2013 Interim Results Announcement
Presentation Transcript – 31 July 2013

Sir Roger Carr - Chairman
Well good morning everybody and welcome. I mean as you will remember, the first half of the year was materially influenced by the unusual UK weather patterns, with low temperatures and that resulted in higher than normal seasonal gas and electricity consumption.

And the effect in the UK was an increase in energy use by British Gas customers and additional demands on our services business. The impact of higher consumption on profits, however, was largely offset by the substantial increase in environmental costs associated with the Government's low carbon policies, particularly the ECO programme, as well as some higher commodity costs.

As we said before, recognising the economic challenges faced by many of our customers and the impact of the exceptional cold weather, in May the Board determined that any benefit arising from higher consumption during the winter would be used to maintain our price competitiveness. And in this context, we have absorbed the significant increase in environmental costs during this period.

In North America, Direct Energy achieved profits modestly above the previous year despite pretty challenging market conditions.

Upstream, Centrica Energy performed well, but low sparks spreads continued to undermine power generation profitability.

Investment in our North American operations with our Qatari partners, coupled with the decision to enter into a joint venture for shale gas in the UK, helped to secure potentially important sources of gas for the longer term.

The new management structure was implemented in June with Chris Weston assuming responsibility for British Gas in addition to the North American Downstream business. Mark Hanafin widened his responsibilities to include all global Upstream activity.

It was also announced that I would step down as Chairman after nearly ten years in the role. And a search for my replacement has been initiated under the direction of Mary Francis, the Senior Independent Director and it is hoped that my successor will join the Board in the last quarter and take over as Chairman from January 1st of next year.

In order to preserve corporate memory and effect a pretty smooth transition, Mary Francis and Paul Rayner will remain on the Board through 2014.

We entered the second half with a revitalised management structure and further opportunities to develop the business both in the UK and North America. In this context, the announcement yesterday of our North American Energy Marketing acquisition does mark an important development for the business, aligned with our strategy of investing in core markets, where we see attractive growth opportunities.

In power generation, we welcome the progress made by Government in setting out their energy policy framework. However further detail is required in order that we are able to identify and measure the economic returns of these projects and then compare them with other uses of our capital.

Looking forward I am very confident that the team, under Sam's leadership, will continue to focus on the delivery of our growth programme and as a result will achieve market expectations for the full year.

And just finally one word from me to you all. I have chaired the Company since about 2004 and this will probably be my last Results meeting. Many of you have witnessed, I think, under Sam and Nick, the huge change in the Group over that period and you have been challenging when necessary, you have been supportive when appropriate and most importantly, you have all been engaged throughout. And we all thank you for that.

And I wish you well with your continued involvement with Centrica as I move on to the very different challenges of the defence industry. And with that I will now hand over to Nick.

Nick Luff - Group Finance Director

Thank you Roger. Good morning everyone. As usual, let me start with the commodity price backdrop to these results. As you all know, UK gas prices were volatile in the first half, and the average outturn price was higher than for the same period in 2012. The same was true for power prices. This helped the upstream of course, but did give us higher input costs in the downstream. Oil prices on the other hand were lower.

In North America, the outturn Henry Hub price was materially higher in the first half of this year compared to last, albeit still at much lower levels than the UK. This helped the upstream to some extent, but did lead to some pressure on margins in the US energy supply businesses.

UK spark spreads remained low, as Roger mentioned, meaning our CCGTs ran even less than last year, and the market is indicating very little recovery for the rest of this year and into 2014.

The cold weather, as you would expect, had a significant impact on consumption in the UK. Although the weather in the first half of 2012 was cooler than normal, 2013 was substantially colder again, with each month colder than the seasonal norm. Gas consumption per customer for British Gas Residential increased by 13% as a result.

Here are the group figures. The Group performed well against this commodity price backdrop, with higher operating profit in each business unit. Group revenue was up 14%, reflecting the higher wholesale gas and power prices and higher gas consumption in the UK, and increased gas and oil production as a result of 2012 upstream acquisitions. Operating profit increased 9%, with our international upstream gas and oil business being the biggest contributor to the increase, again boosted by the acquisitions.

The tax rate as you can see rose to 47%, as a result of the larger contribution from the more highly taxed upstream. This left earnings up just slightly at £767 million, or

14.8 pence per share. The interim dividend will be 4.92 pence per share, 30% of last year's full year dividend, in line with our established practice.

So here's the divisional breakdown of the results. Running through them and starting with British Gas, where profits increased by 1%. The colder weather resulted in higher residential gas volumes as I said, and therefore higher revenue. However increased external costs, commodity, transportation and environmental, meant that residential energy came in only marginally higher than last year, at £356m. These results do include £300m of ECO costs, equivalent to half a year of our estimated costs for the whole two and quarter year programme. This is a significantly higher cost than for the CERT and CESP programmes that ECO replaces, largely absorbing the benefit of higher volumes due to the cold weather.

That cold winter did result in some additional costs in residential services, some of which will come through in the second half as we recover a backlog of annual service visits. However we saw the benefit of 2012 cost savings in the first half in services, mitigating the impact of a challenging economic environment and resulting in an 8% increase in profit.

Market conditions remain challenging for BGB though, with lower volumes and a squeeze on margins leaving the result down 16%, at £78 million.

Then we go to North America, Direct Energy again delivered profit growth, up 6%. Note that this business unit no longer includes the Canadian upstream gas business which has been transferred across to Centrica Energy. And we have restated the comparatives to reflect that switch.

