centrica

2015 Preliminary Results

Thursday 18 February 2016

Iain Conn, Chief Executive

Good morning, and thank you for coming to Centrica's 2015 Preliminary Results presentation. I'll get into a couple of things in a minute, but just a word, if you've been watching the FT online there's a headline that says 'Centrica cut dividend'. We haven't. I just want to make that clear. That was a year ago, they're not that quick off the mark this morning.

Before we begin, just a word 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 rear and front 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 Stonecutter and St Brides Street.

I'm joined here today by Jeff Bell, our Chief Financial Officer, who in a few minutes will run through the financial results. We're also joined by Mark Hanafin, who is the Chief Executive of Energy Production, Trading and Distributed Energy. Mark Hodges, Chief Executive of Energy Supply and Services for the UK and Ireland; and Badar Khan, Chief Executive, Energy Supply and Services North America. Mark, Mark and Badar will join Jeff and I on the stage to take your questions after the presentation, which we expect to take just over an hour.

In the front row we are joined by our Chairman, Rick Haythornthwaite, Grant Dawson, who is General Counsel, Jill Shedden, Group HR Director, and Nick Baird, Group Head of Corporate Affairs. We also have two new members of the Centrica team here today, Charles Cameron, who is our Group Head of Technology and Engineering, and Chris Cox, who has joined Centrica from BG Group plc to head up our E&P business.

So before Jeff runs through the financials in detail, I'd like to take a few minutes to cover some of the key points from our results announcement today. A lot has happened since I joined Centrica just over a year ago, and even since we set out our new strategic direction last July.

Firstly, a word on our top priority of safety and compliance. In 2015 our safety performance was slightly worse, with a total recordable frequency of 1.1 per 200,000 hours. We're very focused on intervention to return our personal and process safety performance to an improving trend. In compliance we've worked hard on our performance and on strengthening our relationship with all of the regulators that we deal with, and of course with the CMA as they conduct their review into the functioning of the UK energy market.

Commodity prices have continued to fall creating a challenging environment for our E&P and nuclear power businesses. However, in 2015 our financial performance was resilient against this backdrop. The low commodity price environment has sent shockwaves throughout the global markets and has caused investors to doubt the strength of companies exposed to oil, gas and minerals. The robustness of Centrica to this much lower oil and gas price environment is so important that I want to take you through it in some detail later on in the presentation.

What I can say is that we've tested the Group in a continuing world of $35 a barrel Brent, 35p per therm NBP gas, and £35 per megawatt hour power prices in the UK, and we project that we can more than balance sources and uses of cash in that environment. We're also confident that in that environment we can deliver at least the 3-5% per annum operating cash flow growth we announced last July, and in fact as you might expect, the growth rates from a rebased 2015 in such a low commodity price environment are actually a little higher than this.

We are committed to paying our dividend at the current level, and to deliver progressive distributions in line with our ability to grow underlying operating cash flow. In short, the strategy of the Group and our financial offer to investors is unchanged by the current commodity price environment even if it persisted for the next few years. What it does mean is that we've experienced some one-off impacts in resetting the Group to this environment, and in response we must continue with our plans to cut capital in E&P to reflect the currently impaired view of that business at low commodity prices. I should note, however, that our E&P business was free cash flow positive in 2015.

We must also pursue with intensity our cost efficiency agenda across the Group. I'm very encouraged by the progress we've made since the announcement of our strategic review conclusions in July, as we develop our platform for growth focused on our customer facing activities, repositioned E&P and central power generation, and as we deliver on our major cost efficiency agenda. Our strategy implementation is on track, and the cost efficiency programme is underpinned in our plans. I therefore remain excited about this next phase and continue to believe that Centrica has all the components necessary to deliver an attractive investor proposition, one of returns and growth, and even in the current commodity price environment.

So let me now turn to the 2015 results. Earnings were down 4% with earnings per share of 17.2p. This was against an extreme fall in commodity prices, indicating the robustness of the Group portfolio to manage through major shocks. However, within this operating profit from our energy and services' businesses, a key part of our focus for growth, was up 19%, helping to partially offset the impact of low commodity prices on our E&P and power businesses.

Operating cash flow increased 2% to £2.25bn, while we maintained capital discipline with total capital expenditure of just over £1bn, including two small acquisitions. These factors, combined with our decision to rebase the dividend a year ago and some divestment proceeds, enabled us to reduce net debt by 9%, or £449m, to a level of £4.7bn even in such a challenging environment. However, given the prevailing prices at the end of the year, we had to recognise major asset impairments on our E&P assets and our nuclear investment. In total the charge for exceptional items after tax was £1.8bn. This resets the Group's balance sheet to reflect today's commodity reality.

Before I had over to Jeff who will cover all of these areas in more detail, I'd like briefly to summarise some of the early progress we've made in implementing our strategy. As laid out in July, our stated purpose is to provide energy and services to satisfy the changing needs of our customers, and our focus in everything we do will be to enable us to be excellent in serving those customers. We already have distinctive customer facing positions and are developing new growth nodes. We must also maintain a strong portfolio of businesses and the balance sheet necessary to allow us to manage the risks associated with serving such a large customer base.

We have made very good early progress in the delivery of our strategy. We are focusing our efforts to grow on five areas: energy supply; services; energy marketing and trading; the connected home; and distributed energy and power. We've restructured the company along these lines creating new business units and centralising functional activities. This will allow us to serve the customer more effectively while unlocking our ability to realise material efficiencies. In E&P given the current commodity environment, we are reducing investment levels and driving lower operating costs. We have good capabilities in E&P, we've made good progress, and as I said, E&P was free cash flow positive in 2015. Given the severity of the downturn this may not be enough. As a result, we are pursuing further cost reductions and will continue to explore all options to structurally improve and strengthen the E&P business.

In the other portfolio changes announced last year we are making progress on divesting our wind generating assets. We announced earlier this month the sale of the GLID wind asset for net cash proceeds of £115m. Underpinning all of this in the near-term is the delivery of cash flow growth through improving our own efficiency and effectiveness. We remain on track to achieve our £750m per annum cost reduction programme, which is now underpinned in our plans. We expect to deliver £200m of the savings in 2016, while reducing the number of direct roles in the organisation by 3,000 by the end of the year.

When we look at our financial deliverable of operating cash flow, our progress in delivering the strategy means that we expect adjusted operating cash flow to exceed £2bn again in 2016 and at current commodity prices. So with a strategy developed around the customer, our diversity of cash flows and further efficiency we can drive into the Group, we remain confident in delivering long-term shareholder value through returns and growth, and even in the current low commodity price environment. This can also be done while funding all of our needs from our own cash flows.

I'd now like to hand over to Jeff to take you through the financial results.

Jeff Bell, Chief Financial Officer

Thank you Iain, and good morning everyone. I'd like to start with the external environment and financial headlines of our preliminary results this morning, and then review business unit results, before finishing on cash flow and the balance sheet.

Once again, the external environment, commodity prices and the weather in particular, had a significant impact on our performance in 2015. As you're aware, the year was marked by dramatic changes in oil and gas prices both in the UK and in North America. Having fallen substantially in late 2014 the Brent Oil price averaged $52 in 2015, around half the levels experienced in the previous year. The reduction in the UK NBP gas price was less pronounced, but the month ahead price was still on average 16% lower than in 2014, and in North America, Henry Hub gas prices were on average 36% lower. And we've seen further falls in late 2015 and early 2016 with Brent dipping below $30. The impact of and our response to this low commodity price environment will be covered by Iain later in the presentation.

With respect to weather, in both the UK and North America average temperatures were colder than normal in the first half of the year and warmer in the second half of the year, with both the UK and the US north east having the warmest Decembers on record. However, in comparison to very mild conditions in the UK throughout 2014, UK residential gas consumption per household was up 5%. The impact of the external environment played through into our financial results where revenue decreased 5% compared to 2014. Lower commodity prices reduced E&P revenue, and led to lower retail prices in our energy supply businesses.

In the UK residential energy supply business, customers saw two gas tariff reductions in the year totalling 10%. Adjusted operating profit fell 12% to just over £1.45bn, with a 19% increase in energy supply and services' profit more than offset by the impact of lower commodity prices on our E&P business. However, the adjusted effective tax rate reduced to 26%, reflecting the shift in profit mix to the lower taxed energy supply and services' businesses. As a result, adjusted earnings of £863m was down only 4%. These figures now include fair value depreciation related to our previous investments in venture and nuclear, a change in definition we announced in our December trading update.

