Centrica plc 2018 Half-Year Results Announcement
Tuesday 31 July 2018

Iain Conn – Chief Executive
Ladies and gentlemen good morning and thank you for coming to Centrica's 2018 Interim Results Presentation. As usual we will be reporting on our first half results and also providing an update on our strategic progress. First a word as usual on safety in this building. There are no planned fire alarms today and any building evacuation will be announced by tannoy. Emergency exits are marked at the front and rear of the auditorium and Goldman Sachs staff will direct you to the muster point which is towards the rear of the building on the junction of St Brides Street.

This morning I will summarise our first half performance, full year outlook and business headlines. I will also provide a reminder of our multi-year performance to date and our current priorities. Jeff will then take us through the results in detail before I come back to provide an update on the progress we are making in demonstrating customer-led gross margin growth, on our asset businesses and on the UK Energy supply default tariff cap.

Before I do that, a moment on the other announcement we made this morning. We announced that after 4 years in post, and 15 years with the Company, my friend Jeff Bell will be stepping down as CFO at the end of October. With his extensive knowledge of Centrica, he has been an invaluable partner as we re-shape the Group and strengthen the company in this first phase of our repositioning following the announcement of our strategy in July 2015. I would like to thank Jeff most warmly for everything he has done for the Company.

Jeff will be replaced by Chris O'Shea who will take up the position of CFO and join the Board on 1st November after a handover period. Chris is an experienced CFO, most recently of Smiths Group plc, and prior to that Vesuvius plc. Chris has broad experience of the energy industry, having spent many years in both Royal Dutch Shell and BG Group plc. He is ideally suited to take Centrica through the next phase of its transformation and I look forward to working with him.

We also announced earlier in July that Mark Hanafin will be retiring at the end of March 2019, and once again I would similarly like to express my appreciation for his significant contribution to the Company. His successor as Chief Executive of Centrica Business will be the subject of a separate announcement.

I realise this is a lot of change within the Executive Team, but the Board has continued to pay close attention to careful succession planning.

We experienced a challenging environment in the first half of the year, with extreme weather, rising commodity prices, regulatory uncertainty and continuing competitive pressures. The rising wholesale commodity prices resulted in margin compression in energy supply, but helped drive improvement in the E&P financial result.

Although challenging, against this backdrop we remain on track to deliver the 2018 Group Financial targets outlined in February. First half gross margin and EBITDA were stable year-on-year while operating cash flow was £1.1 billion, down 11%, including the impact of £200 million working capital build due to rising commodity prices and the impacts of cold weather. Net debt was £2.9 billion.

Adjusted operating profit was down 4% to £782 million while adjusted EPS was down 22% to 6.4 pence due to a higher effective tax rate of 39% reflecting E&P's higher share of the profit mix. Jeff will cover this in more detail shortly.

For the full year we expect higher adjusted operating cash flow than in 2017, within our targeted £2.1 to 2.3 billion range. We expect capital expenditure to be below our £1.1 billion limit for this year and net debt to remain within our 2018 targeted £2.5 – 3 billion range.

As we outlined in February, we expect to maintain our full year dividend at its current level of 12 pence per share, provided we are on track to deliver £2.1 – 2.3 billion per annum on average of operating cash flow over 2018 to 2020 and maintain net debt in the £2.25 – 3.25 billion range.

Let me now cover the main business headlines from our Presentation today. As you know, we have a major focus on stabilising and then growing gross margin from our mix of businesses.

Although consumer account losses continue, this has been at a reduced rate compared to the first half of 2017, especially if the impact of our 2018 price increase is taken into account, and to the full year. In some areas we have made significant progress, with UK Home Services account numbers stable in the first half for the first time since 2011.

We have been developing our capabilities to underpin gross margin through improved customer segmentation, developing enhanced tailored propositions, maximising customer lifetime value and reducing our cost to serve. I will return to some of this later in the Presentation.

In North America, both energy supply businesses have shown improvement relative to the second half of 2017. Although retail power supply continues to be weak in the North America Business, we are seeing encouraging North America Business forward book development for 2019. I should add that UK business has also seen good recovery compared to the second half of 2017.

We are seeing encouraging progress in Connected Home and Distributed Energy and Power, with strong development of our pipeline of products, services and channels in Connected Home and firm order book growth in Distributed Energy and Power. Although revenue conversion is behind planned levels in both businesses, we expect revenue growth to accelerate in the second half. Demonstrating 2018 revenue delivery is important, but even more so is securing a material forward pipeline and momentum of scale and this will be the ultimate determinant of success if we are to hit our 2022 revenue targets.

In Exploration and Production, Spirit Energy has been successfully established and is focusing on reliable operations and creating value through portfolio optimisation. Rough is fully operational as a production asset, and delivered strong volumes in the first half.

Cost efficiency remains a key priority and we continue our strong track record of delivery. We remain on track to deliver £200 million of savings for the full year.

And finally, we are still awaiting clarity on the regulations for the temporary default tariff cap in the UK. This is not a simple task for Ofgem and we continue to engage constructively and have been contributing to their consultations as the process concludes, while implementing our own mitigating actions.

Before I hand over to Jeff, I would like to set our 2018 performance in a longer context - both looking back to 2014 and as we look forward to 2020.

This chart shows revenue, adjusted gross margin, operating cash flow and operating profit for Centrica since 2014. The key message is how resilient Centrica's portfolio and performance has been, despite the collapse and partial recovery of energy prices, increased competition and loss of customer accounts, the structural advantages given to small suppliers in the UK energy market, UK regulatory intervention including two price caps already in place, and the changes we have made to Centrica's portfolio as we reduced our net debt.

What you can see is that despite these significant changes and pressures, and some volatility in our revenues, Centrica's adjusted gross margin, operating cash flow and operating profit have been relatively stable over the period.

This is not just serendipity. We have had to work strenuously to underpin gross margin through a focus on quality not quantity and on reducing our cost of goods. We have managed to deliver adjusted operating profit in a range around on average just under £1.5 billion per annum through the mix of our businesses and through driving operating cost efficiency. All of this has resulted in a £2.1-2.3 billion range of adjusted operating cash flow throughout the period. As I said a moment ago, we expect this to continue in 2018 as indicated on the slide.

It is this delivery of stable operating cash flows combined with discipline in our capital deployment and net debt which underpins our expectation to be able to balance sources and uses of cash flow and to maintain the current level of dividend.

Finally, I recognise that although we have demonstrated relative stability of gross margin over this period, we have not yet demonstrated the ability to grow it. This is key if we are to deliver on our overarching objective of operating cash flow growth, and therefore delivering both growth and returns over the medium term.

Let me therefore turn to our medium-term priorities of performance delivery and financial discipline, which we outlined in February.

We have four performance focus areas to 2020, in addition to maintaining capital discipline and balance sheet strength. They are: demonstrating customer led gross margin growth, driving cost efficiency hard towards being the "most efficient price setter" consistent with our Brand and propositions; improving the effectiveness of Centrica's organisation; and securing the capabilities we need for 2020 and beyond as the world of energy and services continues to change.

We are making material progress in all of these areas, but perhaps the most challenging for us so far is to overcome some of the competitive and regulatory pressures on our business and to demonstrate the ability to grow gross margin through the customer.

After Jeff has reviewed our results in more detail, I will be back in about 20 minutes to spend some time expanding on our progress in this area.

Let me now hand over to Jeff.

Jeff Bell – Group Chief Finance Director
Thank you Iain and good morning. Let me start with our financial headlines for the first half of 2018.

Revenue was up 7% largely reflecting the higher impact of volumes and commodity prices. Gross margin was broadly stable overall while adjusted operating profit fell 4% to £782 million with lower profits from our customer facing division, Centrica Consumer and Centrica

Business, largely offset by increased profits from the E&P Division. I will cover this in more detail shortly.