In North America, higher wholesale prices resulted in increased revenue in residential energy, but some narrowing of margins. We also saw the further expected drop in Ontario, with full year 2013 profitability from that region expected to drop to less than £10 million. However organic profit growth in the US North East and further operational synergies from previous acquisitions meant that profit for DE residential as a whole was only slightly down.

Business energy supply, which now includes power generation and midstream activity, grew once again, with volumes up 17%. There has been some pressure on margins as I said, but an improved result from the power business more than offset this, leaving an increase in profit of over 20%.

Services also performed well, with higher revenues and higher margins leading to an 18% increase in profit.

Moving to Centrica Energy, now including the Canadian gas production business as I said. Here profits increased by 16% to over £800 million. Total gas production volumes were up by 19% and liquids production was up even more, by 31%, with a full period impact from the assets acquired from Statoil, ConocoPhillips and Total in 2012. Together with first production from the York and Rhyl fields, this more than offset the natural decline from existing assets. Volumes in the second half will include production from the Suncor asset acquisition in Canada, which is expected to complete around the beginning of September.

The achieved gas price was higher than last year, reflecting the higher wholesale price, while the achieved liquids price was also up, despite the lower market oil price, due to the impact of forward hedging and FX movements. Although costs increased,

reflecting the increased scale of the business and industry inflation, overall gas profit increased by 32%.

In contrast, as Roger mentioned, trading conditions remained very challenging for gas-fired generation fleet, with our CCGTs no longer benefiting from free carbon allowances and volumes slightly down on last year, reflecting the lower market spark spreads. As a result our CCGTs were significantly loss making.

Nuclear output was once again good and nuclear profit was slightly up compared to 2012, benefiting from higher wholesale prices. Overall power profit fell by 32%, despite a £29 million profit on disposal relating to the sale of our interest in the Braes of Doune wind farm.

Then to storage. Storage benefited in the first half from the higher SBU price for the 2012/13 storage year. As a result, profit increased by over 30% to £47m. However, as you know, summer/winter spreads have narrowed considerably, and as a result the SBU price achieved for the 2013/14 storage year was much lower. We therefore expect profitability in the second half to reduce significantly.

Turning to cashflow, EBITDA is now over £2 billion for the first half, reflecting the impact of last year's acquisitions. Capex was at more normal levels, with no material acquisitions completed, and we returned more than £800m to shareholders in the first half, through the payment of the final dividend and the share repurchase programme. As a result net debt increased slightly, to £4.3bn.

Organic capex was just over £700m as you can see. As expected, the majority of that was invested in the upstream business, with significant spend at York, Statfjord, Cygnus and Valemon. In power, most of the spend was on Lincs, as we move towards final commissioning of the wind farm in the second half.

The second half will also see continued investment upstream, with further spend on Cygnus, Statfjord and additional wells at York, and also at Grove and Kew. We will also have the final spend on Lincs, potentially offset by the sale of transmission assets out of the joint venture. Overall, we still expect to spend around £1.5 billion organically for the full year.

The full year acquisition numbers there you see include some £700m, which includes working capital, relating to the Hess transaction we announced yesterday. We also expect to complete the acquisition of gas and oil assets from Suncor in Alberta, our 60% share equating to around £400m and to close the smaller acquisition of Bounce Energy in Texas. These deals will use some of the balance sheet headroom we have. However, the acquired businesses will generate additional cashflow so once we get into 2014, and have a full year of that cashflow, the impact won't be that significant. So we will still have a strong position, and freedom to deploy the cash generated by the group as a whole to make further investments or returns to shareholders.

In summary then, we delivered earnings growth in the first half, despite economic headwinds, in particular impacting BGB, and weak market conditions for gas-fired generation in the UK. We saw further profit growth in North America, while upstream gas profitability increased, reflecting higher production and higher realised prices.

Continued weak spark spreads and reduced seasonal gas spreads will impact the business in the second half. However we will look for further organic growth in UK services and in North America, and we will continue to benefit from the integration of

our previous acquisitions. Overall, we remain on track to deliver full year earnings growth in line with expectations.

And with that I will hand you over to Sam.

Sam Laidlaw - Chief Executive

Thank you very much Nick, and good morning everybody. As you've just heard, we delivered a good performance in the first half of the year, not only in terms of financial performance, but also in terms of our operational and safety performance which continue to improve. In the first half of the year, our production efficiency increased and our lost time injury rate reduced by a third.

I'd like to put our first half performance in the context of the new strategic priorities which we set out in February, to meet the challenges of a rapidly changing energy landscape.

To recap, we will innovate, to drive growth and service excellence. We will integrate our natural gas business, linked to our core markets, and we will increase our returns, through efficiency and continued capital discipline. And our vision remains the same, to be the leading integrated energy company with customers at our core. I'm pleased to say that we are already making good progress against all these priorities.

Our new management structure is in place, under the leadership of Chris Weston for International Downstream and Mark Hanafin for International Upstream, both supported by strong teams on each side of the Atlantic.

British Gas and Direct Energy both continue to develop innovative solutions to help our customers manage their energy requirements. And the acquisition of the Energy Marketing business from Hess, which we announced yesterday, marks an important step towards our growth targets in North America.

In Centrica Energy, our recent contract with Cheniere for US gas export, the acquisition of further upstream assets in North America in partnership with QPI, and the purchase of a stake in the Bowland shale licence in the UK, all help to secure potentially important sources of gas for the long term.

We have made further progress in delivering organic projects, and we retain a range of investment options across the Group. And importantly we remain on track for delivering our £500 million cost reduction programme by the end of this year.