The full year dividend per share is 12p, consistent with the 30% rebasing announced at the 2014 preliminary results. Importantly reflecting our focus on cash, adjusted operating cash flow increased to £2.25bn. The actions we took in 2015 to reduce capital expenditure meant that the Group net investment of £855m rose only 3% compared to 2014, which benefited from nearly £800m of disposal proceeds, while net debt fell to just over £4.7bn. The return on average capital employed of 11% was within the 10-12% range we announced we were targeting back in July.

Before turning to the individual business unit results themselves, I'd first like to review the exception items that Iain referred to earlier. Post-tax exceptional items were just over £1.8bn, with the continued decline in commodity prices during 2015 resulting in significant impairments in both our E&P and power generation businesses. In E&P post-tax impairments of £1.48bn were recognised, predominantly relating to declining gas and oil prices. In power, a combination of declining forecast capacity market auction prices and clean spark spread prices, resulted in post-tax impairments and onerous provisions of £485m. These impairments were partially offset by a £116m exceptional tax credit following the change in UK tax rates announced in the March 2015 Budget. The net re-measurement of our energy market derivative trade positions was a credit of £129m.

Moving on to the results of the different business units, you can see on the slide a breakdown of operating profit and each business' relative contribution. As I mentioned earlier, the customer facing Energy Supply and Services businesses increased profitability 19% compared to 2014, as increased contributions from British Gas Residential Energy, Direct Energy, and a first full year contribution from Bord Gáis Energy, more than offset the lower result in British Gas business. However, the impact of lower commodity prices in E&P and power meant that Centrica energy operating profit fell 61%, and the Group overall saw 12% lower operating profit compared to 2014.

I will now turn to each business in a bit more detail. In British Gas, profits were down 2% to £809m. Residential Energy profit increased to £574m, up 31% on 2014. This was driven by improved efficiency in the delivery of our eco programme requirements, service improvements, and a return to more normal customer consumption levels following the warm 2014. Post-tax margin was 5.6%, in line with historic levels. Residential services' operating profit was down 5% to £257m. The market environment remains challenging as customers shift demand to cheaper on-demand and home emergency products, and overall product holdings reduced by 4%. In response, the business has continued to focus on improving its cost base, driving down cost to serve per account, while also launching in October last year our new simpler home care product range which is enabling the business to compete more effectively.

In British Gas Business, we reported an operating loss of £22m. This reflects a significant one-off increase in our bad debt charge, and temporary additional operating costs related to resolving the issues arising from the migration of customer accounts and associated data onto a new billing and CRM system. Additionally, this impacted the business' ability to acquire new customers, and was a key driver of the 11% fall in customer supply points during the year. However, with all customer accounts now migrated onto the new system, and operational performance metrics now at or above the levels before the migration began, we expect the business to return to profitability in the current year. We also expect the raised levels of working capital as a result of the operational issues to be largely normalised over the coming year.

In Direct Energy, profit more than doubled to £328m. In Direct Energy business, profit increased to £251m, with the absence of additional costs experienced in 2014 from the polar vortex having a material impact on the year-on-year increase. In addition, since the start of 2014 we have been writing higher unit margin contracts that are more reflective of the risk of supplying energy. Combined with a strong optimisation performance from the utilisation of our pipeline and storage contracts, Direct Energy business' performance in 2015 creates a strong base to build on going forward.

In Direct Energy Residential, operating profit increased 23% to £111m, also driven by the lack of polar vortex related costs, but also increased electricity volumes per customer as the business shifted its focus to targeting higher value households.

Direct Energy Services reported a £34m loss, compared to a £4m like-for-like operating profit in 2014, after adjusting for the contribution of the disposed Ontario Home Services business. This reflects accelerated investment in our solar installation capacity, a new line of business in the bundled energy and services offering that Direct Energy is building. The number of contract relationships continue to grow, up 12% year-on-year as customers reacted positively to the new protection plan and warranty products.

Turning now to Centrica Energy Gas. Operating profit fell 73% to £153m, reflecting sharp falls in the average realised price for both gas and oil across all regions of the business. As announced at this time last year, the E&P business moved quickly to reduce cash costs which, when combined with strong working capital management and lower capital expenditure, meant that the business was net cash flow positive in the year.

Operationally overall E&P production fell 1% to 78.6m barrels of oil equivalent, with a 3% reduction in gas production, mostly offset by a 7% increase in liquids production.

In Europe production declined by 1%, with strong output from our Norwegian assets, including a first contribution from the large scale Valemon project in the North Sea, which mostly offset the impact of the natural decline in our UK fields.

In the Americas total production fell 2% with the benefit of new wells in Canada largely offsetting the natural decline in the portfolio.

As mentioned, cost focus was a key priority. Total lifting and other cash production costs were down 7%, reflecting numerous initiatives across all aspects of the cost base. European lifting and other cash production costs were down 6%, while costs in the Americas reduced by 13%, in part reflecting reduced Canadian royalties as a result of lower North American gas prices. Unit depreciation was down 9%, predominantly reflecting the impairments we recognised at the end of 2014.

In power operating profit increased 40% to £102m. Gas fired generation volumes were down 37% year-on-year, and the thermal business once again reported an operating loss reflecting low market spreads and low utilisation rates. Nuclear profit was up 14%, with higher volumes reflecting improved reliability from the fleet and cost management more than offsetting the impact of lower achieved power prices.

Wind profitability increased to £29m without the one-off project development write-downs that impacted 2014, while midstream profit declined in comparison to a strong performance in the prior year.

And finally to storage, where seasonal spreads fell to historically low levels in the second half of the year, as you can see on the bottom right-hand side of the chart in the blue. However operating profit increased in 2015 with the sale of cushion gas more than offsetting the negative impact of reduced capacity, following the limitation of the maximum operating pressure of the Rough asset.

Improving the operating efficiency of the Group is a critical element of the strategy announced in July. And while we saw improvement in the second half of the year, full-year operating costs were 5% higher than the previous year. Even allowing for adjustments related to depreciation, one-off items and investment in growth, like-for-like operating cost still increased albeit by only 1%. With our £750m cost efficiency programme now underpinned we expect like-for-like operating costs to fall this year compared with 2015.

With respect to net investment organic capital expenditure of just under £1bn was £500m or 34% lower than in 2014. Reflecting the actions we took at the start of 2015 in response to the falling commodity price environment E&P capital expenditure was down 30% to £728m and included spend on the Cygnus gas field which is expected to achieve first gas in the second quarter.

We also reduced capital expenditure in British Gas by nearly 40% as the large-scale systems projects in BGS and BGB concluded. The 2015 acquisitions of AlertMe and Panoramic Power totalled £79m, while disposal proceeds were realised on our debt financing of the Lincs wind farm. The lower level of organic investment and acquisitions meant that despite the higher level of disposal proceeds in 2014 related to the sale of the Texas power stations and Ontario Home Services business, overall net investment was only slightly higher at £855m.

Moving on to cash flow, 2015 saw a net cash inflow of £597m, compared to a net cash outflow in 2014 of £255m. EBITDA fell 14% to £2.4bn, primarily driven by the impact of falling commodity prices on the E&P business. However this impact was more than offset by a combination of lower cash taxes, reflecting E&P's significantly lower profits, an increase in the dividends received from our nuclear investment, and the net result of changes in working capital and other items. As a result adjusted operating cash flow rose 2% to £2.25bn.

As previously discussed net investment was broadly flat year-over-year. But the absence of a share repurchase programme and lower cash dividends reflecting the rebasing of the dividend announced last February and the impact of the script alternative resulted in £852m of additional cash flow compared to 2014.

Taking into account non-cash movements Group net debt fell by 9% to £4.75bn. This excludes a post-margin cash posted balance of £535m, which was £240m lower than at the start of the year, resulting in an overall reduction in net debt and margin cash of £690m or 12%. Although not visible in the numbers during the first half of 2015 we concluded the issuance of 750m euros and £450m of hybrid securities, helping underpin the Group's credit rating and increasing the Group's liquidity.

As we have said previously, we believe that it is appropriate to target strong investment grade credit ratings with Moody's and S&P; however the Group can operate at a lower rating. While we expect our 2015 retained cash flow to net debt metric to be in line with Moody's minimum BAA1 threshold of 25%, as you may have seen, Moody's has placed Centrica on review for downgrade, as part of the wider review of the European unregulated utility sector, as a result of the recent declines in commodity prices. Moody's has stated they expect to conclude their review within 90 days, and we will be engaging with them over this period.