Adjusted earnings fell by 20% to £358 million primarily reflecting the impact of a greater proportion of the Group's operating profit from the more highly taxed E&P Division and historic tax settlements in 2017. As a result, the effective tax rate rose to 39%. We expect the full year effective tax rate to be at a broadly similar level. The Interim Dividend has been set at 3.6 pence in line with our established practice of paying 30% of the previous year's full year dividend.

Turning to cash flow, EBITDA was up 3% to £1.32 billion while adjusted operating cash flow was just over £1.1 billion,11% lower than in the first half of 2017, primarily reflecting working capital outflows due to year on year variances in UK weather.
Group net investment of £463 million is consistent with the prior year period when excluding disposal proceeds from the Lincs windfarm joint venture in 2017. Net debt of just under £2.9 billion is around £300 million higher than at the start of the year, reflecting the higher working capital outflows and the one-off cost of our debt repurchase programme earlier in the year.

Now briefly touching upon commodity prices. Brent Oil, NBP gas and baseload power prices continued their recovery over the first half of this year. This is positive for our E&P and Nuclear businesses. However, with our forward hedging of production, we would expect to see more of a benefit in 2019 and 2020, while in the short term higher commodity prices have put pressure on energy supply margins.

Turning now to Centrica Consumer. Total gross margin for the division was down by 8% to £1.4 billion, while adjusted operating profit was down 20% to £430 million. UK Home Profit was down 20% to £393 million and within this energy supply profit was down 16% to £321 million. Although the cold weather in the first quarter was positive overall for energy supply, gross margin was impacted by a lower number of customer accounts, the full impact of the pre-payment cap and the higher commodity and other input costs.

Additionally, the cold weather in the first quarter was negative for energy services, with the record number of callouts we experienced resulting in higher costs. In addition, we continue to invest in future growth that won't materialise until the second half of the year. Reflecting these factors, services adjusted operating profit was down 33% to £72 million.

We would expect an improvement in the services result for the second half of the year, as we assume a return to more normal weather conditions, and as our cost efficiencies accelerate. The investments we are making in data science and customer segmentation are also expected to improve our pricing sophistication and customer mix.

Ireland operating profit fell 55% to £15 million, predominantly reflecting the impact of scheduled extended maintenance outage at the Whitegate Power Plant, its first major overhaul since it was commissioned in 2010, and higher commodity costs. The Whitegate plant came back online in May, and has seen high levels of reliability since, while the tariff increase, to reflect the higher commodity input cost will take effect in August.

North America Home profit rose 14% to £66 million, with improved gross margin from our services business and the impact of the closure of our loss-making residential solar business in the second half of 2017.

In Connected Home, gross revenue rose by 31% to £21 million with an increase in product sales. Gross margin also grew by 67% although the adjusted operating loss was flat year on year at £44 million as we continue to underpin future growth through revenue investment.

Total Centrica Consumer adjusted operating cash flow declined by 60%, which largely reflects the impact of the working capital outflows I referred to earlier and lower year-on-year profitability.

While the previous slide showed the first half performance summarised by business unit, this slide shows the primary commercial drivers of the Consumer division's first half operating profit. External factors were slightly positive, with negative impacts on gross margin of the prepayment and safeguard tariff caps, and foreign exchange movements, more than offset by the positive impact of higher consumption in energy supply due to cold weather despite the additional cost and service.

The choices we made to invest in services growth and to undertake the maintenance outage at Whitegate negatively impacted profit, while lower customer accounts in UK Home and North America Home energy supply were the primary drivers of reduced gross margin. As in the previous periods, our cost efficiency programme played a significant role in partially offsetting these factors at an operating profit level.

Now let me turn to Centrica Business, where gross margin was down 13% to £507 million and adjusted operating profit fell to £96 million, primarily driven by continued weakness in retail power in North American Business and losses from the legacy gas contracts in Energy Marketing and Trading which we highlighted in our February Preliminary Results. I will provide more detail of these performance drivers in the next few slides.

Before I do, although small, the Central Power Generation segment operating profit was down £12 million, primarily due to nuclear outages earlier in the year at Sizewell, and the current outage at Hunterston B. Adjusted operating cash flow fell 41% to £262 million, largely reflecting the timing of working capital payment in Energy Marketing and Trading.

Here is a summary of the primary drivers of Centrica Business gross margin and operating profit. The impact of external factors, namely weather, foreign exchange movements and commodity price changes, were broadly neutral while additional investment in Distributed Energy and Power was offset by cost efficiencies.

The lower gross margin and adjusted operating profit were predominantly driven by the impact of the losses on our legacy gas contracts and weaker performance in North America Business, partially offset by improved underlying Energy Marketing and Trading and UK Business performance.

As we did in February, this slide breaks out North American Business gross margin by its components. On the left-hand side, you can see good gross margin capture in the gas supply and optimisation books in the first half, with a particularly strong performance in the first quarter as the business captured value in the cold weather environment. However, this was more than offset by a reduction in the retail power book with unit margins remaining at lower levels during 2018. The latter was driven mainly by the timing of revenue from historic sales of longer-term fixed price retail contracts compared to the timing of the input cost, in particular, capacity market charges.

As a result, operating profit fell by 51% in dollar terms to $69 million. Although by 55% in sterling as foreign exchange movements had a £10 million year-on-year impact. However, the launch of new customer propositions, an improved sales channel mix and the system and process improvements implemented in the second half last year are delivering, and we should begin to see improvements going forward. And as you can see on the right-hand side of the chart, our margin under contract in 2019 is ahead of where we were at this time last year, as we see the unwind of the higher capacity market and other input costs, and a progression towards more normalised power retail unit margins.

Turning now to the remaining Centrica Business Segments. UK Business is recovering as we expected and delivered a 28% increase in gross margin, with no repeat of the electricity cost volatility and phasing of energy settlements seen in the first half of last year. The number of small and medium sized enterprise accounts was broadly stable, while we continue to deliver and improve operational performance.

Distributed Energy and Power gross revenue was slightly down compared to the first half of 2017, although growth margin was up reflecting improved project delivery. The business reported an increased operating loss due to continued investment in growth. With the order book significantly higher than at this stage last year, we are building good momentum and expect strong revenue and gross margin growth in the second half. We currently expect full year revenue to grow by around 50% or 40% after the impact of the adoption of IFRS 15 this year for the full year, and the second half operating loss to be broadly similar to the first half.

Energy Marketing and Trading delivered lower gross margin and reported a reduced operating profit, although as you can see from the chart, our core Energy Marketing and Trading activities - route-to-market services, trading and optimisation and LNG - delivered good growth as we were able to capitalise on commodity price volatility in the first quarter. Gross margin from these activities was up 30% year on year.

However, gross margin from the remaining three flexible legacy gas contracts, the light blue on the chart which we have been optimising for value since we demerged in 1997, was negative, in line with the guidance given in February. With the two most profitable of these contracts ending during 2018, and the remaining contract expected to be loss-making this year based on the current commodity price inputs that make up its commercial terms, we still expect 2018 full year adjusted operating profit in Energy Marketing and Trading to be around half the level of 2017.

Moving to Exploration and Production, which now includes Spirit Energy and Centrica Storage. Production in Europe was up 36% to 32 million barrels of oil equivalent, as the Bayerngas assets were consolidated into Spirit Energy and we saw significant production from the CSL-operated Rough asset.

Realised European gas and liquids prices rose, and, when combined with the increased production, realisations were significantly higher than in 2017. With stable unit cash lifting in other production costs, as well as unit DD&A, adjusted operating profit increased to £256 million. Adjusted operating cash flow also rose, reflecting the increased operating profit but also the phasing of working capital, which will normalise over the year. As a result, we would expect E&P adjusted operating cash flow to be heavily weighted towards the first half of the year. With capital expenditure of £231 million, in line with our full year expectation of around £500 million, E&P also saw a material rise in free cash flow year-on-year.