Downstream, our customers remain at the heart of what we do and we will help them to save money wherever we can. We have already implemented many of the recommendations set out by Ofgem in their Retail Market Review to make the supply of energy simpler, cheaper and fairer, including our unique 'Tariff Check', which allows customers to make sure that they are on the most appropriate tariff for them. We will also move to a single standing charge and, later this year, we expect to simplify our offering to just four core tariffs. We are supporting those who are most in need. This winter more than 500,000 customers received £130 off their energy bills through the Warm Home Discount.

And we continue to develop a skilled workforce for the future with 1,000 apprentices currently in training across the business.

The new ECO programme is well underway, delivering carbon savings and efficiencies for some of our most vulnerable customers in partnership with local authorities and other community organisations, albeit at significantly higher cost than the previous environmental initiatives. The ECO programme alone has increased the British Gas cost base by some £100 million in the first half of the year.

And in Business Energy, we have announced that we will phase out auto-rollover of contracts. We believe this is an important step in building trust with our business customers and look to other suppliers to follow our lead in this area.

During the first half we have seen further benefit from the investment in our industry leading digital platform. A third of our UK residential customers are registered online, and we now receive more customer contact through digital channels including our top rated smartphone App than by any other method.

We are also leading the industry in putting customers in control of their energy use and have now installed over one million smart meters in homes and businesses.

British Gas Services delivered good operational performance during the unusually cold weather, attending a record 1.6 million boiler breakdowns in the first half. We are also launching a number of new services propositions, with packages tailored specifically for landlords and tenants.

In British Gas Business, the environment remains challenging. With a new management team and structure in place we are making improvements to position the business for the future. Our systems upgrade project, which we expect to deliver improved service at lower cost, is progressing to plan. We also continue to develop our services proposition for businesses and have commenced work on eight energy performance contracts across the country.

In North America, the recently announced acquisition of Bounce Energy gives us a market leading online capability which will allow us to acquire new customers at a much reduced cost.

And in Texas, we are launching our Free Electricity Saturdays tariff, building on the time of use offering which our customers in the US Northeast already enjoy. While across Direct Energy, retention levels have improved, reflecting further advances in the quality of our customer service.

In British Gas Residential we added 56,000 accounts in the first half and strong momentum has continued in July reflecting our competitive pricing position and our leading digital platform.

In North America, we continue to deliver organic growth in the US North East. We will also benefit from the full effect of the NYSEG Solutions and Energetix acquisition we made last year, while the purchase of Bounce Energy will add another 80,000 residential accounts, predominantly in Texas.

We also saw organic customer growth in Direct Energy Services, while In Direct Energy Business we are achieving higher volumes, reflecting strong sales activity in the prior year. And the acquisition of the Hess Energy Marketing business, which we announced

yesterday, will transform the scale and capabilities of our B2B operations in North America.

Turning to the Hess transaction in a little more detail, the acquisition will make Direct Energy the largest business gas supplier on the US East Coast and the second largest power supplier, in the competitive US retail markets.

The transaction builds on our existing North American B2B model, with focus on long standing customer relationships, tailoring the offering to meet their specific energy requirements. The acquisition will also strengthen our position along the gas value chain, linking gas supply from producers, including shale producers in the Marcellus through transport and storage, to the gas and power customer base. Over time, these integration capabilities will play an increasingly important role.

We expect the transaction to complete later this year, marking another significant step towards our target of doubling the profitability of our North American downstream operations. And we look forward to working with the Hess team, building on the long history of success that they have delivered.

Operational performance from our international gas and oil portfolio upstream has also been strong in the year to date. Including 100% of the assets to be acquired from Suncor, we are on track to deliver a production increase of nearly 20% for the full year, with the combination of new fields coming on stream and the benefit of acquisitions more than offsetting the natural decline in the underlying portfolio.

In upstream project delivery, York and Rhyl achieved first gas earlier this year, and we have approved plans to bring a further 86 million barrels of reserves into production over the next three years. Costs are increasing in some regions, in particular the UK North Sea, however we are now able to direct an increasing proportion of our capital towards the most attractive developments across our international portfolio.

In drilling, two exploration and appraisal wells were successful, out of three drilled so far this year. A further 10 wells are planned for the second half of the year.

In UK power generation, the nuclear fleet continued its good operational performance. Our gas-fired power stations achieved high levels of reliability and success in bidding into the STOR contracts. But with the combination of a well-supplied market and relatively cheap coal and carbon, the environment for gas-fired generation remains extremely challenging.

Our £1 billion Lincs wind farm, capable of supplying the power needs of 200,000 UK homes, is now substantially complete and will be officially opened tomorrow.

In the year to date, we have taken significant steps to strengthen our position along the gas value chain, in line with our strategic priorities.

Our 20-year agreement with Cheniere to export Liquefied Natural Gas from the Sabine Pass facility in Louisiana represents an important opportunity to secure gas supplies for the future under a “capital-lite” operating model.

And the acquisition of operational gas and oil assets in the West Canadian Sedimentary Basin from Suncor was our first investment under the Memorandum of Understanding with QPI which we signed in 2011. The assets are in a region we

know well and offer potential reserves upside, as well as allowing us to benefit from any increase in wholesale prices.

Last month we announced the acquisition of a 25% stake in the Bowland Shale licence in Lancashire in partnership with Cuadrilla and A J Lucas. Shale gas has the potential to make a long-term contribution to the UK energy mix and this acquisition gives us an important option for a relatively small initial outlay. We welcome the Government's announcement concerning tax allowances relating to shale gas, although much remains to be done to determine its commercial viability in the UK.

For the full year, we expect to invest around £1 billion in the North Sea upstream business, with work progressing on projects such as Cygnus, Valemon and Kew in the UK. These investments are important for the UK, helping to secure long term supplies of gas for our customers.