In July I set out the financial framework we will use to set the boundary conditions and evaluate our financial progress towards achieving the Group's strategy. The framework will use 2015 as the baseline for comparison purposes going forward, and provide a set of financial parameters that the Group will operate under, linking cash flow generation and reinvestment in the business with the desired outputs of a progressive dividend and a strong investment grade credit rating. Only in the most extreme scenarios, such as a further sustained downwards move in commodity prices, would we expect to need to move away from the financial framework parameters.

We also mentioned in July that we would publish rules of thumb with respect to the profit after tax impact of changes in commodity prices. We have now published these on our website, and they are included at the back of the presentation. We believe these will prove helpful in understanding the financial impact of our asset businesses of changes in prices.

So let me summarise before handing back to Iain. We delivered a resilient financial performance in 2015 against the backdrop of a challenging environment. The customer facing businesses turned in a strong improvement year-over-year with operating profit up 19%, despite the system migration issues experienced in BGB, although not completely offsetting lower profitability from the E&P business from the falling commodity prices. As a result earnings fell 4% to 17.2 pence per share.

A lower commodity price environment also meant that our E&P and power generation assets were impaired, with write-downs totalling £1.8bn after tax. Operating cash flow increased 2% to £2.25bn. And when combined with the additional actions we took in 2015 to balance the Group's sources and uses of cash net debt fell to just over £4.7bn.

Looking forward to 2016 E&P and central power generation earnings and cash flow will continue to be impacted by the low commodity prices. However, with our focus on cash flow growth and cost efficiency we expect to deliver operating cash flow in excess of £2bn, subject of course to the usual variables of weather and commodity prices.

With that I will hand back to Iain.

Iain Conn

Thank you very much Jeff. I would now like to talk in more detail about the themes I covered earlier, in particular how we will fare in a low commodity price environment.

Firstly, I'll remind us of the fall in commodity prices since our prelims a year ago. I want to then spend much of the remaining time on the Group in a low commodity price environment. I'll touch on the implications for E&P and central power generation, our sources and uses of cash flow, the role of our efficiency programme, and what this all means for our ability to grow operating cash flow.

Our ability to balance sources and uses of cash and our ability to grow operating cash flow in this environment are the key determinants of how secure the dividend is and our ability to deliver a progressive dividend over time. We are very committed to the dividend and to our ability to grow it over time in line with our confidence in cash flow growth.

Having outlined the financial picture I'll then briefly cover our recent organisational changes and how that positions us to deliver our efficiency programme and growth objectives.

Finally, I'll update you on the progress we've made in implementing our strategy in some of our growth areas.

Starting with commodity prices. These graphs show how the commodity curves for oil, gas and power have fallen over the last year. These falls have been significant. Oil has fallen from about $60 a barrel to $35 a barrel. NBP gas from about 50 pence a therm, to 33 pence a therm, and power prices from about £45 per megawatt hour to £34 per megawatt hour.

Centrica is of course exposed to such price falls. But as our robust 2015 results have shown, the impact is limited to the upstream parts of the Group. The key questions in this environment must be: How will Centrica fare? Is the dividend secure? And can Centrica deliver growth and returns? So this next section deals with Centrica in a low commodity price environment.

After oil and gas prices began falling a year ago we took the very difficult decision to rebase the dividend with a cut of 30%. The degree of dividend cut was designed to allow the Group to be free cash flow positive and also to provide as a result a cushion against adverse circumstances, including further falls in commodity prices, allowing us to balance sources and uses of cash in an even more challenging environment. This has proved to be the right decision. We've remodelled the Group for a flat real $35 per barrel Brent oil, 35 pence per therm NBP gas, and £35 per megawatt hour UK power commodity price environment. I'll refer to this in this presentation as the $35 environment.

We've assumed reduced capital expenditure, with the major impact on E&P, as we respond to lower oil and gas prices. We've improved our focus on cash flow delivery, and are pursuing our major efficiency programme which we laid out in July. As a result of these actions in the $35 environment the headlines are that firstly sources and uses of cash flow are at least balanced for the next three years. This is before any major divestment proceeds from portfolio restructuring of E&P and the power portfolio.

Secondly, we expect 2016 adjusted operating cash flow to exceed £2bn, providing ample ability to fund capital, pay the dividend and our other obligations.

And finally we are confident of delivering at least the targeted 3% to 5% per annum operating cash flow growth out to 2020 from a lower 2015 base. In fact with 2015 rebased to this environment we estimate that our operating cash flow growth rate would actually be slightly higher.

So let me take you through that. This slide shows 2015 operating cash flow rebased to the $35 environment. In addition to the price effect, if we also exclude the actual benefits from hedging we saw last year then operating cash flows fall by £600m to £1.7bn. When combined with disposal proceeds last year, even at this level it would have been sufficient to cover commitments of £1.9bn. And those commitments include capex in E&P which was above our target range. This demonstrates the Group would have been at least free cash flow neutral in 2015 even if prices had fallen to current levels for the whole year and without the transient benefit from hedging and before reducing E&P capex to our target range of £400m to £600m per annum.

As we move forward in the $35 environment clearly the additional benefit of hedges will roll off, but we'll also be able to respond in terms of costs and capital investment, so once again allowing the Group to more than balance sources and uses of cash. I'll show you the multi-year picture in a moment.

Turning then to the necessary response in E&P to a $35 environment. We clarified the financial role of E&P in the Centrica portfolio in July over the commodity cycle to provide diversity of cash flows and balance sheet strength. We concluded that we have more exposure to E&P than is needed to fulfil this role, and we announced that we would move towards a stable E&P business that produces between 40m to 50m barrels of oil equivalent, and requires between £400m and £600m of capital expenditure a year.

Our E&P activity will be focused in the UK, Netherlands and Norway. We're developing a plan with our partner, Qatar Petroleum, to exit Canada at an appropriate time. It only makes sense for us to continue to invest in E&P if the Group's cash flows can support the investment, and our new projects are of high quality and add value at a range of price environments. If current prices were to be maintained we are likely to make further cuts in our capital expenditure.

In 2016 we therefore expect to spend around £500m on capex in E&P; a reduction versus 2015 of more than £225m and significantly below the 2013 and 2014 levels of £1.1bn per annum. The 2016 capex largely reflects expenditure on existing projects such as Cygnus and Maria, and a core level of maintenance expenditure.

Beyond 2016 we would reduce capital still further to the bottom end of our target range of £400m to £600m per annum if the low price environment continues.

We will also be pursuing further operating cost reductions in 2016. We now expect cash production costs to be 15% or £150m lower in 2016 compared to 2014, £50m lower than the levels previously announced.

Finally, as I outlined at the beginning, we will consider all avenues to make E&P more robust in this environment, including sharing infrastructure and scale economies with other market participants. We're targeting making E&P broadly free cash flow neutral for the Group in this $35 environment in the 2016 to 2018 period.

We've also been responding to the current environment in power. As we announced back in July, we're moving towards a more focused central power generation business. We'll have less emphasis on large central thermal power generation, preferring to seek opportunities in peaking units and distributed generation offerings, linked to serving our B2B customers.

On our gas fired fleet, we're in the process of rationalising our portfolio with a view to simplification and cost reduction, while retaining low cost optionality.

Humber and Langage remain core assets, alongside Brigg, which is now operating, as a distributed energy asset, and Peterborough, where we have the potential to make a similar conversion.

Killingholme will close next month, once its Supplemental Balancing Reserve contract ends, while Barry will only continue to operate if profitability can be secured in short term flexibility markets.

We do also retain optionality to rebuild the King's Lynn A Gas Fired Station, which is currently mothballed, and also to build a new power station on an adjacent site, King's Lynn B. However, any future investments in central power generation are likely to be dependent on the evolution of the UK capacity market.

In Nuclear, we announced in July that we would consider the portfolio role to be financial in nature. In delivering this, our focus with our partner EDF will be on excellent operations and cost efficiency. We've made progress on both during 2015. Output from the fleet was the highest for ten years, while earlier this week, EDF announced life extensions for four of the nuclear power stations.

We also announced in July that we intended to exit our positions in wind power generation, the disposal of our 50% interest in the GLID group of wind farms, for net proceeds of £115m, leaves us with Lincs as our only remaining wind generation asset, which we intend to exit by the end of 2017. We'll continue to purchase wind power from other market participants.