This chart shows the primary drivers of the increased E&P adjusted operating profit. The impact of the sale of the Canadian assets in 2017 was small, with the largest drivers of the improvement being the impact of production from Rough and higher commodity prices, partially offset by higher remediation costs at Morecambe and increased drilling activity resulting in higher exploration costs.

For the full year, Spirit Energy production is now anticipated to be around 50 million barrels of oil equivalent, at the lower end of the range we expected at the start of the year, reflecting continued performance issues at Morecambe and lower volumes from our non-operated Norwegian fields, while Rough production is expected to be in the 9-11 million barrel of oil equivalent range.

I would like to turn now to our cost efficiency programme. As a reminder, here is the slide we showed in February setting out the increased target of £1.25 billion of annual efficiencies by 2020 when compared to 2015.

Our efficiency programme is on track to deliver £200 million of savings in 2018, with £92 million realised in the first half of the year. While foreign exchange movements benefited our cost base, our efficiency programme wasn't completely able to offset inflation and 'other' costs, which are mainly a combination of one-off credits reversing from the prior year, exploration and platform remediation works in E&P and increased bad debt cost in the customer facing divisions that aren't counted as part of our efficiency programme. This 'other' category has typically resulted in a reduction in overall controllable costs since we commenced our efficiency programme in 2015.

Delivering on the full year cost targets is underpinned by various initiatives, including further digitisation of our customer operations activities in response to customer demand for self-service, and field force effectiveness through the integration of our field operations and associated back office and support activities.

We also delivered further procurement and supply chain savings, including from the simplification of our IT systems landscape, while the ongoing transformations of our HR and Finance functions are proceeding to plan.

Moving now to net investment. Total capital expenditure increased 28% to £493 million, with increased investment in both Centrica Consumer and Centrica Business, including the development of merchant assets and Distributed Energy & Power and two small bolt-on customer acquisitions in North American Business. E&P capital expenditure was broadly unchanged, and in line with expected full year view of around £500 million. Overall including the impact of some small disposals, Group net investment was £463 million while 2017 included the disposals of our stake in the Lincs Windfarm as well as our Trinidad and Tobago E&P assets. Capital discipline is a key priority for the Group, and we expect to spend no more than £1.1 billion on capital expenditure in any small bolt-on acquisitions for the full year.

Moving onto cashflow, as already referenced, EBITDA increased 3% to just over £1.3 billion, although an increase in working capital outflows as a result of year-on-year variances, driven primarily by weather, led to adjusted operating cash flow following 11% to £1.1 billion. In addition to the increase in net investment already described, we incurred interest costs of £139 million associated with the early bond settlement charges as part of the Group's debt repurchase programme earlier this year. A lower scrip take-up resulted in higher cash dividend payments, while other cash flows include payments related to restructuring charges and pension deficit funding.

As I mentioned in the financial summary, net debt was £2.9 billion at the end of the first half, within our targeted 2018 range of £2.5-3 billion, while we maintained strong investment grade credit ratings with both S&P and Moody's, having achieved our target financial metrics at the end of 2017.

The efficiency of our balance sheet has been improved by the completion of the £1.1 billion debt repurchase programme earlier this year, and surplus cash will fall by approximately £400 million further in September when another bond repayment is due.

In addition, the IAS19 pension deficit has reduced from £886 million to £29 million over the past six months, back to a level we last saw in 2015. We are in the midst of our triennial pension review with the Pension Trustees, which of course is based on a different set of

assumptions than for accounting purposes, and at this early stage makes it difficult to predict the final outcome. We would expect to complete this review in early 2019.

I will finish by summarising our 2018 Group Financial targets. As Iain has already mentioned, adjusted operating cash flow is still expected to be within our targeted £2.1 – 2.3 billion range. Capital reinvestment is expected not to exceed £1.1 billion. We expect to maintain the current level of the dividend at 12 pence per share, subject to achieving our targets for adjusted operating cash flow and net debt.

We also remain on track to achieve £200 million of efficiency savings in 2018, with like-for-like headcount expected to be lower by around 1,000 for the full year. And with our focus on capital discipline, net debt is expected to remain within the £2.5-3 billion range.

I will now hand back to Iain.

Iain Conn – Chief Executive

Thank you Jeff. In the rest of the Presentation I would like to cover a few specific topics.

In the context of our performance agenda I will spend some time on the progress we have made developing our capabilities to deliver customer-led gross margin growth, with some specific examples. I will then cover progress in our asset businesses, E&P and Nuclear, before updating you on how we see the UK energy supply default tariff cap.

This is the same slide I showed earlier, indicating our priorities over the next three years.

Today I would like to provide a deeper understanding of our progress in one priority area and namely the first one, what are we doing to grow gross margin through our customer relationships.

Centrica's strategy is built around our purpose of satisfying the changing needs of our customers in energy and services. We have developed new skills and capabilities in both Consumer and Business divisions which allow us to provide more than just commodity energy, within clear strategic frameworks depending on the customer. We are leveraging the significant customer data resource we have, providing new propositions and solutions platforms which customers value, and channels which make it easier to deal with us. We are enriching the customer relationship with rewards and improved levels of service. Over time, we believe this will allow us to stabilise our customer account relationships, stabilise gross margin, and then begin to grow.

I realise that in some other consumer sectors these capabilities would be regarded as more commonplace. However, in the energy supply sector it has been normal to use simplified averaging assumptions. We have also not taken full advantage of the wealth of customer data we possess. Not anymore. Although we have more to do in embedding these capabilities, we believe Centrica is accelerating quite quickly towards some of the best in class sectors.

Let me begin with Customer Service.

We have been paying strong attention to getting the basics right, and monitoring key indicators such as customer complaint levels.

This chart shows customer complaint rates per 100,000 energy customers in Consumer indexed to mid-2015. Over the last three years you can see that we have made steady progress in all the energy supply businesses, with a reduction in complaint levels on average

of over 60%. This represents a run-rate of about one million fewer actual complaints per annum relative to 2015.

Turning now to account numbers in Consumer. Here is the slide we have show previously, showing the movement in Consumer accounts for the first six months of the year. Consumer accounts fell by 226,000 in the first half of 2018, or less than 1% of the total. This is a material improvement compared to last year's run rate in both the first half and full year, where on average we were losing over 100,000 accounts a month. In 2017 the majority of our losses were from unattractive channels we closed and from largely loss-making customers switching away.

This year, reductions due to loss-making or very low margin collective tariff or white label customers - shown in the "yellow bar" - were less significant, and we lost a further 50,000 prepayment customer accounts, who are now subject to a price cap.

Competitive pressures did result in a net reduction of a further 247,000 accounts in the first half, predominantly in UK energy supply where we saw a spike in churn, as is typical, following the announcement of our standard tariff price increase in April. However, this was partially offset by the gain of a further 135,000 Connected Home Customer accounts during the first half of the year.

Most of the net losses in the UK in the first half of the year were Standard Variable Tariff accounts or SVT. However, in line with our strategy in advance of the default tariff cap, within this total we were able to encourage many other SVT customers to move to alternative tariffs offered by British Gas. Over the period just under 900,000 SVT accounts moved internally to other British Gas fixed term contracts, or onto the new vulnerable customer safeguard tariff, or our new fixed term default temporary tariff.

Our goal remains to stabilise the net position in our core Consumer portfolio and then begin to grow it, with a strong focus on customer value. We are deploying more advanced customer segmentation, data science, development of actionable insights, and delivery of tailored propositions.

We have been moving rapidly from average assumptions about groups of customers to seeking to understand customers at the individual level - ultimately in pursuit of the "customer segment of one."

We now understand individual customer behaviour and propensity to consume other propositions, and can use this to drive differentiated pricing, develop new propositions which are tailored to meet the needs of individual customers, reward loyal customers with differentiated offers, and optimise our sales and marketing activity towards the channels and customers that maximise customer lifetime value.

Let me show you an example from the UK Home business unit.