In upstream gas and oil, we have a pipeline of investment opportunities, building on our existing portfolio. In power generation, we await further details from the Government in respect of our Race Bank offshore wind farm to ensure that there is a sufficiently attractive framework for investment. But we also retain the option, subject again to the necessary incentives, to build further offshore wind projects, in the Round 3 Irish Sea zone, as well as new build gas-fired generation and also potentially gas storage.

And we continue to seek attractive acquisition opportunities, both downstream in North America and upstream across the portfolio. However, as with all our investment decisions, we will only deploy capital where we see appropriate returns for shareholders.

In conclusion, we have delivered a strong performance in the first half of 2013. We are on track to deliver full year earnings growth in line with expectations, driven by a growing customer base downstream, volumetric growth upstream and our £500 million cost reduction programme.

We have made good progress against our strategic priorities, continuing to lead in innovation and customer service and expanding our activities along the gas value chain. And the transaction we announced yesterday marks another important step towards the growth targets for Direct Energy.

We continue to have a robust balance sheet and generate strong cash flows, with further investment options across the Group. And we are on track to deliver real dividend growth for the full year, all paid in cash, in addition to the capital returned under the share buyback programme, maintaining our focus on efficiency and capital discipline.

With that, I think it is a good opportunity to open it up to questions.

Questions and Answers

Q1. Mark Freshney, Credit Suisse [question not audible]

Answer – Sam Laidlaw
For those of you who didn't hear it, hopefully you can hear me. The first question I think was around whether the contract proposals for CFDs from the Government are going to be sufficient for Race Bank? Those outline proposals are not yet definitive and you know the precise terms of which projects are eligible when is not yet clear. And the Government is still in a consultation process on that. So we are awaiting the outcome of that and we understand that actually the final CFD prices won't be set until the end of the year. So we can't give you an answer on that at this time.

I think your second question Mark was around moving down to four tariffs which we will do before the end of the year and in common with the rest of the industry, the industry will have to introduce a standing charge. So at that point clearly there will be some movement in overall differentials clearly that is something the whole industry has to do under the Ofgem recommendations before the end of the year. But it is too early to say what the overall impact of that will be on prices. Clearly half the Bill is made up of the commodity, although they don't yet know what the outlook for the rest of the year or commodity prices is going to be, although there is some price pressure on the UK costs. Clearly it is too early to call what the impact of that will be on prices.

Follow up question
...........If contracts do remain at the current I think £155 per megawatt hour for offshore wind, is that what you are looking for on Race Bank to reach FID and potentially your partners as well?

Answer – Sam Laidlaw
We are in the realms of hypothetical here so I think I would rather not comment on it, but I think generally the industry would say if projects that were sanctioned today qualified for the £155 would generate some offshore wind activity.

Q2. Ashley Thomas, Societe Generale
A question and a request actually. The question on ECO, so the £600 million accrued for the full year is basically linear, £1.4 billion over the 27 months. Will there be a material cash difference in the spend across that period?

And the request is actually, you have given us a of additional detail which is good, can I request the average gas price that has been sold is now blend of Henry Hubb and UK NBP, can I just request that in the future potentially we still have a UK NBP price?

Answer – Nick Luff
A good question on ECO, absolutely that the cash profile of the spend won't be even, it is taking a while to ramp up the programme, so we haven't spent that much in terms of cash so far. It will ramp up in the second half and equalise over 2014. And I note your request on the gas price. The old price we used to publish included some things that were not NBP linked, Trinidad for example. There is, as you point out, more of the Henry Hubb element in there because of the Canadian production going into it. But I note your request and I will think about it.

Q3. Lakis Athanasiou, Agency Partners
Three questions on the US please. One on, I think I understand what you are doing on gas and integrating upstream and downstream. But if there is a soft spot in your strategy I think it has got to be in US power, particularly in Texas. I just wondered what your thinking on this is, particularly for the coming years when high demand should be tightening in that area?

The second thing is, you mentioned a few times today and in your release about the pressures on margins with increases in prices in the US. Can you explain a little bit about that, is it a transient mechanism or is it something systemic that you just lose competitiveness somehow with higher prices?

And thirdly on the Hess acquisition, you mentioned yesterday I think that you expected growth, but not the regular integration costs you get in the residential acquisitions. I presume therefore through the top line. If you could give a bit of flesh and colour on that please?

Answer – Sam Laidlaw
I will touch on each of those. Firstly I think in terms of our integration position in Texas, we do still have three power stations in Texas and actually that provides us some cover peak prices in Texas and we are also able to cover in the market. I think our general view has been that actually if we can cover off severe weather risks through market mechanisms rather than having to own assets that have relatively low utilisation and high capital intensity and low returns on capital employed, that is a better thing to do, provided we can cover those exposures. And we have been successful in being able to do that through a combination of our three power stations and buying in the market. So there is no plan to change that. I think you can expect to see us having a less integrated approach to power generation than we have to gas production for that reason.

I think the second question on the US was around compression of margins. The margins actually I think are still pretty good, but clearly there was a period in the first half where Henry Hubb prices moved up briefly above 4 dollars and actually I think both in the DE business made customers reluctant to renew for a period of time and resulted in some margin compression as you will have followed. Henry Hubb prices have drifted back down again now so I think we see this as more of a transient phenomenon than a structural phenomenon. And I think what is important about the Hess transaction is we are actually getting much more significant market presence too which will be important.