That covers what we're doing to reposition both E&P and central power generation, the businesses most impacted by these low commodity prices.

I'll now turn to the Group cost efficiency programme. As we said back in July, our cost base and the efficiency with which we go to market is a major opportunity and we announced a £750m per annum efficiency programme by 2020, focused on operating costs and controllable cost of goods to be delivered without compromising improvement plans to safety and compliance and customer service.

We remain on track to achieve this target. This will allow us to more than offset the impact of inflation over the five-year period, and by 2020, we expect to see like-for-like controllable costs, £300m, lower than in 2015. It also creates the space to invest additional operating resources into our growth areas, estimated by 2020 at around £200m per annum, in Services, Connected Home, Distributed Energy and Power and Energy Marketing and Trading, and still report nominal operating costs in 2020, at a lower level than in 2015.

We've made material progress towards this cost efficiency target. Our plans across the Group are in place and underpin this objective. We've already made a number of restructuring announcements across the Group, focused on simplifying our business structure, and to date, have announced a reduction of over 2,000 roles, including 700 third-party resource. We plan to have reduced direct headcount by 3,000 roles by the end of 2016, halfway towards our expectation of 6,000, as a result of the Efficiency Programme.

Reflecting this, and some third party cost savings we're already achieving, we expect to deliver £200m of pre-tax savings in 2016 and are on track to deliver two thirds of the £750m annual savings by the end of 2018. And as this slide shows, in 2016 we will therefore be able to offset, more than offset the impact of inflation.

When combined with our interventions on capital expenditure and E&P and the continued focus on working capital efficiency, this allows the Group to more than balance cash flows in this environment while planning to deliver progressive dividend growth.

Let me now put this all together and show you our cash flow projections in a low commodity price environment. This chart shows our sources and uses of cash in a $35 environment. A positive hedging effect is in place in 2016, but to a very limited degree thereafter. What you can see is that organic sources and uses of cash are at least balanced in this environment. The dark blue bars represent adjusted operating cash flow. In addition to organic operating cash flows, we've indicated the GLID Windfarm divestment into 2016 cash flow, and assumed the divestments necessary to reach the minimum of our announced £0.5 to £1bn range, or an additional £385m, are achieved in 2017. And that's the light blue bars.

We're presuming further reductions in capex to £850m per annum if this environment persists, mainly by taking E&P capex to the bottom of our planned range. Clearly, there's also flexibility beyond that level, should prices worsen significantly.

In 2016, in addition to the hedge benefit, the operating cash flow bar includes a one-off release of working capital as levels in British Gas Business, built as a result of the IT system response roll-off. All of this means that for 2016 we continue to expect to be able to reduce debt levels even in a $35 environment.

In 2017 and '18, with the further cuts in capital expenditure, if this environment persists, and the benefits from our cost Efficiency Programme and underlying growth, we are still able to more than balance our sources and uses of cash flow, even once we lose the benefit of forward hedging.

We've also stress tested the Group in an even lower environment and are confident we have the ability to approximately balance cash flows even at $25 per barrel Brent, 25p per therm NBP gas, and £25 per megawatt hour UK power prices. This would require further reductions in capex.

So in summary, the actions we've taken to date, and are continuing to take, mean that we're able to cover our interest, capital and dividend commitments from existing cash flow, even at current low prices; a strong position for the Group to be in.

We've built our growth strategy around operating cash flow and have firmly indicated our intent to tie our progressive dividend to our ability to grow underlying operating cash flow in a flat commodity price environment.

In July, we showed you this picture in a very different flat commodity price environment, $70 per barrel Brent and 50p a therm NBP gas. This chart shows the resultant Group operating cash flow growth from 2015 to 2020, in both the conditions we modelled for you at the time of the Group's Strategic Review last year, and also in a $35 environment, with 2015 rebased to those conditions and excluding any hedge benefits.

Under the conditions of the Group's Strategic Review, we can grow adjusted operating cash flow on average at 3% to 5% per annum up to 2020, as we said last year. If we rebase 2015, and our expectations of 2020, to a continuing $35 environment all the way out to 2020, we would still be able to grow operating cash flow, and at a slightly enhanced rate, relative to our goal of 3% to 5% per annum from this lower base. When combined with our ability to more than balance cash flows, this should give you confidence in the investment proposition for a range of environments.

So to summarise this important section on Centrica in a low commodity price environment, the Group's sources and uses of cash flow are more than balanced at today's prices and with today's level of dividend, and when combined with our Divestment Programme, we would expect to continue to pay down debt in both 2016 and 2017. And with the prospect of underlying operating cash flow growth from our cost efficiency programme and our focus areas for growth, we're confident in delivery of at least 3% to 5% operating cash flow growth per annum from today's base, underpinning a progressive dividend policy.

In a moment I'd like to then move on to some of the strategic progress we've made since the announcement of the conclusions of our Strategic Review in July.

Before that, let me briefly comment on the ongoing Competition and Markets Authority investigation into the functioning of the UK energy market.

The CMA is expected to publish their provisional Decision on Remedies next month, with the final report due in June. Throughout, we've welcomed the review of the market and worked hard to contribute to the process. Ensuring customers have faith in the proper functioning of the energy market is something that all market participants should welcome. We believe the CMA has a unique opportunity to encourage innovation in the market, moving to a principles-based regulatory regime and rolling back aspects of the Retail Markets Review, that have restricted innovation and aspects of competition, will be critical next steps in this regard.

We've also been clear that we have concerns over some of the provisional findings, most notably over the need for the potential introduction of a safeguard regulated tariff, and we have concerns regarding their analysis of profitability and returns. However, evidence of our desire to contribute has been our suggestion to end evergreen tariffs to increase customer engagement. We will welcome changes which support the development of an even more competitive energy market.

We believe Centrica is well placed to compete in the future, innovating for customers, increasing product choice and relevance and ensuring prices are competitive are all central to our strategy.

We will of course continue to engage with the CMA as their process comes to a conclusion over the coming months.

I'd now like to turn to progress we've made in restructuring the Group to deliver the strategy.

Part of the targeted efficiency savings are enabled by a major shift in the way that Centrica is organised, Until now, Centrica has operated as a holding company for a number of different and largely self-contained companies. Each of these companies had its own organisation and way of doing things. However, this model created silos, making it harder for us to work together across the businesses, and more difficult to be efficient and share best practice or new ideas.

It also meant that we were not taking advantage of the international scale of Centrica. We're therefore now moving from a holding company of companies, if you like, to a single joined-up Group, and will make Centrica greater than the sum of its parts. Our Business Units will continue to be the core building blocks of our organisation. We'll have 11 Business Units in total, represented on this slide in dark blue.

The Home and Business BUs in each of North America and the UK will be supported by the common operating functions of field operations and customer operations. These functions are where we touch the customer and are fundamental to our success. They'll also act as a route to market for our new Connected Home and Distributed Energy and Power businesses, ensuring that we maintain a coherent face to the customer. E&P, Nuclear and Centrica Storage will be operated as individual Business Units. All our Business Units will be supported by centre-led Group functions to enable access to international scale efficiency. This new organisation structure will make us more efficient, enable us to serve our customers better and make Centrica more scalable.

To reflect the new organisation structure we've also changed our reporting segments. These are shown on the left-hand side of the slide and essentially represent the BUs I've just described. The only exception is that all of central power generation will be reported as a segment, comprising Nuclear, large central thermal generation and wind for as long as we have it.

We've also defined a new suite of key performance indicators we will use and report against to allow us and you to track our success.

This slide shows a summary of the Group level KPIs. We'll also be showing additional KPIs for the individual segments. All of this can be found in the results announcement from this morning. We'll continue to report performance and safety. The KPIs for our energy and services businesses are consistent across geographies, in line with the establishment of a common operating model, while the KPIs for all Business Units are intended to provide an appropriate balance of growth and efficiency metrics. We'll report these KPIs and against these segments for the first time at our Interim Results in July.

I'd now like to cover some of the progress we've made in developing our main focus areas for growth before summarising: Energy Supply and Services, the Connected Home, Distributed Energy and Power, and Energy Marketing and Trading.

The two growth nodes of energy supply and services of course remain key contributors to Group cash flow and we're making good progress in improving our businesses in the UK, Ireland and North America.