These three graphs depict the customer life-time value distribution of our energy only, services only and energy and services customers in UK Home. Customer life-time value is shown on the x-axis and the proportion of the customer base at each level of value is shown on the y-axis.

We know where each of our customers sit within these curves and the key drivers of value.

Customer life-time value is driven by several factors, including propensity to take other products, propensity to churn, propensity to contact us, and the preferred channel through which they contact us.

In addition, for energy only customers, consumption, debt risk and meter type are also factors driving value. For services only customers, we considered number of products bought, number of claims and type of central heating system installed.

As you can see from the chart on the right, and as you would expect, joint customers are typically more valuable - demonstrating that cross-sell and up-sell are key to driving incremental customer lifetime value. You can see they are more valuable by the mode of the curve being further away from the red line.

As you can see on the left, we also have energy-only customers with a negative customer lifetime value. For these customers, we must ensure that we reduce our costs to serve if we are to move them up the value curve, while directing our resources to more valuable segments.

So how are we using this data to drive customer lifetime value?

We can deliver top line growth through improved customer retention and acquisition. We are targeting higher value energy customers through our sales channels. We are also increasingly using personalised roll-off offers for customers we know are high value. British Gas Rewards is also allowing us to improve retention through our offer of personalised rewards.

We are focused on increasing the value of our existing customers through cross-sell and up-sell - increasing the number of holdings per customer. We develop propositions focused on customer needs, such as breakdown only cover for less-risk averse customers. We are also using data to be more sophisticated in our pricing, with a greater focus on risk-based pricing at an individual customer level.

In Ireland we have been offering differentiated service levels for certain customer segments who would value them, such as reduced wait time and call length.

We can serve all our customers in a more cost-effective way, with online journeys tailored to different customer types. We are now able to target marketing spend to the highest value channels and segments, and have increased our digital marketing capability.

British Gas Rewards has been a successful drive of retention and customer life-time value. It involves simple digital customer journeys and tailored experiences, and we now have over one million customers signed up. We have developed a wide and increasing range of personalised offers, providing more valuable customers with a greater number or value of rewards.

We are already seeing the benefits of this. Average churn is 22% lower for Rewards customers, and net promoter scores are six points higher. Rewards is prompting more customers to manage their accounts online. It is also driving incremental product sales and more customers opting-in to receive future marketing communications.

Highly targeted segmentation and proposition development is not unique to the UK and Ireland.

In North America Home as you can see on this chart, we have also segmented down to the individual customer level and as a result we identified an optimal sales channel mix and better targeted marketing spend. We have delivered new offers targeted at the highest value segments, and as you can see from the chart, we have materially increased the percentage of sales to higher value customers, and at a much lower cost to acquire.

Across Consumer we are beginning to benefit from our enhanced capabilities in data science, insight generation, segmentation and proposition development.

So, let me now move onto another source of gross margin growth, through building our customer base, products and propositions, platforms and channels in both Connected Home and Distributed Energy and Power.

We saw further growth in Connected Home products, hubs and subscriptions in the first half of 2018. The cumulative number of customers increased by 135,000, and cumulative product sales were up by 90% on a year ago and nearly 500% on two years ago. Gross revenue was up 31% in the first half relative to 2017. This reflects the wider range of products now available on the Hive ecosystem, including the Hive view camera, Hive Hub 360 and our new GU10 lighting product, all of which we launched during the first half. We also introduced subscription options for camera storage, Hive Video Playback Membership, and water leak detection.

We continue to develop and build strategic partnerships. In the UK, we announced a partnership with EE, allowing customers to bundle Hive with their monthly mobile subscription. We have now expanded Hive into mainland Europe, with our partnership with Eni Gas and Power in Italy going live in April and the launch of the Hive website in France.

Most recently we have entered into a partnership with Anglian Water and their Wave channel for 250,000 SME customers, through which we are offering Hive Leak, and made our first sale last week. We have other water companies also interested, probably for obvious reasons, in Hive Leak.

All of this underpins momentum. This shows the Connected Home pipeline and indicates the number of products, services and channels we launched during the first half that will be fully available in the second half.

As a result, we expect growth to accelerate in the second half of 2018 and we continue to target a doubling of revenue and an additional 500,000 customers for the full year compared to 2017.

Moving onto Distributed Energy & Power, we are also beginning to see real momentum. Although first half revenue was slightly down compared to the first half of 2017, we have seen significant growth in our leading indicators in 2018, with firm order intake up 119% compared to the same period last year and the secured order book up 47% over the past 12 months.

The exact monthly phasing of when this firm order book revenue will come through is challenging to forecast. We clearly expect revenue to be weighted towards the second half of the year, and although challenging we are still aiming to achieve our targeted full year like-for-like revenue growth of 50% versus 2017. However please note as on the slide, when restated now under IFRS15, the same results will be recognised as 40% growth.

DE&P has been developing an Integrated Solutions Platform which will allow customers to access all DE&P offerings through one consolidated user interface. Customers can now access services to help them with their energy usage, operational efficiency, demand management and optimisation, demand response and operations and maintenance services - through a single user interface. All of these services are enabled by a common market interface information subsystem. The platform will give customers monitoring, diagnostic, predictive and remote-control capabilities for their equipment and enable them to interact with energy markets.

The first instance of this is now live and we believe it provides a unique and differentiated customer offering for distributed energy products and services with the key differentiators being, ease of interaction and Centrica having the full suite of capabilities to offer. The platform incorporates the capabilities gained from our targeted acquisitions of Panoramic Power, REstore, NEAS and ENERG Cogen. Over the next two years we will continue to enhance the platform and deepen the full suite of services it offers.

Distributed Energy & Power is no longer a concept but a reality. We now have a large number of projects which have been completed. I would like to give you a few examples.

In December 2017 we began a contract with Riverbay Co-op City, a 330 acre housing community with 40,000 residents located in the Bronx, New York. Under the contract we offer a wide suite of services including wholesale energy management, power and gas procurement and supply and demand response. Riverbay is saving over a million dollars a year compared to their previous contract.

In June, St George's Hospital in Tooting in South London opened a new energy centre delivered by Centrica Business Solutions. The project features two combined heat and power units, as you can see in the picture, that will deliver almost all of the power needed to run the hospital, with four boilers, a highly efficient chiller system and energy efficient lighting and controls. We guarantee that St George's will save over a million pounds per year while their annual carbon emissions are reduced by 20% or 6,000 tons.

Also during the first half of the year Centrica's REstore business, which was acquired in 2017, successfully launched a 27MW power plant or VPP in Terhills, a holiday resort on the Belgium/Dutch border, although it is right next to a coal mine, but it is a holiday resort. The project combines an 18MW Tesla battery project with flexible load and generation from a group of industrial customers to deliver up to 27MW of flexibility services to the European transmission grid.

Distributed Energy & Power currently has an installed base of over 1,400 combined heat and power units in seven countries, is currently building 130 projects in six countries and has another 200 projects within a total of 1,300 opportunities in the pipeline. I am very encouraged by the prospects for future growth and we continue to target unit gross margins of 20-30%.

Let me briefly turn to our asset businesses and first Exploration and Production. E&P continues to play an important role in our portfolio providing cash flow diversity and balance sheet strength for the Group. Our focus is now solely on Europe with the disposal of Canada and Trinidad and Tobago in 2017.

Spirit Energy is successfully established creating a stronger and more sustainable self-financing European E&P business. Spirit Energy's current focus is on reliable operations and value creation through accessing synergies and portfolio optimisation with medium term production expected to be in the 45-55 million barrels of oil equivalent range. Equivalent to 123,000 to 150,000 barrels a day, with annual capex of £400 – 600 million.

The E&P Division also includes Centrica Storage Limited which in January received consent to produce all recoverable gas reserves from the Rough Field. Early production from Rough has been stronger than expected. In addition, CSL has significant commercial optionality and we are actively engaging with a number of companies to explore gas processing contracts to realise value from the CSL owned Easington Terminal.