Your third question was around growth of the Hess transaction which, you know I think what we were signalling very clearly on the call yesterday is this isn't like some of the retail acquisitions that we have done where we have actually been able to take the customer base, put them on our systems and eliminate a lot of overhead and take immediate synergies. This is actually a business that gets us into a whole new customer base of LDCs and the sort of New York commercial properties, but links

those with pipeline capacity and storage where there is a lot of optionality. We therefore want to keep that capability. And if you look at the other part of the business they have which is effectively being an aggregator for Marcellus and Utica gas producers, that is only going to grow with Marcellus production. And we expect growth from that. Now I think given the nature of the business, I think it is too early to put clear numbers around that, but I would hope as we get to close this in the fourth quarter and as we start to integrate it in the balance of the year, by the time we get to February we will be able to talk more about that.

Q4. Edmund Reid, JP Morgan
Two questions. Firstly you talked about increasing digital interaction with your customers in residential energy. I just wanted to understand what the implications were for churn and also for cost to serve from digital interactions?

And then secondly on the CCGTs, I wanted to check whether they are loss making on a cash basis and if so, whether you had any plans to mothball some of them?

Answer – Sam Laidlaw
Why don't I ask Chris Weston to talk about churn and cost to serve as a result of the increasing online please and then Mark if you could actually talk about the cash economics of some of the CCGTs that would be good?

Answer – Chris Weston
In terms of online, we have seen online account management grow by about 19% half on half, so we are now about 3.6 million customers and they are doing about 13 million transactions. So the more you drive it online obviously cost to serve will come down. I can't tell you what the precise impact of that is on the cost to serve, but it is obviously beneficial. The one thing we are very mindful of is as you drive more online you get less opportunity to talk to customers. So we are now thinking about how you integrate your call centre with the online experience to ensure that you can make sure you are servicing that customer appropriately and offering them additional products and services. We have seen churn come down. Churn has fallen from just over 8% to just under 7% since H1 2012. Part of that is the experience we offer. We are without doubt the industry leader online. We offer a broader breadth of products and services. We are competitive with our price. We have also seen the end of channels like door to door and all of that has contributed to an improvement in churn.

Answer – Mark Hanafin
So the answer on the CCGTs is that there are two parts to the portfolio. There are the three small plants that are in the STOR contracts, they are pretty much written down and therefore if they weren't slightly positive on a cash basis, we would be mothballing them. So they are cash positive and hopefully set for improvements in margins. The three larger plants that we run as proper CCGTs in the regular market are about £700 million of capital employed in that set of assets. So clearly the DD&A is dragging down the operating profit, but again on a cash basis just about okay. Let's say poised to capture recovery in increased spark spreads we are expecting to see.

Q5. Martin Brough, Deutsche Bank
I just wanted to ask a bit about how comfortable you are about the messaging of the free electricity for Saturdays? I can see the US is in a different political place to the UK, but climate change and energy are global issues and are you comfortable with the message it is sending to consumers about the value of energy and the climate impacts you know as a group about that kind of marketing?

Answer – Sam Laidlaw
It is a very valid point. I mean we haven't launched it yet in the UK and we will think very carefully about how we launch it, but it is of enormous assistance as we have seen in the US to low income households, particularly those that have high energy usage, because they may have a large family and actually it has been regarded by a lot of the state regulators and the Governors of the States in which we are doing it as an enormously positive thing to help people with their energy bills. I don't think it is translating into massively high consumption, because I think the people that are taking advantage of it are basically switching and what is does of course in addition to helping customers with their bills by reducing the peaking and power generation, it actually significantly improves the CO2 footprint of power generation because it is, the peakers tend to be the high CO2 emitters. And if you can remove some of those peaks, you actually end up with CO2 savings.

Q6. Peter Atherton, Liberum Capital
In the flurry of documentation that came out around EMR implementation plan a few weeks ago, the committee on climate change, DECC and National Grid seemed to be coming out with some very low demand forecasts for the end of this decade, they seem to be lowering those forecasts, partly I suspect wishful thinking that makes hitting the targets a lot easier. But what are you thinking in terms of the medium term demand as we go through this decade for gas and electricity? And if those forecasts turn out to be true, some of the forecasts were another 20% reduction in gas demand for example, how does a company like Centrica prosper in a substantially lower demand world?

Answer – Sam Laidlaw
I think we have to distinguish between gas and electricity. A lot of those forecasts were around electricity, where I would agree with you, I think the energy efficiency that was implied is a little optimistic. On the other hand I think some of the analysis that came out from Ofgem was also quite pessimistic in terms of the availability of the interconnector, some of the availability of wind and so forth as well. So those two to some extend offset each other if you are looking at overall security of power generation.

In terms of the gas side, we have seen a 20% reduction in gas demand over the last five years from a domestic customer base. That has largely been brought about as a result of the things we have been doing in terms of loft insulation, cavity wall insulation, but also of course installing a lot of condensing boilers. We will continue to do that, but I think actually that will start to tail off and therefore I agree with you that this isn't going to be linear in terms of energy efficiency. Inevitably and we see this with the ECO programme where the costs per tonne of carbon abatement are now in the order of £100 to £120 per tonne. This is becoming much more expensive as we start to get to hard to treat properties and solid wall insulation. And therefore I think actually that inevitably having picked a lot of the low hanging fruit in energy efficiency that the trajectory will slow down. And we can continue with the services business that we have which is obviously uniquely well positioned to do things like boiler replacement, but also the leading position we have got in the Green Deal and so forth. This is a business which will continue to grow.

Further question
On smart meters where are we on the national rollout, I sort of lose track of it. And how does your million meters already installed fit into that? Are you certain you are going to be remunerated for that investment?

