were in line with guidance we gave to the market in December 2008 and we have increased the annual dividend payment to shareholders by one cent per share.

AGL has completed the program of selling assets considered not to be central to the development of our strategy in Australia, realising approximately \$3.2 billion. These sales proceeds have been used partly to reduce debt levels and partly to invest in new assets to support our strategic objectives. With its low debt levels, AGL is in a strong position to take advantage of opportunities we expect to emerge as the economy strengthens and as changes occur in national energy markets.

The assets we acquired include holdings in coal seam gas reserves, with the purchase of a gas exploration licence in the Gloucester Basin in the central east coast of New South Wales and the successful takeover of Sydney Gas Limited. AGL now has control of significant certified gas reserves and exploration acreage in New South Wales, which we expect will provide long-term gas supply to service our core gas markets in Sydney and Newcastle. A work program is in progress to further 'prove up' and develop these gas reserves, and the other interests we have in gas projects in the Bowen, Eramanga and Galilee Basins in Queensland.

We also expanded our renewable energy assets. Construction of the 140 MW hydro generation plant at Bogong has now been completed and the plant will be officially opened in November. The 71 MW Hallett Stage 2 Wind Farm in South Australia is nearing completion and will be fully operational later this year and, since the end of 2008/2009, we have committed to the construction of a new wind farm at Oaklands Hill in western Victoria. AGL is the largest private owner of renewable energy assets in Australia.

Serving our customers

During the year, AGL introduced a new SAP billing system to replace eight major outdated legacy billing systems. The new billing system will allow AGL to provide enhanced customer service levels. This conversion process has taken longer than we had hoped, as the limitations of the legacy systems were deep and complex.

Many of our customers experienced unacceptable delays in receiving bills and, as a consequence, we received an increased number of complaints. Some enquiries to the Company did not receive the standard of service that our customers should expect. AGL has been very concerned by these problems. The billing delays have now been resolved and service levels restored but this has resulted in a six month delay in AGL realising the full benefits from the new billing system. On behalf of the Board and all of AGL's employees, I apologise for the inconvenience and frustration we have caused many of our customers.

AGL's goal is to provide excellent standards of service to our customers. We still have much work ahead of us to achieve this goal. The investment we have made in our new systems was a necessary and important first step in allowing us to know more about our customers' needs, and to improve our levels of customer service.

Australian energy markets are among the most competitive in the world, with more than 10% of consumers changing suppliers in nearly all the markets in which AGL operates. AGL's churn rate for the year was lower than the industry average and, even with the billing issues we faced, we maintained our share of market and increased average margin earned for each mass market customer.

The new billing system will enable AGL to build on this position and develop new market opportunities. The insights about our customers and their energy needs will allow us to tailor product offerings and increase retention rates for our higher value customers. We will also be able to direct promotional activities to attract new high value customers.

Energy policy

AGL has itself been frustrated by the uncertainty surrounding government policy on energy. A prime example has been the many years of delay in privatising the New South Wales Government's electricity businesses, which has simply taken too long. Although ultimately successful, our efforts to gain planning approval for our proposed gas fired power plant at Leafs Gully in south-western Sydney were hindered by the drawn out approvals process in New South Wales. At a Federal level, delays to legislation for the implementation of the Carbon Pollution Reduction Scheme (CPRS) have contributed to investment uncertainty for business.

AGL supports the implementation of both the CPRS and the increased targets for the proportion of Australia's total energy needs to be obtained from renewable energy sources. These are the critical elements in reducing Australia's carbon emissions. The continued uncertainty about

the implementation of the CPRS means delay in investment decisions and financing decisions. The existing energy infrastructure is stretched and huge new investment is needed for a carbon constrained future. The delay in implementing the CPRS is creating a risky supply situation for all energy users.

Your Board

Two new non-executive Directors were appointed during the year and two long-serving Directors retired from the Board.

Les Hosking was appointed as a non-executive Director in November last year. Les has more than 30 years' experience in electricity and in financial markets. He was previously Managing Director of the National Electricity Market Management Company (NEMMCO) and, before that, Chief Executive Officer of the Sydney Futures Exchange Limited.

John Stanhope joined the Board as a non-executive Director in March 2009. John's career with Telstra spans more than 40 years and has given him extensive experience in finance, corporate strategy, risk management, and systems development to support large customer bases.

Both Les and John have expertise in managing risks in complex operating environments. Both have been appointed to AGL's Board Audit and Risk Management Committee.