As Jeff outlined, in 2015, we saw a 19% increase in operating profit. We've dedicated additional resources to Customer Service and we're seeing the results in terms of improving Net Promotor Scores, particularly in services in the UK. Our energy pricing stance has been very proactive and in the UK we've now reduced gas prices three times since the beginning of 2015. As a result, the number of energy customer accounts fell by less than 1% in a highly competitive market.

Finally, being the leader on Smart meter rollout in the UK is also giving us the potential to provide more helpful insight into energy use, while reducing the number of calls we have to deal with related to estimated bills, a major simplification and advantage of smart meters.

We continue to develop energy services propositions targeted at new segments, which we plan to launch during 2016. The number of energy customers who are taking new energy report products from us is increasing and the feedback is very good. This is changing the nature of the relationship and giving customers what they want and find useful in addition to commodity energy supply.

In North America, we saw an improved customer mix, acquiring higher consuming customers and selling more bundled energy services and Connected Home propositions. Improving the value of customers and growing market share remain key areas of focus in 2016.

Turning to the Connected Home, we continue to build on our high quality capability. We've now sold over 300,000 smart thermostats in the UK and nearly 200,000 in North America. We're utilising our end-to-end capability and operating platform design and operation, hardware and software development, data analytics, installation and maintenance, to develop new products.

We recently launched three new products under the Hive range in the UK: the Active Plug, Window and Door Sensors, and the Hive Motion Sensor. We expect to launch Active Lights later this year and are currently trialling our innovative Connected Boiler with 300 customers.

Our Hive products are all powered by the same hub and controlled by the same app, so as soon as you've got one Hive product you can easily add others. Later this year, we plan to launch something called rules and recipes, linking all of our Hive products together, creating the ability for a powerful combination of customer actions. For example, you could set a recipe when you go on holiday to put your heating in frost protection mode, turn your lamp on a random schedule and activate your motion sensors.

We’ve launched Hive in Ireland and are also developing plans to launch Hive products into other geographies, such as into North America, where we can leverage our strong existing positions in energy supply and services.

We increased our capability this year in the field of data analytics. We already have three million customers with access to our analytics and insight products in the UK and North America, and are targeting an increase to five million by the end of 2016. We have a good starting position in the Connected Home and believe it could become a material part of the Group by 2020.

Distributed Energy and Power is a market into which we’re expanding. As a reminder, this is for the business customer and is focused around five offerings: energy efficiency, flexible generation, integrating new technology offerings such as battery storage, energy management systems and virtual power plant, or VPP, and optimisation.

This activity is being focused at commercial and industrial customers, many of whom are seeking ways to drive energy efficiency and save costs, but may not have the internal capability or capital capacity. And we have a strong starting position with many of the relevant skills already residing in the Group.

These have been brought together with the establishment of our new distributed Energy and Power business unit. We already have over 1,100 customers across 4,500 sites, mainly in the UK and the US, though with the acquisition of Panoramic Power this has now extended to more than 30 countries and added new technology and insight into our offering.

Our customers include the NHS and Heathrow Airport in the UK, and John Hopkins Hospital and University in the US. In North America we have 450 megawatts of demand side response assets and 20 megawatts of solar projects in partnership with Solar City.

In the UK our virtual power plant will allow us to remotely control and optimise a portfolio of customer assets earning revenue and reducing costs for our customers. We expect to commence installation of new VPP assets on customer sites in the summer ready for optimisation next winter. We continue to believe that distributed energy could become a very material growth node for Centrica and over time in geographies outside our core markets.

Our fifth and final focus are for growth is in Energy Marketing and Trading. As we said in July, we have good capability to pursue growth in LNG, marketing and risk management services for customers, and in trading and optimisation of our portfolio where we delivered a strong trading performance in the second half of 2015. In LNG we completed a number of “Free On Board” cargoes including our first delivery to South America.

That covers an update of the progress we’ve made in delivering our strategy in our growth areas and how we’re reorganising to achieve it.

Before summarising let me remind you what you can expect from Centrica this year. This slide shows our targets for 2016. We expect adjusted operating cash flow to exceed £2bn in the current environment.

Capital expenditure will be limited to below £1bn, including any small acquisitions of less than £100m and within that E&P capex is assumed to be around £500m.

We will deliver £200m of cost efficiencies and therefore see like-for-like direct operating costs below those of 2015 in nominal terms. And as part of our simplification efforts we would expect like-for-like headcount to fall by about 3,000 during the year.

So now let me summarise. The Group delivered resilient financial performance in 2015 with operating cash flow growth and good dividend cover from earnings. I've demonstrated that the Group is robust in a low commodity price environment. We project sources and uses of cash to more than balance with today's dividend level, even at current low commodity prices and before divestment proceeds.

We have stress-tested at even lower commodity price environments of up to 30% worse than today, and although there would be regret costs we would be able to balance sources and uses of cash flow out to 2018 even if we see this further degradation from today's environment.

We are confident in delivering at least 3% to 5% per annum underlying operating cash flow growth as outlined last year even in the current environment so underpinning our progressive dividend policy.

We've made good early progress against the strategic objectives set out in July with our cost efficiency programme on track and good responsiveness in E&P and central power generation to the current environment.

We have delivered solid profit growth in energy supply and services and important milestones in capability development in our Connected Home, Distributed Energy and Power and Energy Marketing and Trading Business Units.

Although the environment is challenging we're making good progress in reshaping our business so that it's aligned with what our customers need and we're on track to deliver both returns and growth.

Thank you for listening and I'd now like to ask Mark, Mark and Badar to join Jeff and me on stage to take your questions. Thank you very much.

And in responding to your questions I'll, as we've done before, field the questions, it would be very helpful if you could identify yourself before asking the question, just your name and affiliation and that helps us keep track of who's asking. There are lots of questions. Okay we'll start over here and we'll just work across please.

Q&A

Question 1

Mark Freshney, Credit Suisse

Just on the Moody's review for downgrade my understanding is that Moody's gave you a courtesy call ahead but didn't give you the opportunity to respond. Given everything that you've announced today do you think that's enough for Moody's to take you off the review for downgrade and to attain the Baa1 rating? And if Moody's were for whatever reason to decide that wasn't enough, perhaps because you're in the wrong industry, I don't know, and take you down to Baa2 would that require remedial measures from Centrica?

Iain Conn

Let me just give a general response to our demeanour towards our rating and then I'd like Jeff to just talk about the impact and what options are available if that were to occur.

So our financial framework, as Jeff outlined earlier, clearly indicates a target of strong investment grade of Baa1, BBB+. Moody's have put us, and a number of other companies, on review for downgrade, we believe the business, as Jeff said, is very robust in these conditions, as we've outlined today. And we'll be working with the agencies over the coming months.

If we were downgraded, we've indicated previously, and in one on ones with you, that we could operate at BBB, Baa2, but it is below our target and we would seek over time to restore our target rating. But Jeff, the impact, the options, and how are we going to be working with the agencies over time?

Jeff Bell

Yes so I think Mark to your earlier observation it's early days in terms of Moody's having announced the review of the European unregulated utility industry and so we haven't had a chance to engage with them as part of the process, that will unfold over the next 90 days and clearly we will be doing that as I said.

In terms of the impact, the actual impact is primarily around our requirement to post additional collateral for decommissioning liabilities or within our trading and procurement activities. That is not significant, or not of a great extent moving from Baa1 to Baa2. However as we've said previously, over time that would start to impact our business model, particularly in terms of being able to, in North America, provide some of the longer term fixed price contracts that are a function of that market. And so as Iain has said we do very much believe that Baa1 is the most financially efficient rating for us to be at, but we could absolutely live and operate at Baa2.

As you'd expect we have other levers, Iain has talked about those, capital expenditure, the timing and implementation of our cost efficiency programme and divestments and we'd be looking at all of those levers, depending on the rating agency's view of our forecast in the commodity environment we're in.

Iain Conn

And Jeff to Mark's question, I know it's speculative, about how do we think the rating agencies will react to what we've just shown, any views on that?

Jeff Bell

I think at this point I wouldn't want to speculate before we get into a discussion with them.

Iain Conn

I mean, Mark, I think we believe this is a very strong story about the investor story, our ability to manage our own cash flows but obviously we'll have to see how they feel about it.

Mark Freshney

And just a follow up, where do you think RCF to debt will have landed for 2015? I know it's a complex calculation but how do you think it would have come out?