Answer – Sam Laidlaw
Clearly we are ahead of all the competitors on this, but I will let Chris again speak to this. But as we said in the Statement, we have installed a million smart meters and I think the nearest competitor is less than 100,000. Chris.

Further answer – Chris Weston
Our closest competitor is Eon. We are far the largest in the market. We now have a SMETS 1 capable meter out there, we have deployed just over 90,000 of those at a run rate of 8,000 a week. These are meters that you can upgrade over the air. We have very good success rate, 100% success rate in doing that and these will then roll into what is called the enduring phase in 2015. And the recent legislation that we have seen ensures that they will roll into that. So we are gaining valuable experience and we are a considerable way ahead of our competitors.

Further question
So does that mean that the other 900,000 or so are obsolete?

Further answer – Chris Weston
No they are not obsolete, they carry on performing, there is a continual functionality in providing meter readings etc. And they will stay on the wall until we eventually replace them with a SMETS 1, what we call phase 3b meter. So they are not obsolete.

Further answer – Sam Laidlaw
I would just add to that that the customer experience has been extremely positive and that is before we talk about things like free energy Saturdays and so forth. And really take advantage of the time of use capability that smart meters will offer. But in terms of net promoter scores, in terms of the number of calls that customers with smart meters make to us, but also in terms of the retention of the customer base, I think all of those metrics have been very positive.

Q7. Fraser McLaren, Bank of America Merrill Lynch
Good morning. May I just ask about the relationship with QPI. What do you think they bring to the table? And might we expect the JV structure to be repeated in future deals?

The second question relates to yesterday's Hess deal. If you could talk a little bit about the contract duration and the profile both for procurement and also sales please? Thank you.

Answer – Sam Laidlaw
The first question in terms of QPI, the relationship we have with them really started as we as if you like one of Europe's largest importers of gas and them as one of the largest exporters of LNG, there is a natural fit there and that was the basis of our original three year LNG contract. But then we broadened that and said actually in one of the things that we are looking to do clearly is secure diverse supplies of gas for our customers. They are also looking to diversify their gas production. And that is the genesis of the discussions we have had with them, that led to the acquisition of the Suncor properties, but we have been clear also that we would like to do more together. I expect their appetite to be primarily in the E&P area which is where they would like to develop a more diversified supply base to supply European and US markets with a lot of their Qatari gas going to Asian markets, but not exclusively in that we have also had discussions with them about other forms of investment too whether it is in renewables, storage or other areas. So I think it is a broadly framed

memorandum of understanding and I think where it meets both the strategic objectives and the financial criteria for both parties then we will do more.

In terms of the second question which is around the Hess assets in terms of the duration of the contracts, most of them are one to three year contracts on the demand side and probably slightly shorter on the upstream side. But the churn rates have been low because many of these relationships are very longstanding relationships. Whether it is with commercial buildings in the New York area which were originally oil customers of Hess who have switched to gas or whether actually they are local distribution companies where Hess has historically been selling them not only gas but a bundled solution that includes pipeline and storage and therefore the churn rates have been relatively low. I think critical for our success is going to be retaining the team and retaining relationships going forward. The Marcellus business is clearly a younger business in terms of the customer base, but most E&P producers don't sort of shop around on a monthly basis, they will aim to put their production away on a hedged basis for a period of time with a counterparty that is a good credit.

Q8. John Musk, RBC
Just a quick question on the balance sheet. Could you give some guidance on where you would expect net debt to be, come year end, post acquisitions, plus any working capital movements and what that might mean for your credit metrics, where you would expect those to go and what head room would then be available on the balance sheet come year end?

Answer – Nick Luff
A good question, clearly the acquisitions are going to add to the debt, but broadly as you know, the Group is cash neutral overall before acquisitions. So you can broadly add on that £1.1 billion of acquisitions in the second half. Working capital, that all depends on how cold it is in November and December and exactly what the gas price does. So it is hard to forecast.

In terms of what that does to our credit metrics, obviously it will push us down around under the 30% retained cashflow to debt with Moody's, but remember we won't have much cashflow in this year for the acquisitions that we are making. So when you roll that forward into next year and build in the cashflow we generate from the Suncor deal and indeed the Hess deal, then it remains comfortable through to 2014.

Q9. Dominic Nash, Macquarie
A couple of questions, firstly on your potential for building CCGTs. What would you actually need to see before you actually pressed the final investment decision? I.e. is there a risk you build in anticipation of a rise in spreads, thereby putting the rising spread story at risk?

And secondly, on supply. I think your underlying retail margin in the first half was about 3% weather adjusted, you can correct me if the numbers are slightly wrong. In the second half if there is no retail tariff rise it will probably be slightly lower than that I suspect, but not that much. Is there a minimum retail tariff rise that you need to put through before you put one through if you see what I mean? I.e. you wouldn't put a 1% tariff price through or would you?

Answer – Sam Laidlaw
Let me deal with the second one first Dominic, I think we are getting into a lot of hypothetical's here and obviously I think it is actually not helpful for the business to have a lot of speculation about possible future scenarios. What we have said is there are a lot of uncertainties left in the year both in terms of the commodity price which is

a big part of the bill, the weather, but also of course the ECO costs which are a big part of the cost increase in the first half of the year. What level of commitment and spend we have in the second half of the year remains a variable and we will be aiming to sit down with the Government as soon as possible to try and have a sort of ex-post audit on the ECO spend so far this year to actually determine whether given the very high costs of carbon abatement this is the best way of achieving our environmental targets. So I think there are a lot of uncertainties about that.