Spirit Energy continues to focus investment on the most attractive development options in the portfolio and made good progress during the first half. The operated Oda project is

progressing to plan and we have commenced offshore installation with first oil currently expected in the fourth quarter of next year. In May, FID was taken on the Nova oil field development in which Spirit Energy has a 20% interest. An appraisal well was also successfully drilled at the Spirit Energy operated Fogelberg discovery in which Spirit owns 51.7% resulting in an improved research range. Spirit will make a final investment decision on Fogelberg in 2019.

In Exploration, Spirit has had success at the Hades/Iris prospect, is drilling the Scarecrow well in the Barents Sea, is evaluating a number of other well results and was awarded exploration licences in the latest UK and Norwegian rounds.

Let me briefly cover Nuclear. In February we announced that subject to ensuring alignment with our partner and being very mindful of UK Government sensitivities in this area we would hope to divest our shareholding in UK Nuclear Power by the end of 2020. A process of pre-marketing has now begun with full support of our partner. We plan to commence the first round of the sales process in September.

Finally, before concluding let me touch on the UK energy supply market and the default tariff cap. The default tariff cap bill was passed into UK law two weeks ago with Ofgem due to publish a statutory consultation on the cap setting mechanism on 23 August. That consultation should give us a good sense of where the cap might be set but the Regulator's final decision is not due until October with the initial cap levels set at the end of October and the cap in place by the end of the year.

Particular areas of concern for Centrica have been our appeal rights in the event of a poorly designed cap, understanding how a cap can take account of significant differences in cost to serve for individual suppliers depending on their customer mix. And how it will take account of differing spend levels on the rollout of smart meters. We are also concerned to understand how the cap design will continue to incentivise competition, one of the Government's criteria for an effective cap. We continue to engage constructively with the Government and Regulator, we also remain focused on lowering the impact on Centrica through the implementation of mitigating actions, namely the withdrawal of the SVT for new customers, encouraging existing SVT customers to take up another fixed term tariff, competitive default pricing and a continued focus on driving cost efficiency.

So, let me update you on our current position. We now have 3.5 million customers on the Standard Variable Tariff down from 4.3 million at the start of the year. As I said a few minutes ago, many of these customers have moved onto alternative British Gas fixed term tariffs and we continue to aim to have reduced this number to 3 million customers on the SVT by the end of the year.

We also currently have around 250,000 customers on our new 12-month fixed default tariff, the temporary tariff, which would also be subject to the default tariff cap, but taking this into account we are meeting our objective of reducing our exposure to the cap.

On the left is the chart we showed in February updated to today which shows that our current SVT is cheaper than 77% of the other SVTs in the market and £52 below the average of large supplier SVTs. While our temporary tariff is currently £77 below. These gaps have actually increased since February with many suppliers raising prices in recent months as wholesale energy costs have continued to rise. We are watching this trend carefully.

As in February, this chart shows that the price cap will impact the majority of the market first before it impacts us. The impact on those with the highest SVT prices including some of the smallest suppliers will be more significant. We also continue to target an additional £20 per customers of efficiencies by 2020, further protecting us against the impact of the cap.

With the final level of the cap still uncertain, as we said in February, net margin compression is possible in 2019 before we see the full benefit of further cost efficiency. But with these mitigations we continue to believe that we can deliver an attractive and sustainable energy supply business in the UK even under a price cap.

But let me now summarise. The environment in the first half of 2018 was challenging with extreme weather, rising commodity prices, regulatory uncertainty and continuing competitive pressures. Against this backdrop we delivered stable, adjusted gross margin and operating profit with adjusted operating cash flow of £1.1 billion. Earnings per share was impacted by a higher tax rate. We continue to make strong progress on cost efficiency as we pursue our target of £1.25 billion per annum of cumulative cost efficiencies by 2020 relative to 2015. We have developed significant new capabilities to allow us to capture, optimise and grow gross margins through the customer. These are now being deployed in market with encouraging early results.

We are on track to deliver the Group financial targets for 2018 although we recognise there is still a lot to do in the second half. We await the final outcome of the UK default tariff cap regulation and have clear mitigations underway.

Our portfolio of businesses has shown material resilience in terms of adjusted gross margin, operating cash flow and operating profit over the last four years. It is this resilience which continues to be reflected in our forward targets to 2020. As a result, for 2018 to 2020, provided we can continue to deliver adjusted operating cash flow on average in the £2.1 – 2.3 billion range and net debt between £2 ¼ and 3 ¼ billion, we expect to maintain the current dividend at 12 pence per share.

Ladies and gentlemen, I would finally conclude by noting that while it is a fact that against the challenging backdrop of today we have not yet proved we can grow the Group as a whole, from the base we have established I believe we are beginning to demonstrate the factors which will get us there.

Thank you for listening. I would now like to invite Mark Hodges and Mark Hanafin to join Jeff and me on the stage and we look forward to taking your questions, thank you.

Questions and Answers

Q1. Deepa Venkateswaran, Bernstein

Thank you this is Deepa Venkateswaran from Bernstein. I have two questions. The first one is on tax payments. So, if I look at the overall EPS it is lower because of the tax, the mix shift, but then in terms of your cash taxes it is actually a positive £6 million. So, I was just wondering more for the long-term, do you expect your cash tax situation to be worse than your book tax situation?

And then the second, and also maybe anything on the second half if we need to keep that in mind. In terms of the price cap, on August 23rd what exactly do you expect? I mean they won't give the final level of the cap but do you expect them to say that if the cap was enforced for 6 months this is the level and so maybe we can benchmark it to the cap or the existing level of expertise? Thank you.

Iain Conn
The first one for Jeff on tax and the second one Mark Hodges on the tariff cap.

Answer: Jeff Bell
Deepa you are absolutely right, the actual payment of cash taxes is lagging somewhat behind the actual recognition in the income statement. And it is just really a phasing issue more than anything else. I mentioned for the E&P business for instance that we would see more of a sort of phasing of the tax payments in the second half of the year. And as we move forward I would expect over time for cash taxes and the tax charge over a run of 12-18 months to start normalising and be roughly similar. But of course, it depends, particularly for the E&P business if it is increasing in profitability there just tends to be a lag in terms of when the cash tax payments are paid versus the P&L.

Iain Conn
Mark, on the tariff cap what can we expect on August 23rd?

Answer: Mark Hodges
Good question Deepa. I think the honest answer is, Ofgem have used words that are slightly ambiguous. So, they have said they are going to publish a policy decision and they have said they are going to publish an impact assessment, but it is not entirely clear what will be in the policy decision. And our expectations is that it will be a paper for consultation and therefore it might not have all of the detail that would allow us to be able to calculate what the cap would look like. We would probably expect that later in October. We are trying to clarify with them, the open letter I am sure you have seen from Dermot Nolan to the market, we are trying to clarify with them exactly what policy decision means in terms of a form of words. But, being entirely transparent at this stage, it is open to interpretation. I don't have a precise answer. But if you want my best guess, we will see the choices continue to narrow. We will see. I think we already know where we are on things like commodity input strategies. I think they will start to hopefully indicate the direction of travel on some of the key parts that Iain outlined. So how are they going to deal with the concept of different customer mix, how are they going to deal with smart metering? And again, to date the detail around smart meter allowances have been fairly scant. So, I think we can expect to see more. I am not convinced we will be able to model a price cap from what we see. But at this stage that is as much as we know.

Iain Conn
Thank you Mark and obviously Deepa we have a clear plan as to how we are going to deal with the cap whatever it turns out to be. None of us have very long to wait, somewhere between one and three months and we should know exactly how this is being done. I don't envy Ofgem's challenge here given the detail that Mark has outlined. It is going to be extremely difficult for them to balance all of the things that the Government wants them to do, but we are helping as best we can.