Carolyn Hewson AO retired from the Board in February 2009 after serving for more than 12 years, while Graham Reaney will retire from the Board at this Annual General Meeting, having served as a Director for more than 21 years. Carolyn and Graham have served the Board with hard work and clear thinking during AGL's transformation into Australia's largest integrated renewable energy company. They have served Shareholders' interests well and, on behalf of all Shareholders, I thank both Carolyn and Graham for their substantial contributions to AGL.

What lies ahead

Australian energy markets remain dynamic. Very substantial new investment will be required over the next several years to maintain security of energy supply to domestic and industrial consumers while achieving Australia's carbon reduction targets. The global financial crisis has added a new dimension, with the cost of capital likely to increase for all participants in the energy industry. The private sector will only invest if investment returns are positive and the long-term outlook is clear. The Federal and State Governments must set the framework for the private sector to invest with confidence, and allow end-user energy prices to truly reflect the costs and risks faced by energy companies.

AGL is preparing for a new energy world. The CPRS and expanded renewable energy targets will reduce reliance on carbon-based fuels across the economy, but will force prices up. New technologies are likely to emerge which will change the way in which energy is produced and delivered to our customers. AGL is looking forward to the challenges and opportunities these changes will bring. We are working with our customers to help them use energy more efficiently so they buy less energy from us. We are building our skills base in other areas, such as geothermal and solar technology and customer profiling, so AGL can continue to play a leading role in the evolution of Australian energy markets in the years to come.

Michael Fraser, AGL's Managing Director, and all AGL's employees deserve recognition for their hard work and achievements over the last year. AGL has performed strongly in a difficult environment and is now well placed to play a leading role in supplying Australia's future energy needs.

Your Company has a strong balance sheet, with many good assets and low debt levels. It has a clear strategy which has been in place for several years. This strategy has been resilient in difficult economic circumstances and flexible in meeting the needs of a dynamic industry. Pursuing our goal of delivering excellent levels of customer service has the highest priority.

Processes and disciplines are in place to direct capital only to investments which should enhance and grow long-term Shareholder value. Your Board will continue to tell you honestly and directly how your Company is doing.

Mark Johnson
Chairman

\$3.2 billion

The proceeds from our program of assets sales have been used to reduce debt levels and to invest in new assets consistent with our strategic objectives.



This has been a particularly busy and productive period for AGL. The business is performing well, we have strengthened our balance sheet and we are continuing to implement our integrated energy company strategy.

Michael Fraser

Managing Director

This year, AGL delivered on its upgraded earnings guidance and continued to provide healthy dividends to Shareholders. We have built a strong balance sheet by divesting non-core assets and focusing on our core strategy. We are now well placed to build on our position as Australia's largest integrated renewable energy company.

Legislation to expand the renewable energy target – to require that 20% of Australia's energy needs be met from renewable energy sources by 2020 – has now been enacted. To meet the expanded renewable energy targets, Australian energy companies will need to make substantial investments in new renewable energy assets over the next decade. The steps AGL has taken over the last few years to secure the best development opportunities provide us with a strong platform for growth.

In my report last year, I paid tribute to the efforts of our employees in working hard to help steady the business after a period of internal turmoil. I again thank all our employees for continuing to work hard to deliver the strong financial results we achieved this year. It was a particularly busy and challenging year in which many employees delivered above and beyond what would normally be expected.

2008/2009 in review

Our focus this year was to ensure the business was in the best possible shape to pursue our integrated strategy. We completed our asset divestment program and made significant reductions in our total debt levels. We also acquired some new assets consistent with the continued development of our long-term strategy.

Our underlying profit after tax increased by 11% to \$378.8 million, which was at the top of the range of our upgraded earnings forecast of \$352–\$382 million. This has been a commendable achievement against the backdrop of a weaker economy which has seen many companies report lower earnings and declare reduced dividends.

AGL finished the year with a strong balance sheet following the completion of a \$3.2 billion worth of non-core assets sale program. We deployed some of these sale proceeds into growth areas through new commitments such as the decision to build the AGL Hallett 4 Wind Farm in South Australia, the acquisition of the Gloucester coal seam gas (CSG) reserves and the takeover of Sydney Gas Limited.

We successfully refinanced \$800 million in debt and now have no debt due until 2011/2012. The ratings agency Standard & Poor's reaffirmed our BBB credit rating and returned our outlook to Stable.