I think in terms of CCGTs, my expectation is actually with the first auction whenever it happens, now if the auction happens in 2014 that is a good thing, but it is a question of in what period is it for. But my expectation is the first thing that will be incentivised is the continued running or the de-mothballing of old plant before it actually incentivises new plant. We will see what other people bid into, but I think the economic theory would suggest that the cheapest thing to do is try and keep some of the old plant running rather than actually build new plant.

Q10. Peter Bisztyga, Barclays
I wonder if you could give us some detail on the programme for the Bowland shale over the next sort of couple of years? When do you expect to have a better idea about the production capabilities and economics of that asset please?

Answer – Sam Laidlaw
I will let Mark speak to that.

Further answer – Mark Hanafin
So the current plan is that we are this year looking at all of the available sites, combined with work from the seismic, environmental impact assessments. We are working up a number of options. From those options we will select probably a couple of sites for drilling, hopefully in Q2 next year, starting in Q2. So in terms of the scale of the programme it is in that two well, maybe three well range for next year. And you really have to think of this as an exploration play. It is really in a sense no different from us going into a part of the North Sea and saying we think there is a good prospect there, let's drill and see what happens. There is only so much you can do with the geology and the seismic and the analysis. You have to drill it, you have to fracture it and you have to see how it flows. And depending on how those results go, we'll determine what forward programme looks like. But that is the plan.

Further question
So just to follow up on that, planning and local issues, how big of a problem do you think that will be? Or do you think the Government are trying to get all of that pushed through?

Further answer – Mark Hanafin
Well just by watching the news in the last 24 hours, it is clear that it is an emotive issue. I think that we are pretty confident we wouldn't have gone into this if we didn't think it couldn't be done safely and properly. And I think there is a lot of education needed on that because there are some views out there which don't necessarily hold true in terms of what we plan to do. But we have to take those local considerations into account. We have to talk to people. But at the end of the day you have to remember this is gas that is literally under our feet and we are a country that is becoming more and more dependent on imports. It is prudent for the vast majority of people to see, can we make this work? And that is what we are planning to do. We are just trying to see, if this is feasible.

Q11. Andrew Mead, Goldman Sachs
Can I just ask on British Gas business, what sort of lag if there is or sensitivity to changes in the economy? I mean if there are signs whether they are sustained or not in terms of a pick-up. It seems when we saw a downturn, it was a while before we started to see it in the British Gas business?

Answer – Chris Weston
I mean the clear sensitivity is to business failure and I mean if we see the economy pick up then obviously it will be easier to control and manage the debt we have to manage associated with these customers. I mean that is the key sensitivity within that business unit. I think we are very mindful in terms of the programme we are undergoing there. We are introducing a new billing and CRM system that will improve both the experience the customer has and that rolls out over the next nine to twelve months or so. We have already had phase one in, and that went in successfully. And that will also make the business more efficient. So it positions it well as the economy recovers that we can offer a more cost effective and better product to our customers. I think the key area is around management of bad debt.

Further answer – Sam Laidlaw
I don't think Andrew you should think, apart from acquiring customers, I don't think you should think of our customers consuming a lot more as a result of the pickup in the economy because most of our customers tend to be in the commercial and retail space where we lost a lot of customers with the downturn in the retail space. I don't see a lot of retail start-ups if you like coming back. So it will be a case of gaining market share but also taking a lot of cost out of the business, to actually improve the overall margin.

Q12. Edmund Reid, JP Morgan
Thank you very much. Two questions. One is on the difference between margins in gas and electricity supplies. I think the Ofgem segmental accounts suggested much higher industry margins in gas supply versus electricity supply. I guess part of that was weather in 2012 but I was wondering if there was anything structural going on which might account for that?

And the second question is bigger picture and vague really. But on DECC's analysis of Government policy it suggests that electricity unit prices for electricity retail prices are going to go up 20% by 2020. And you will be the ones putting that through. Clearly politicians are not going to take the credit for that. So there is a risk that you get stuck in the middle slightly and I wonder how you look to manage that risk?

Answer – Sam Laidlaw
Both very good questions. I think we would obviously gas demand and therefore gas margins are much more sensitive to the weather and therefore they are more volatile and they will tend to be higher in periods of cold weather and lower in periods of warm weather. But I don't think there is anything sort of structural apart from the competitive dynamics which obviously we are primarily a gas producer and most of our competitors are primarily electricity generators. But I don't think there is anything very significant there.

In terms of unit costs of electricity going up and the DECC forecast of 20%, I don't think we would fundamentally disagree that electricity prices as reserve margins compress are going to have to move up in order to incentivise various new forms of generation and our challenge is always, how do we communicate that to our customers and help people understand what is behind it. Now we have done a lot in terms of transparency. Obviously the 44 pages of analysis you have got today is an

example of that. We break down our profits very clearly to help our investors understand it but more importantly for our customer base, on page 3 of the British Gas bill you see very clearly how much is the cost of the commodity, how much is cost of transportation and distribution and how much the environmental charge is. And we will see as a result of for instance the ECO charges, the ROCS and FITs and carbon, those pieces increase and we use the light bulb that many of you have been shown, to illustrate the point. But it is going to require clearly continued education and helping people understand that actually the driver of increase in retail energy prices is not the profits of energy companies, it is actually the other components on the bill. And we spend, I spend, Nick, Mark and Chris and the whole of our management team spend a lot of time with external stakeholders trying to get that message across.