Q2. Mark Freshney, Credit Suisse
Mark Freshney from Credit Suisse. Two questions. Sorry to dwell on the price caps, but you have a situation where forward curves have increased looking at the pre-payment price cap and the formula it seems that that will move up to where the standard variable currently is. So, it is fair to say that, under the current environment, customers could well be paying, we could well not see an optical saving as we move to price caps. When you speak to Government Iain and Mark do they understand that because that is an important part of their political proposition.

And just secondly, a question for Iain and Jeff. British Energy could potentially be sold, you might be looking at proceeds of £1.5 billion. Can you remind us of the framework you would

go through in seeking to allocate that capital, be it the pension fund where the deficit has gone down, shareholders or potential acquisitions?

Answer: Iain Conn
Thanks very much Mark. On those, I mean firstly the optics of what actually happens when a price cap comes into being are pretty important. I fear that the political realities of the current situation are going to be at least as difficult as the Ofgem situation for some of the reasons you have said. Although a price cap is now in law through the recent bill, I feel satisfied that we have been very clear of the unintended consequences of a cap. We and the CMA have brought to bear the evidence from around the world, and when price controls get put into competitive energy markets, I am afraid the unintended consequences can be quite significant. We are getting on with it. I mean there is no point in us now arguing about the fact it is going to happen and we have been very clear that we are not challenging the price cap from a legal perspective. Obviously, we reserve our rights, but we are not going to do that.

In discussions with the Government, we have moved from warning about some of these unintended consequences to being very clear what we recommend should be done to improve the energy market, which is what we are pursuing and what we think the Government should do, including removing policy costs from people's bills. I have to admit I have had limited success with the Chancellor on the last one, but we keep talking about it. And now we are just moving into a place of engagement with the Government to try and create the best possible outcome here for the customer and for the market. So, we are just going to have to see.

On British Energy, I indicated last time when the question was asked. Firstly, let's have some proceeds before we start arguing over where they should go. It is not going to be a simple thing to transact and we are working very closely with EDF on this and keeping the government informed. There are some sensitivities about the buyer universe shall I say. If we are successful I believe there is a competition for funds between our balance sheet, other obligations such as pensioners and obviously our shareholders. Let's wait until we have got there before we start defining where the money might go.

Answer: Jeff Bell
Of course, Mark we are very pleased to see the accounting pension deficit reduced as it has. It clearly plays into things like our financial credit metric. We should also remember that the triennial pension review that sets our deficit payment is based on a different set of assumptions and they don't always move in the same way. So, as I said in my presentation, it is still too early to see where we land on that. But I just wanted to make sure we flagged that.

Iain Conn
Thanks Jeff, you have a lot of experience in this area, you are going to be advising us a bit after 1st November about the triennial review as well.

Q3. Nick Ashworth, Morgan Stanley
Morning everybody. So, a couple of questions on Centrica Consumer if possible. Firstly, just on Connected Home. You have obviously had very good trajectory in terms of product sales, but it is not yet being converted into revenues. What is the issue with that? Why aren't we seeing such strong revenue growth there?

And just quickly on the operating profit for the full year. I think Jeff you said for DE&P, if I heard it correctly, you are expecting operating losses to be similar in H2 to H1, I just wondered whether there was some steer for Connected Home as well.

And then secondly on the legacy business, on BGRE, I note that cost per customer is starting to edge up again and going back to that slide around profitability, it is very clear that cross selling drives profitability from here. How do you think about BG Rewards? Again, you have had good uptake in that but it looks like that is starting to slow down. Do you have medium term targets around that number of customers? How do you think that can help profitability in the legacy business going forward?

Answer: Iain Conn
I think these are largely for Mark Hodges. Just to frame it in terms of what we said previously about Connected Home, we said we expected last year 2017 to be the bottom of the cash S curve for Connected Home. That still holds true. Our current view around DE&P is that it is getting there as well and we are starting to see the growth coming through from some of the projects that I just described. But Mark a number of questions there for you.

Answer: Mark Hodges
Okay so let's try and work through. So Connected Home first half revenue is up. I think it was 30% or 31%. We are really focusing on, if you go into the numbers you will be able to calculate, that the average revenue per customer is up. You can see the average products per customer is up. Having got to the million hubs level, I think this is about trying to use the scale we now have in the business. So rather than just chasing hubs, it is about actually making sure we are chasing revenue with the customer relationship, so that is why those average holdings and average revenue per unit numbers are important. Traditionally the business over the last 2-3 years has been second half weighted. I think the slide Iain showed, showed you that we spent a lot of time in the first half of the year really making sure that the product set is expanded, that the channel set is expanded for all of those products and all of those channels. Effectively we are expecting to deliver in H2 and we have been successful in each of the last couple of years in delivering a much stronger H2 delivery than H1. So, I am optimistic, it is not easy, but we have stretch targets. I know there is a huge amount of interest in those stretch targets in this room and outside. But the customer demand is strong. I feel the wins we are having with partners and being able to get to other companies, other brands customers is going to be a really important part of the development of the business.

Iain mentioned the EE relationship as an example. That actually gives us not only the opportunity to bundle Connected Home within the mobile tariff it actually gives us a shop front presence going forward so we will be in the EE stores, that is something we haven't had before so I think that is a very exciting development.

So, I think all of those things lead me to believe that we will see accelerate revenue growth in H2 but we are going to have to keep working very hard on Connected Homes.

In terms of the other two questions, cost per customer in UK Home has gone up. The thing I would remind you is we lost an awful lot of customer accounts last year. Now we demonstrated as we went through the Prelims that they were low value, so the gross margin loss was not particularly high, but you have lost the customer account numbers in that equation so really that is the biggest driver of the change.

And in terms of Rewards, yes we are really excited about it, Iain showed the slide. It is a great example of segmentation in action. Every single customer who signs up for the rewards programme does get an individual tailored offer for themselves with different offers based on their needs, their attitudes, the value of the relationship. We tend to see sign-ups linked to when we are doing promotions, it is something we are still having to promote. It is being promoted in or contact centres, promoted in our marketing materials. That has slowed down a little bit in Q2. It is a little bit of seasonality, it is harder to or it is easier to engage customers frankly when it is colder and they are thinking about energy which is obviously the biggest set

of relationships we have. But we do have, we are not publishing them, but we do have ambitious targets. I do want to see millions of customers benefiting from the Rewards programme and enjoying if you like both the offers, but the engagement it gives them with us as a company.

Iain Conn
Mark thanks. And I know that Nick mentioned DE&P second half versus first half. Mark Hanafin do you want to comment on how you see DE&P this year?

Answer: Mark Hanafin
Yes, so as Iain had in his presentation, the revenue is broadly similar to last year in the first half, a little bit less. But that is the whole mix issue and just how the orders flow into revenue. But what we are seeing is a real pick-up in projects, a real pick up in the size of the order book which is as you know the difference between the orders going in and how the orders are actualising to revenue. 120% increase in order intake in H1. So, there is real momentum there, we spent a couple of years developing the central marketing propositions, products, capabilities and now we are executing those on a worldwide basis. So, a lot of excitement in that business. The acquisitions we have made, very strategic, are really complementing the overall proposition we are making to the customer.

Q4. Chris Laybutt, JP Morgan
Good morning Chris Laybutt, JP Morgan. Two questions please. The first is in terms of the disappointment first half but it sounds like the full year you are quite comfortable with. I know you don't provide any guidance at EPS or any commentary there, but if you could give us an idea at a high level, are we looking at a second half that might be better than the first half, so a second half skew which is a rare occurrence for Centrica, and do you think that is a fair assumption for us to carry forward into the second half?

And secondly just while we have you here, any information you can give us on the new LNG contract in terms of pricing, what we can think about in terms of modelling that one up in the future would be very helpful, thank you.

Answer: Iain Conn
Thanks Chris. In a moment I will pass to Mark Hanafin to talk about LNG. Because of the presentation we are covering quite a lot of ground we didn't have a chance to talk about this growing part of our business and there is quite a lot that has changed in the last couple of years so I think it would be a good opportunity for Mark to talk first about Mozambique and what we are doing there, but also more broadly.