Jeff Bell

So I think I said in my statement that we expect to be at or slightly above the minimum threshold for Moody's of 25% that they've set as part of their Baa1 threshold. It will be, as Moody's has undertaken, the look forward of those calculations in the lower commodity price environment we're in that I'm sure we'll be talking with them about.

<u>Question 2</u>

Gus Hochschild, DECC

Just two very straightforward questions if I may. With regard to the CCGT fleet what was the average load factor?

And then somewhat surprised in the November trading statement when you guided us to over 75 barrels of oil per year and indeed 78, so your timeframe for the 40 to 50 production range is that for this year or '17 or '18?

Iain Conn

So I'll just touch on that last one and I'll ask Mark Hanafin to comment on both the flow factor and also how did we achieve such an over-performance versus our guidance in E&P.

Look first of all we haven't given a timeframe, quite deliberately, because I think some of our shareholders would say rushing to sell E&P assets at $35 a barrel when we've got this strength of sources and uses of cash flow would probably be not particularly appreciated. Clearly what we want to do is do everything we can to strengthen the business and we believe that through the right capital selection and the right optionality retention we can create the right value for our shareholders.

But I did mention the one specific thing of course we've kicked off which is alignment with our Qatari partners on how would we exit Canada for value for our shareholders in the right way? But we're not giving a timeline for the obvious reason I've described. I mean most people in the commodity market at the moment it's clearly a buyer's market in lots of ways, but it's a very difficult market for people to want to sell assets and you wouldn't expect us to be rushing to do anything actually. But we are looking at lots of different ways we could strengthen it.

Mark, on flow factors and how did we deliver such a good result in E&P.

Mark Hanafin, Chief Executive, Energy Production, Trading and Distributed Energy

Sorry I thought the question was on CCGT.

Iain Conn

It was CCGT flow factors I think was what I heard Gus.

Gus Hochschild

Yes the first question was on your average load factors of the CCGT.

Iain Conn

Oh load factors, sorry.

Mark Hanafin

So less than 20%.

Gus Hochschild

So marginally better than 15% for the first half?

Mark Hanafin

No probably not. Sorry. Langage had a generator problem in the first half that was fixed so in terms of the overall performance it was probably better but very low load factors across the fleet.

Question 3

Fraser McLaren, Merrill Lynch

Good morning. I have three questions about the actual cash flow targets please. First, if the implied hedging benefit for '15 was around £500m what is the equivalent number for 2016 and do these all roll off in 2017?

Secondly, do your numbers assume that there is no negative effect from the energy market investigation on BGR?

And then thirdly, just to check, are you saying that if we take the rebased starting point of £1.7bn and increase it by say 5% each year to 2020 that you would merely make it back to 2015 reported levels? And if we then take cash as a proxy for earnings does that imply that earnings could be broadly flat over the next five years?

Iain Conn

So can I touch on the last two and ask Jeff to address the cash flow question?

So look firstly on your last question, Fraser, the graph was trying to help explain that we can maintain the growth trajectory at lots of different environments and that we weren't locked on to planning at $70 a barrel or at $35 a barrel but the growth strategy is intact, which means if we can pay for the dividend and we can grow cash flow in a range of environments the progressive dividend should also be underpinned.

Your statement about going from £1.7bn plus 5% per annum and only just getting back to the reported level of 2015, if you look at the graph and you imagined a world all the way out to 2020 at $35 a barrel then it's conceivable that we would only deliver a flat profile of operating cash flow. Now in that scenario, on a reported basis, obviously on an underlying basis it would be growing quite strongly. In that scenario our sources and uses of cash flow would still pay for the dividend, would still demonstrate confidence in cash flow growth and therefore should still underpin a progressive dividend as well.

Now clearly the nominal cash flow in any year is going to depend on lots of things. So don't take that graph please as a plan graph, we're not predicting that cash flow in 2020 will simply be what it was in 2015, we're just pointing out how the growth rates look at a range of different environments.

On the CMA effect, I'll just comment briefly, we've assumed as we indicated last year, some competitive degradation in our unit margins in British Gas Residential Energy, and we've not published the degree of that degradation. But clearly there are aspects, given that we're the largest market shareholder in the UK, there are aspects of our starting point that are akin to running up a downward escalator, which is why Mark is spending so much time on pricing and offers and innovation. And we think we've got the judgement about right but we'll know in a month where the CMA are going to come out.

Jeff cash flows and hedge benefits.

Jeff Bell

Yes I think we've talked previously at times about the fact that in our asset businesses we have roughly a two year hedging strategy that rolls in over a two year period. So what I'd say is that as you look to any particular year in terms of the hedge benefit rolling into that year is to imagine that as we come into the year, for the beginning part of that year we're largely hedged. At the end of the year we're roughly half hedged so maybe two thirds. And if you then take your view of commodity prices over the previous 18 months to two years gives you some indication. And the rules of thumb, in the back, can help in terms of using that commodity price to get some estimation of roughly what the hedge would look like.

<u>Question 4</u>

Edmund Reid, Lazarus

Three questions. The first one is on nuclear, so there was quite an improvement in nuclear output in 2015. I think EDF have put out some numbers around 2016, would you expect nuclear output to remain strong in 2016, obviously given various variables etc.?

The second question is on Nest in North America, can you just remind us on your relationship there and what might happen if you start selling Hive products in North America?

And then the third question is on the impact on depreciation from the impairments, what kind of impact would that be?

Iain Conn

Thank you, Ed. So we'll go in the order, Mark Hanafin on nuclear, Badar on NEST in North America and if Mark Hodges wants to add any comment from the Connected Home perspective because Mark looks after the Connected Home broadly across the world, then add that. And Jeff on the impairment impacts on depreciation.

Mark Hanafin

Nuclear. So 60.6 terawatt hours for the fleet for 2015, as Iain said in the presentation a record over the last ten years, and that was despite the boiler spine problems at the four reactors at Heysham and Hartlepool. By the end of the quarter, this quarter, three of those four reactors will be back at 100% load, subject to other factors, but in terms of the boiler spine work. The one with the original crack in the boiler spine, Heysham one, reactor one, should be at the 75% load so that's three quarters of the boilers in the reactor. And then in the remainder of the year work will be done with the regulator to see is there a way of increasing upwards from 75 but that will require a lot of additional work.

So I would say difficult to give numbers in terms of what it could be but from a planning point of view we would hope that it would be at or above last year's production.

Iain Conn

NEST Badar and Mark.

Badar Khan, Chief Executive, Energy Supply and Services, North America

We have an ongoing relationship with NEST in North America and we continue to have that relationship for some portion of 2016, we haven't landed when that relationship will change. Clearly it makes sense for us as a group to be thinking about joined up capability with regard to insights for our customers, propositions for our customers and to develop them for all of our markets; and the Connected Homes team that Mark oversees is delivering that for us and so we are looking at our plans for expansion of all of our capabilities and particularly insight and analytics offers where we can help our customers engage in their own individual energy consumption and help them to control their consumption in North America. So it's an ongoing dialogue.

Mark Hodges, Chief Executive, Energy Supply and Services, UK & Ireland

Just a quick build, we're obviously working on the technology stack in Connected Home to make sure it's operable in the US market. That's a key focus so that it gives us choice. And working with Badar looking at which states in the US where Direct Energy isn't present but we have a clearer run in terms of the Hive brand.

Iain Conn

Badar, do you want to say anything about the benefits of this data analytics? How are customers responding to it?

Badar Khan

We've launched a number of different offers in our markets in the United States where we've launched this past summer a tool that helps people understand their consumption by household appliance. We've introduced an offer where people can customise their energy and services in a Connected Home bundle, which allows customers to choose from the contract length of energy, to the energy type, to energy efficiency programmes, to services, protection plan offers. And that offer since we launched has now become the second highest most chosen offer, or programme, by our customers for digital and inbound sales.

What we're seeing from all of that is what we were hoping to see which is that we are attracting what we would consider higher-value customers. There's a very large range of home size in North America, and we're attracting higher-value customers as a result of that. And we're also seeing some very good evidence of higher levels of loyalty. And that's very consistent with our strategy around differentiating our offer in a marketplace in the United States which is largely undifferentiated. And we think we have a source of real competitive advantage, particularly when we put together our capabilities across the Group.

Edmund Reid,

I was just going to ask on net promoter scores if you can give us any metrics around customers with data analytics. Do they have better net promoter scores or do they give you better net promoter scores?