Two new appointments were made to AGL's Executive Team: Ken Hodgson became Group General Manager Retail Energy and Paul Simshauser became Chief Economist and Group Head of Corporate Affairs.

The business units

The Merchant business performed strongly through the year.

Our integrated generation portfolio provided strong returns and showed the benefits of diversity of geographic location, fuel source, and generation type. This diversity mitigates our exposure to both market risks and operating risks, and provides a platform for growth in a carbon constrained future.

Through our new Carbon Management Services team, we worked with our major commercial and industrial customers to help them manage their own carbon footprints and to prepare them for more onerous reporting on carbon emissions and higher future energy costs.

Upstream Gas was formed as a stand-alone business unit to focus on meeting our target of acquiring 2,000 PJ of equity gas in the medium term. The acquisitions during the year of coal seam gas reserves in the Gloucester Basin and the successful takeover of Sydney Gas Limited have put us well on the way to achieving that target. Those acquisitions also provide AGL with 100% control of nearly all reserves of coal seam gas around our key Newcastle and Sydney markets in New South Wales. Any other gas competing with us in these markets must be transported far greater distances.

Our Retail Energy business finished the year strongly following implementation of the Project Phoenix change program, which integrated a number of legacy billing systems onto a single SAP platform. While there was a regrettable downside to the project which saw some customers experience delays in receiving energy bills, we head into the new year confident that we have fixed those issues. Our focus now is on delivering the promised benefits of the program to the business and on improving customer service for our 3.2 million account holders.

Valuing our people

Employee engagement is a key indicator of how our people are feeling about the organisation and I am very pleased to report that AGL's overall engagement score was up by more than 10% on the previous year. It was also satisfying to see that more than 85% of our people took the time to respond to the survey. This improvement is a result of our hard work to improve the basics of how we work together and manage the business. It reflects the success of internal programs including the new face-to-face 'Welcome to AGL Day', the reintroduction of service awards, ongoing leadership and career development programs, and giving people better tools with which to perform their jobs.

We also achieved a 30% decrease in our Lost Time Injury Frequency Rate (LTIFR), from 3.6 to 2.5, reflecting the importance we attach to ongoing employee safety.

Regulated pricing

Industry profitability is going to be a key driver of future energy development in Australia as governments continue to look to the private sector to fund the heavy investment required to meet future energy infrastructure requirements. To attract that investment, there needs to be clear evidence that rates of return to investors are adequate. That return can only be guaranteed by appropriate pricing mechanisms in the marketplace.

During the year, we saw important signs that regulators and governments were beginning to acknowledge the reality that retail energy prices need to reflect the true costs faced by retailers. Significant tariff increases from 1 July 2009 in New South Wales for electricity and gas, and for electricity in Queensland following our successful court action there against the Queensland Competition Authority (QCA), were positive outcomes in the critical area of regulated retail pricing.

To illustrate the importance of this issue, it's worth noting that before the 1 July tariff increase, New South Wales had the second lowest retail electricity prices in the developed world behind South Africa, meaning there was little or no profit margin for retailers in the State's energy market. Without an uplift in retail prices, there would be scant interest from the private sector in investing in the State's future energy needs.

Conclusion

The strengthening of the balance sheet through the non-core asset sales program has positioned AGL for growth at an important time. In 2009/2010, we expect to learn more detail about the New South Wales Government's proposed electricity privatisation program, which is likely to be a good fit with our business growth strategy. We will also continue to develop our portfolio of renewable and low-emission generation projects and to 'prove up' gas reserves in New South Wales and Queensland.

Commissioning of the Hallett 2 Wind Farm in South Australia has already commenced, and the landmark 140 MW Bogong Hydro-Electric Power Station will be formally commissioned in November. Construction of the Hallett 4 Wind Farm will continue. Since 30 June, we have committed to the construction of a 67 MW wind farm at Oaklands Hill in Victoria and we are likely to commit to at least one more wind farm before the end of 2009. We finished the year with a strong Balance Sheet, with plenty of development growth opportunities to pursue.

AGL has performed strongly in a difficult environment. We have the skilled people, the asset base and the financial strength to play a leading role in contributing to Australia's future energy needs in a low-carbon environment.

Michael Fraser
Managing Director

2.5 LTIFR

Our Lost Time Injury Frequency Rate (LTIFR) fell by 30%, reflecting the ongoing importance we attach to employee safety.