On the full year. We don't give fully year guidance at the half year and we always get the question, not surprisingly. What we have done is given clarity that operating cash flow this year will be higher than last year. That is what we expect as of today, and that it is going to be within our targeted range. Now if you take the mid-point of our targeted range that would imply that operating cash flow in the second half is going to be the same as the first half. And that is the only guidance we are giving. But clearly one thing that a number of people got wrong I think in terms of assessment for this year was the tax rate, the effective tax rate, even though a number of you got the mix right.

So, Jeff do you want to comment about the second half in terms of any other comments you want to make about expectations on tax but without giving guidance on EPS unless you fancy doing so?

Answer: Jeff Bell
I don't think I will go that way. I think you have made the right point. We have tried to signal in a few areas at an operating profit level, particularly where we have seen the first half slightly

different than where we might have seen things previously, how we might think about the full year. But at the same time, you know, even though we are seeing some of those higher prices playing through as we saw into E&P, the effective tax rate we expect to be in that sort of high 30% range and therefore you would want to take that into account when you look at the full year.

Iain Conn
I mean Chris the other thing, I know people focus a lot on EPS and it is absolutely, it is a very important metric on one basis relative to the DPS. But we do need to also remember that cash flow per share and the dividend per share is also rather important. And right now, the financial framework that we have, as I tried to demonstrate with that new slide on looking back just four years, is that we have been delivering every single year £2.1 – 2.3 billion of operating cash flow. Now not without a lot of hard work. But that is what our guidance says on average for the next three years. And as long as we can do that then we estimate we can pay for all of our outgoings and we just need to watch the net debt range to make sure that we don't burst out of that.

Mark, LNG?

Further answer: Mark Hanafin
Yeah, so typically in these sessions we sort of look forward to the contract and how the dynamics in the gas world are shaping up. What we have seen in recent months and over the last year is that the global gas market has been a lot tighter than it has been forecast and so supply liquefaction projects have been going backwards, demand has been increasing particularly in China and it has created more of a tightness in the market than was expected. So, when we look at the forward prices for next year for 2019, when you take Henry Hub at around $2.80 and the equivalent NBP at around $7.5 with a $5 cost for liquefaction, shipping and reclassification, there is just a small loss there now in terms of basic economics to North-West Europe. If you target the Far East then there is a healthy profit in terms of the forward numbers for 2019.

Now we do still see with the projects coming on stream that 2020 and 2021 still look over supplied. But what is interesting, that over supply is being worked off really quite quickly and beyond that period things start to look really quite tight so the Sabine contract starts to look very attractive in that sense.

If I just remind you what we are really trying to do with LNG, we are trying to build a global network which has geographic diversification. It has pricing diversification and it has optionality. And that is what we are aiming at. The Mozambique announcement is very much in line with that. It is too early to talk about it as a contract, it is a Heads of Agreement where we are in negotiations to turn it into a sales and purchase agreement. We are partnering with Tokyo Gas, we have a terrific relationship now with them. What we are trying to do in that contract is we are trying to get a very healthy element of NBP pricing. What that means is we can point the ships at our home market with reasonable economics. And then with volatility in the rest of the world we are able to divert and capture that. Now there will be an element of oil pricing in the contract as well. But as I said we are looking for diversifying our pricing mix.

Just finally, we have traded 43 cargoes so far this year, that is about three million tons and that is into all kinds of new destinations globally and that also bodes well for our ability to handle Sabine as it starts to ramp up in the fourth quarter of next year.

Iain Conn
Thank you. I would just add that energy price risk management and global natural gas optimisation are important elements when you supply the quantity of gas that we supply to

our customers. And Mark and the team have done a terrific job building on the early positions in LNG to get to where we are now.

Q5. Dominic Nash, Macquarie Securities

Dominic Nash, Macquarie, two questions please. Firstly, going back to the SVT price caps again. You stood up and said you had some concerns over the appeal process if the price cap turned out to be quite detrimental. Can you give us some more clarity on what the options are available to you if the price cap were indeed to come out with an unreasonable number?

And secondly on Spirit, can I just have a couple of points of confirmation on that one please, which is looking at the 2017 numbers does that include the minorities within it? And on your operating cash flow forecast you don't take the minorities out of there, I think that is correct isn't it on that number? And was your cash flow target set before we had the Spirit minorities added in, you set it up 18 months ago, I think it was, wasn't it?

Answer: Iain Conn

Jeff if you don't mind I will just quickly answer the second part. Our target, the £2.1-2.3 billion on average was set in February, and that was after Spirit was established. You are absolutely right, we do consolidate all of the cash flows and then of course we pay the minorities. I should know that, remember what we have been doing in the portfolio, we had minorities in Canada, we had minorities in our Wind portfolio. And actually if you look at the minorities that we have now got in E&P versus what we had before, it is not, the actual net interest is not that different.

On your question about the price cap and what we do, look we lost the argument about the Competition and Markets Authority being the right body to be the first port of call in an appeal if the cap is not well designed. There were a number of Members in the House of Lords that tried to get that changed. I think it is a dangerous precedent, it is the first time I think, maybe the second time in the post privatisation era that a Government has removed that recourse. So, we would be left with recourse through judicial review if we have an issue. We are not intending to challenge. Obviously, we need to wait and see. I think, Mark, our interactions with Ofgem say they are certainly thinking about all the right things, whether they will come to the right answer is a different question. But it would be the judicial review process. Okay if I can go to Martin Brough.

Q6. Martin Brough, Deutsche Bank

Thank you, Martin Brough from Deutsche Bank. Just to push you a little bit more on the Connected Home side. Just over a year ago you set yourself an ambition of getting £500 million of revenue I think for 2019. Obviously, we are a year down the line. You talked about maybe still being on track to get double the revenue in 2018 as the new product channels sort of come through. But even if you had like a couple of million hubs in place by 2019 that is an awful lot of revenue per hub that you would need to get to a £500 million sort of revenue number. Obviously, it is more important to build capability in the near term to end up where you want to be longer term. But could you give us some handle on that, is that still a current number that is out there or is it already clear that really that is going to be too ambitious?

Answer: Iain Conn

So, Martin first of all our guidance was actually a billion of revenue in 2022 with cash break even as early as 2019. But Mark do you want to talk about the shape?

Answer: Mark

I think it is a great question. It is challenging, we set an ambitious target, that was deliberate. We see the dynamics in the market and the opportunity is there and why aim low when you can aim high. What we need to do is we need to hit the doubling of revenue target this year

and every year for the next few years to get to that 2022 billion. We said break even as early as 2019 but the small caveat around that was to some degree it depends on how successful we are. The more successful we are the more subscriptions we are growing for instance. The more strain there will be on the profit number because we will be frontloading the growth. As we sit here today, I am expecting us to grow in the second half as I have already said because of the delivery in the first half. I think that break even in 2019 is as early as we will still be gunning for but it is looking more difficult, it is definitely a challenge. But as you say, the most important thing here is to remember this is a strategic play for the Group, that we see a market opportunity, that we have a leading position here in the UK, that we are now expanding into new territories. We are expanding into new relationships. We are learning all of the time how to make those successful. And I think in the long run it is the learning we get from the partnerships, from the customers in new markets as well as from exploiting the position in the UK that will stand us in good stead. But there is no doubt, it is an ambitious target.