Mark Hodges

In the UK, whether it be Smart or whether it be Hive or whether it be My Energy report, wherever we are I think having a broader relationship with the customer we do see an improvement in net promoter score, anything in the range of 18 to 21 percentage points - so significant. And as Badar said that helps also I think with churn and retention.

Badar Khan

We are very, very consistent. And I think the point about net promoter score is you are likely to stay with your energy supplier and services provider. And the proof is whether loyalty is rising – and loyalty is rising.

Iain Conn

And impairment?

Jeff Bell

So, the short answer is about 1 pence per share. The slightly longer answer is of course it's non-cash so it doesn't affect the operating cash flow.

And the second thing is that our impairments were a combination of write-down of asset values and impairments of goodwill, roughly two-thirds one-third. So there is an element of that impairment that of course won't have any impact from an earnings perspective.

Question 5

Martin Brough, Deutsche Bank

A couple of related questions. One is that following the write-downs I think your book value of equities is now about 24p a share. Doesn't it mean the return on capital metrics aren't really all that useful now, given that the capital employed is on an equity basis is so low?

I guess related, the UK nuclear business if you did a mark-to-market would be roughly free cash flow zero after capex. Obviously hopefully power prices would increase, but if they do turn cash negative would you participate in a capital increase in UK nuclear if that was required temporarily? If you decided to write off your stake in UK nuclear I think that would take your book value of equity below zero, because I think it's 32p book value for UK nuclear, would that constrain your ability to pay a dividend if there was a write down of some of your upstream and that brought your overall Group equity below zero?

Jeff Bell

Two observations. The first in terms of the return on capital employed metric: it's very fair, particularly in customer facing businesses, which is clearly where the strategy is taking us, they tend to be more capital light business. It's why over time, as we indicated in the strategy itself, we would expect over time our return on capital employed to move in a success case well above the 10% to 12% range we've articulated. It's why also there are a number of KPIs that we've indicated in the back that we're setting out that aren't capital employed related, because in those businesses it's as much about efficiency, customer growth, profitability type measures. I think we will over time see that.

I wasn't going to comment on the value of the nuclear example at all; but more to say that we've clearly taken a level of impairment such that we believe the value we have on the books for all of our assets are appropriately fairly valued and believe that value exists based on our view of the discounted cash flows. The actual ability to pay dividends is related to the distributable reserves we have within the Group and within Centrica plc itself. We have sufficient distributable reserves to pay dividends there. And we run a process each year to make sure that we move distributable reserves up the chain of statutory entities we have to ensure that that continues to be the case going forward. So it's not really directly linked to our level of book equity.

Iain Conn

The only other thing I'd add about the ROCE thing is the financial framework is designed to be exactly that, a framework. The ROCE metric can be argued about, some people prefer different return metrics. But it's a boundary around the framework. As Jeff said earlier, if we go below any one of these metrics obviously we'd be designing plans to restore ourselves to within the framework. And I think you've heard a number of times from me and Jeff that our level of commitment to the dividend is extremely strong, and you would find us adjusting capital and doing all sorts of other things before we'd think about going anywhere near the dividend again. And I don't think based on the cash flow projections, although you can never, never say never, it's very difficult to imagine a scenario where that's likely to happen. So that's how you should think about the ROCE as part of a financial frame.

<u>Question 6</u>

John Musk, Royal Bank of Canada

Going back to Hive firstly, given the positive net promoter scores and the retention benefits, are you looking at other ways of offering Hive out to customers, perhaps even offering Smart thermostats free with energy tariffs perhaps once we get through the CMA process?

And then secondly significantly, in a 35-35-35 world, how do you look at the value of the Cheniere contract, long-term contract that you have, and current thinking around how that contract is going to pan out?

Mark Hodges

I'll get to Hive just via the CMA, because you raised that point specifically. Obviously we're hoping the outcome will be pro-competitive. And in a pro-competitive world we have a very strong brand. We're working on our cost base so that we can leverage scale, and you come to something like Hive; but I would also throw Smart into the mix where we are innovating and we think we're leading the market in terms of innovation. So do we see a world where we can start to utilise those innovations, utilise the investments we've made in a broader way post CMA? Then the answer would be yes, hopefully, so that we can capitalise on the strength we've created.

In terms of pricing models for Connected Home, both in North America and in the UK and Ireland, there are a number of different ways we can create value. We can reduce churn, as we've already talked about, that's a useful way of creating value. We can make margin on the sales of the devices, of the hero products. So we have the thermostat out there today, as Iain referenced, we'll have another hero product in terms of a connected boiler in a few months time. So those products can make margins.

But it's really this integrating of the devices, the hero products, the hub through the data analytics and trying to figure out a way to monetise that in terms of a revenue stream that we see as the kind of real prize. We don't have an answer for that now. There isn't an answer out there in the market that's something we're working on. We think we'll get there through testing and learning different types of opportunities. But that's a key focus for the team every day, right now.

Badar Khan

Can I just add as a point of evidence? In North America 46% of new customers that are attracted to our company, at the residential level, have chosen a bundled energy and services protection plan or Connected Home offer. That's up from 11%. So I think the point is when you develop innovation and propositions to appeal to customers in ways that they don't yet have we can find very good response rates. And particularly in North America where the market is really very undifferentiated we have a real source of advantage. And being able to bring that kind of innovation and that kind of thinking to the UK would be outstanding.

Mark Hodges

Just a small data point: with the 300,000 Hive thermostats we've sold to date around 11% of those customers have gone on to buy another British Gas product. Remembering it's not just energy there's also the very valuable services area as well.

So we see, I think we see opportunity, but obviously the challenge for us is to create more value from that.

Mark Hanafin

Cheniere, the main driver to watch of course on the Cheniere contract is not the absolute 35-35 world it's the spreads, it's the differentials.

If we look forward to the first full year, so 2020, maybe let's say $4 Henry Hub sort of world, you need about $5 to liquefy, to ship and to re-gasify to Northwest Europe. So you'd be looking at $9 per mmbtu in Europe, 50 pence per therm. So in 2020 it depends on your view of those spreads at that time.

My view is that LNG will be oversupplied in that period so the spreads will be reasonably flat, so we may have some losses in the first year or two of that contract. But I think when you look into the 2020s clearly all the liquefaction projects that are not under construction at the moment have been pushed back, they're not getting built. And I see the market going back into a tighter situation, spreads opening up. And remember this is a 20-year contract. So I'm quite positive about that.

And I've already given one example of a simple movement from North America to the UK. This is a FOB contract. We have worldwide options, we have options to market gas on Henry Hub, we have options to market it on percentage of Brent all around the world.

The second aspect of it that I would mention is the other way to think about this contract is: where is the liquefaction project at these commercial terms in the merit order globally? And one of the things that I take comfort from is it is extremely well placed when you look at future liquefaction projects around the world, it's very competitive.

And the final point is that although spreads at the moment, because of the oversupply of gas in the world, are squeezed, that's given us an opportunity to really start building our capability. We've built a very strong LNG team, that team is buying and selling cargoes around the world. That would have been difficult to do two or three years ago when spreads were very wide. So we're building that capability in this oversupplied period, and then we have a 20-year contract that I think is very valuable.

Iain Conn

Thank you Mark. And I just want to make one other comment on the questions around Connected Home and distributed energy and power, which is simply to your question about, 'are you going to market all these products to your energy customers?' well the answer is of course yes, as Mark and Badar have talked about. But we also have the opportunity to market these products to customers we don't have, in geographies we don't have. And that makes the business units that we're building here much more translatable into new value pools as we face customers in other geographies potentially. And as you've seen with the acquisition of Panoramic Power, we've suddenly found ourselves with a customer base in lots of countries and the potential to expand as well in that.

Question 7

Jenny Ping, Citi

Just two questions. First of all, on your use of cash bar that you have in your presentation what sort of assumption do you make on Scrip dividend?

Then secondly in terms of the 750 cost cutting plan, would you be able to put that in context in terms of the retail business, in terms of cost to serve whether you've given a target or a range of what the most efficient company would be?

Iain Conn

On the second part, one of the KPIs that you'll see in the back of the announcement today, that you'll hear more about in the summer, relates to cost to serve. So I'd like to leave that part of your presentation until we give a disaggregated picture of the Group in the new segmentation with the new KPIs. And I think we'll be able to have the right conversation about that at that time.

In terms of the Scrip Jeff, what are you plans?

Jeff Bell

We've had quite an atypically high Scrip take-up originally back in May, but the interim dividend in November of 2015, which was just under a 20% take-up, we consider to be probably more normal, and therefore in our projections of net cash flow we've assumed something similar to that.