Q13. Martin Brough, Deutsche Bank
It was just expanding on a point that Sam was making earlier about long-term gas procurement for Europe. Do you worry that there is an unhedgeable chunk of procurement in European gas over the next 5 to 10 years in the sense that Europeans are going to need more firm committed pipe or LNG gas to be delivered over the next 5 to 10 years and yet it is going to be hard to get all of that committed without, on the basis of market prices. So it is going to be difficult for the market to go in and sign lots of new oil linked contracts. So is there a gap there that customers could suffer due to. Is there anything that policy makers could do to help fill that gap or is it up the market to go out and take the price risk and hope it can pass it onto end users?

Answer – Sam Laidlaw
Well I think it is dangerous for policy makers to get involved in global markets. It generally tends to result in unintended consequences and I will give you an example of that. If policy makers were to introduce a requirement for suppliers to have a certain amount of gas availability, the only way we could get effectively un-divertible gas from LNG producers would be to sign up to an oil price linkage which would automatically result in much higher prices for our customers. So rather than it being a general policy, I think it is up to individual companies to make the appropriate arrangements and we are very conscious of security of supply for our customers which is why we did the Cheniere deal which is linked to Henry Hubb prices and why our existing Qatari deal is linked to UK NBP prices. And as long as we can go on doing those type of transactions which are clearly very competitive with oil linked project contracts, or if the European oil linkage starts to weaken further and there are some signs it has started to weaken, then I think we will be able to continue to source international, sufficient international quantities of gas. It is not an immediate problem for us, we are well supplied with the arrangements we already have, but we are obviously on the lookout for options of gas for our customers.

Further question
I just wondered why you think oil linked contracts in the long-term are definitely more expensive? Because if you do get into a situation where you have to hoover up marginal LNG if could be very expensive and if, I mean Europe doesn’t need to do that now, but in five years time it may well find itself paying more than oil linked contracts for gas?

Further answer – Sam Laidlaw
Well you know that is a perfectly plausible scenario and if you look at our input pricing, it has a variety, we have a variety of different indices. Some of them are oil linked. So I think diversity is important. So we will have some that are Henry Hubb, some that are NBP and have a small proportion that is oil linked.

Further Answer – Sir Roger Carr
And five years ago, who knew about shale, it is such a variable.

Q14. Jamie Tunnicliffe, Redburn
I wanted to ask about residential services in terms of when you see revenue growth coming back into that business, how confident are you to start hitting that top line?

Answer – Chris Weston
This is a business I know well and love and I think there is an opportunity there. I am going through a process looking at what the strategic priorities should be for British Gas that's running over the next few months. One of the key things is growth, I am very keen to ensure that we get growth back into British Gas services, I am six weeks into this at the moment, I can't give you a concrete answer. But I think when you look at services and the unique capability that we have, and you look at what we are doing with smart meters, you look at online boilers, connected boilers which I think is a huge opportunity for us and they are becoming a reality now. And you look at smart thermostats, that is a very interesting set of capabilities that we are well in advance of developing and we have already got some products out there are the moment in terms of remote heating controls. We have got the smart meters out there. That is a very interesting mix of capabilities that I believe will enable us to get more growth into this business. So I haven't got a complete answer yet, we are going through a process at the moment, very systematically looking at what we prioritise and where we focus and I hope towards the end of the year we will know more about what we can do to grow the business, but I am confident from what we are seeing at the moment and excited about what I am seeing of what the possibilities could be.

Q15. Mark Freshney, Credit Suisse
Just two follow-up questions. Firstly regarding the 500 million sterling share buyback, is there a possibility that you would choose to look at another buyback for next year once this one is complete?

Secondly, Sam I think you make a reference to North Sea costs. Since the strategic update to February, can you perhaps comment on how you have been seeing the various tenders and cost inflation going in the North Sea and whether your £1.1 billion per year guidance for reserve replacement over the next three years still stands? Thank you.

Answer – Sam Laidlaw
I mean in terms of the North Sea costs, clearly we have seen quite a significant escalation in the cost base but that is really more reflects change in mix in our portfolio as we bring smaller fields which are higher cost, both in terms of lifting cost, but in terms of depreciation. Or if you look at the numbers for the full year we would expect the costs to be slightly lower than they are for the half year because we had quite a lot of shut down activity during the first half of the year. If you actually look at rig rates and a lot of the oil field supplies, I think we are still seeing quite significant cost pressure. Mark I don't know if you want to comment on those?

Further answer – Mark Hanafin, Managing Director International Upstream
I don't know how to put a single number on it, but with industry inflation, we have a mix going on in these numbers so you have more Norway, you have more Southern North Sea as a percentage of our portfolio because of the acquisitions and the projects we have brought on-stream. You have also got a little bit more oil bias in the acquisitions we did last year, particularly the Total one which you know you can accept is slightly higher cost. So I think it is not a healthy trend, but what we are doing about it is we are focusing on getting the maximum out of the fields. So what is the

maximum production potential, minimising the losses, improving the operational efficiency and then ultimately applying the capital and rationing it to where we have got the best returns and that is the option that we have. So if there is a marginal field, we won't be chasing after it in this kind of cost environment.

Further answer – Sam Laidlaw
The other question was around share buybacks so I will let Nick speak to that one.

Further answer – Nick Luff
So on that, we are only half way through the current programme, so it is a little premature to start talking about the next one. We will have to see what the position is when we come to the end of this current programme. As we said in the Presentation, though, clearly although we have used some of the balance sheet headroom with some of these acquisitions we are making, they do generate cashflow so the impact isn't that as significant as the raw headline cost of the acquisition might imply. So we do expect to still have a strong position and freedom to make that choice between further investment in the business and returns to shareholders.

Sir Roger Carr
On that very shareholder friendly note, are there any other comments? Excellent, thank you all very much indeed for your time this morning, have a good summer, thanks.

End of Presentation