Iain Conn
As Mark said and I tried to say in my presentation about DE&P as well, the important thing here is the momentum we are building rather than precisely in which month the revenue is going to accrue. Clearly, we are focused on short term delivery as well as building that pipeline. The pipeline development in both these businesses is becoming pretty encouraging and we are getting a lot of incoming on Connected Home from people who want our platform. I don’t think I could have dreamt of that possibility three years ago. People are really ringing us up saying what is this product, what is this platform, can we have it? And we are saying you can but it is our brand, we want exposure to the customer and we want to have access to the data. And partners are saying, okay. That tells you something. Now it is early days I have given you for the first time today some sense of the pipeline that is building in Distributed Energy & Power. It is the first time we have disclosed that we have got 1,300 opportunities, 200 active projects within that and a 130 projects under construction. This is no longer small stuff and it is expanding all the time. Now it is growing very high rates from small base and therefore as Mark says, there is an uncertainty envelope that we have got to try and manage. If you hold us to X dollars in every single time frame we are obviously going to miss a few but I am very encouraged by these businesses playing into the trends that we are seeing customers now pursuing. Thank you Martin. Ian Turner.

Q7. Iain Turner, Exane
Thanks, it is Iain Turner from Exane. Can I ask a couple of questions. One on the existing price cap, PPM and the vulnerable customer one, what you thought that cost you in the first half and the switches you have seen, the 50,000 PPM switches, are those people going to do PPM somewhere else or are they switching onto one of your other default tariffs?

And then just if you have any thoughts about whether you might be open to moving Rough into Spirit in the future? I am not sure whether I am going to be the last question or not, but if I am I am obviously the oldest analyst here so if I could just thank Jeff and Mark for all their contributions and help over the years as well.

Answer: Iain Conn
Well thank you Iain. Neither of them are quite gone yet but I also echo that. I mean these guys have made a huge contribution to the first phase of repositioning Centrica and I think we are in a much stronger place as a result of both their contributions. But we do have a number of months yet of active contribution, we are not letting them off.

On Rough and Spirit, we currently don’t have any active plans to put Rough into Spirit. Clearly it is part of Exploration and Production now. We are leveraging all the synergy between Exploration and Production and Rough so the skills, the capabilities, the risk assessments, some of the technology we have developed on process safety barrier models. I

could never rule it out completely, but you also have to remember that Rough is a declining field. It has a finite amount of gas in it and obviously it will generate cash flow for a number of years. But I think for Spirit they also might look at this and go, you know it is pretty near in stuff. I think it depends a lot on how much of the commercial optionality that we manage to capture for the Easington Terminal. If it becomes an important hub for the North Sea, that could change that equation.

Mark Hodges, lots of questions on pre-pay PPM switchers?

Answer: Mark Hodges
Yes, so the 50,000 net accounts we lost were to the market so that is effectively to competitors so it was an overall net reduction. And in terms of the safeguard tariff I think it was, and the cost effectively, it was a quarter's cost of PPM and then the second quarters cost of the safeguard tariff. It is kind of in the £30-40 million range of impact. And in terms of PPM that is in line with what we have said before in terms of what the nine-month cost was last year.

Q8. Sam Arie, UBS
Thank you. I have got a high-level question if you like. I have just been looking at what has been going on in the sector for the last six months. We have seen an increase in M&A activity and Innogy, Uniper, EDP, maybe EDPR, a lot going on in the sector. I think last year there was a story that Centrica could be a takeover target. I am sure you can't comment on that in any detail, but I am interested in what your perspective is if you like on the industrial logic for that? Are you in the camp that says Centrica needs to be independent to be successful or do you feel that actually being part of a larger group could be an advantage to you given the investment opportunities you have in front of you.

Answer: Iain Conn
Thank you, Sam, for that low ball. So basically, my demeanour is our focus should be on delivering on the strategy. I think that the strategy is right for this company. I think we are pretty unusual in our mix of businesses and they appear to be, judging by the trends that are continuing over the last three years, in line with where the world is going. Therefore, I suppose we could be attractive to someone else, but I haven't seen much sign of it. The question I get often is, is one of the oil majors going to buy us or is Amazon going to buy us, those are the most common ones I get. I don't know how to think about that. Is that a complement? I don't know, but having been in one of the oil majors they have differing views on how to extract value out of customers. They are also very familiar with the oil value chains and their derivatives, they are looking at electric vehicles and integration of electric vehicles in the home. Because actually if you think about it, electric vehicles are probably going to take customer flow away from a fuel retailer. So, the question is how do you hang onto the relationship with the customer if the main reason for them going to where you sell petrol is actually changing? So, it is perfectly understandable for these companies to look at all of this. It is not clear to me at all that it would be necessarily an interest of Centrica shareholders just to be part of another Group. There would have to be industrial logic. So, it is not something I spend most of my time worrying about. It is not something I am running around pursuing. We just need to get on with delivering value for our shareholders through this strategy and we will see in the future. Ajay?

Q9. Ajay Patel, Goldman Sachs
Hi, Ajay Patel at Goldman Sachs. I just wanted to ask a quick question on slide 34 where you went through the Connected Home pipeline. Just looking at those different parts of the list, is there any sort of indications you can give us on gross margin as in, is the gross margin broadly similar for all of this or is there a range and what kind of range would that be? I am just trying to understand if the profit dynamics are changing at all as we move down these channel services and products?

Answer: Iain Conn
I will remind you what we said at the Capital Markets Day last year and then pass to Mark Hodges. We said that indicatively the unit gross margins that we are pursuing and seeing in Connected Home are 20-40%. I just said today that the unit gross margins we are seeing and pursuing in DE&P are 20-30%. Mark how is the dynamic changing?

Answer: Mark Hodges
So gross margin year over year has gone up from 19-24%, that sits within the range that Iain has outlined. There is a range from some of the simpler one-off sale products through to, as we think about, things like Leak or some of the camera functionality, you are into subscriptions and the gross margins are much higher. But I think at this stage, given everything we have said about the development of the business, where we are, that 20-40% range as we look at the mix is not an unreasonable expectation. It is good to see it building as I would like to see it build some more over time. But I think there will be some products that sit outside of that range, but I think for now as you are thinking about it, it is certainly not an unreasonable range 20-40%.

Iain Conn
Thanks Mark, are there any more questions?

Q10. Alex Leng, UBS
Thank you, Alex Leng here from UBS. Just one question from me on Spirit. As I understand it Morecambe is not currently operating and has been pushed back another month or so. So, to reach your 50 million barrels of oil equivalent target for the full year are you essentially expecting a repeat of this first half. So, what I wanted to ask was what does that actually require from Morecambe or put in another way what did Morecambe add to the first half?

Answer: Iain Conn
What we said is about 50 million barrels, at the bottom end of our range of 50-55 and that is partly driven because of Morecambe and because of the non- operated fields, particularly Maria, and some of the others that have not been performing very well this year. You raise an important point. I mean Morecambe has not been performing very well from an operational perspective. It is much, much more rigorously managed from a process safety perspective and I am very pleased about that and we have seen our Tier I and Tier II process safety event rate come down from fourth quartile to bordering on first quartile. But it has slowed down Morecambe's agility and we are working with our partner in order to improve Morecambe to get its reliability up. I would encourage you to see this as an upside not a downside because actually the availability of Morecambe should be significantly higher in the future, but we have got quite a lot to just resolve in terms of the operating capability.

Closing Comments
Iain Conn

Ladies and gentlemen, I would just like to thank you for your patience. In summary the first half was a challenging first half. I am afraid there are a lot of moving parts in the external world around us. I take a lot of encouragement and I hope you do by the fact that we delivered a resilient performance. Gross margin and EBITDA were flat year on year. We delivered £1.1 billion of operating cash flow and we have repeated that we are on track to deliver our targets this year. I do hope that the longer wavelength look back and look forward actually helps penetrate away from the near-term numbers into how resilient is this portfolio as a whole. We are clearly waiting for the price cap analysis and our focus in the second half is on performance delivery and financial discipline. And as we look to the medium term I hope we have demonstrated today that we are building some of the capabilities necessary to start to serve customers in a different way and therefore to start to stabilise customer account

numbers, stabilise gross margin and ultimately grow it. I also acknowledge we haven't demonstrated yet that we can grow it but I feel very satisfied and believe the capabilities we are building will get us there. Thank you very much.

End