Question 8

Lakis Athanasiou, Agency Partners

Three very quick questions. One on the write-downs below book value: how is that impacting your headroom for your hybrid equity component?

Secondly on the working capital. You showed a working capital move up in calculating the adjusted operating cash flow despite the issues at BGB. Could you give a flavour of how you expect that to evolve going forward in a rising price and a falling price environment?

Thirdly, nuclear depreciation. Could we please have a number for that? Because it's going all over the shop and we've no idea what it is, even looking at the EDF's segmental accounts.

Jeff Bell

With respect to the hybrid bonds we think we're within the appropriate parameters still, so I'm happy to take that one offline in more detail if you'd like.

From a working capital perspective the business itself, primarily because of weather in any particular year, we could see working capital moving around by anything up to probably £200m would not be uncommon or would be quite normal. So within those sort of boundary conditions only outside of that would we be looking to flag up working capital movements as outside the norm. And you're absolutely right, within 2015, while we had working capital degradation in BGB, we actually had very strong working capital management, particularly within Direct Energy, and also to an extent within British Gas Residential Energy. As I said earlier, we would expect the higher working capital levels that we had within BGB at the end of 2015 to largely have worked off through the course of 2016.

Lakis Athanasiou

And how have they evolved in a rising and falling price environment, other things being equal?

Jeff Bell

All else being equal, in a falling commodity price environment you would expect to see slightly less working capital because of that.

Lakis Athanasiou

But still positive?

Jeff Bell

Yes, absolutely.

Lakis Athanasiou

So pretty much your adjusted operating cash flow projections are underpinned by other things being equal however flat to positive working capital movement?

Jeff Bell

That would certainly be true of 2016. Beyond that we would expect it to be broadly normalised around zero in that sense.

Lakis Athanasiou

And depreciation?

Jeff Bell

In terms of depreciation, the 2015 fair value depreciation…

Lakis Athanasiou

No, I want the total depreciation.

Jeff Bell

You'll have to give me a minute for that number.

Iain Conn

While you're thinking about that, and maybe we'll take it up with Lakis offline if you can't, Lakis what you just pushed on I just want to use it, if I may, just to illuminate something. We've not given earnings per share guidance for 2016, I suspect that hasn't passed you by. Let me just try and use the cash flow conversation however and Jeff's disclosure just now to try and give you some help with that.

Our operating cash flow guidance for this year we've said over £2bn. For 2015 we delivered £2.25bn and we didn't indicate that there was a particularly abnormal working capital movement. So Jeff just said anything up to £200m is pretty normal. So you can assume the working capital component from 2015 is less than £200m. So our underlying operating cash flow in 2015 is a bit above £2bn, for argument's sake.

You then say, well we've just announced over £2bn operating cash flow for 2016, but we haven't given a working capital number in that. But if you recognise that the BGB number, which we're not giving, is normal, or normal-ish, but it could be hundreds of millions, not tens, which I think is the important point; i.e., it could be the £200m or whatever type number again, we've not specified it as an abnormal item. So for judgement's sake, let's go to the top end of Jeff's range. And then you recognise that there's some efficiency that we're driving in to the business, which is going to improve the underlying you could argue that the operating cash flow this year on an underlying basis is basically around flat to slightly below 2015's operating cash flow. And that translates into, in a consensus view of earnings for this year is below 2015, but it's in quite a range.

Obviously I've given you a description of an imputed EBITDA way of thinking about things. Now there are lots of other moving parts in all this, but we would therefore, on balance, agree that earnings below 2015, in line with consensus, it's probably a sensible place to be, but at or below, but it's too early to give any specific guidance on it. Because at the end of the day, operating cash flow comes from EBITDA, so does earnings, and I'm just giving you a way to think about it, but we're not giving earnings per share guidance at this time.

Question 9

Elchin Mammadov, Bloomberg Intelligence

I have three questions. The first one on the margin. Apart from your BGB business, there was a very strong performance in both North America and the UK. How do you expect your supply margins to develop this year versus 2015? Is it going to be due to change is driven by market share or costs or changes in demand?

The second question is on life extensions, like EDF announced a five-year extension to four units. What does it do to your capex and cash positions going forward?

And the third one is about the UK market in generation. We've seen some reports that some generators consider shutting down plants that were granted the capacity payments. Is current low price environment persists do you see this happening, and if so, at what scale? Thank you.

Iain Conn

Can we keep these quite brief? So Mark and Badar on supply margins, given we don't actually publish them, how do you want to characterise the drivers? And Mark Hanafin, the last two on life extensions and UK generation.

Mark Hodges

So shall I start in the UK in terms of supply margins, just the characterisation as you describe it, Iain?

I mean we're taking a price leadership position around the standard variable tariff you've seen that we've reduced three times in just over the last year. That's had a positive impact on customer numbers. We think that's something that we can continue. Obviously the CMA Review is the big issue on the horizon, not too far away now, and that will I think set us up for a more longer-term competition. But right now, price leadership, reducing churn, maintaining customers numbers, or certainly fighting hard for those customer numbers, improving service, you'll see that there are, in the pack, quotes around reducing complaints, improving NPS, and that all helps with customer numbers as well. So it's really all of those forces going into our UK energy supply market and making sure we're competing hard.

Badar Khan

Yes, and I think your question was on the margins for businesses in particular. And we've been saying for a couple of years now that the polar vortex that hurt us, and many others in the marketplace, allowed our customers in the market to realise that we weren't pricing the risks that we manage on behalf of our customers around price and volume variability. And we have been developing, consistent with our strategy, deeper relationships with our customers, both homes and businesses, while at the same time repricing that risk more properly. And what we're seeing in 2015's results is the effect of that repricing of risk to what we consider more normal levels, with strong loyalty, with no impact on the loyalty of our customers. And I think that's partly because of the level of differentiation and innovation in our offering.

Mark Hanafin

On life extensions, there's really no impact on our cash flow. If you look at previous statements, there was an expectation of an average of eight years of life extensions across the AGR fleet, and all that's happened is that the specifics of which plant that applies to has been revealed, so it's been part of our assumptions, it's been part of our plans going forward.

On the capacity market, you've seen a number of different plants, different types, making these sorts of decisions, or looking like they're making these decisions. If you look at Trafford Park a new plant, miraculously, well, surprisingly, suggesting it would be built at less than £20 per kilowatt, not getting funding and not looking likely, that's one example.

Longannet was never actually bidding on the capacity market but elected to say that it would be available, and therefore was taken out of the procurement requirement, that now not being available, so creating a gap. And then Fiddler's Ferry, that won a contract, and the owner electing to take the penalty and not build it. So there are a lot of different examples there.

From our perspective, and I don't know whether there will be other examples like that, but from our perspective, we have two plants that have won contracts in the two auctions so far. Those plants currently, which are Langage and Humber, I currently see those as broadly cash flow breakeven, pre-capex, pre-capacity market. And so the capex that we will need to put in to those plants in the next three years is really seen as needing to get a return in the capacity market and once the capacity market comes in, they are cash flow positive. And if you see clearing prices in the future, then you'll see rising cash flows associated with them.

So at the moment, I'm fully expecting to bring Phase 1 of Humber back on stream, ahead of the capacity market, and I'm fully expecting the rest of Humber and Langage to be participating.

Iain Conn

Thank you, Mark. And I know there are at least three questions. Are there any more? I think we're going to really struggle. Let's hope these are quick, and if we can keep the answers quick, we'll try and do them. We need to finish at about 11.30 at the latest.

So over at the back, who's been very patient?

Question 10

Ashley Thomas, Societe Generale

Three quick questions.

The operating cash flow forecast that you've given on Slide 33, obviously in 2018 you've got a lower operating cash flow but you'd also have lower debt, so that sort of indication that you've given, is that in line with the Moody's 25% RCF target?

Secondly, the £70m power provision, I assume that's Spalding? Does that basically cover the annual losses for Spalding out to 2021?

And lastly, could you give us a feel for the scale of the ECO cost reduction you saw last year and the broad scale for the ECO cost reduction you will see this year? Thank you.

Iain Conn

The easy one on the last one is we don't publish the ECO phasing, and so I can deal with that. Jeff, on the other two quickly?

Jeff Bell

The £70m is on Spalding and is primarily, is a combination of the asset in an onerous contract provision out until 2021, your exactly rightr.

And then just remind me of the operating cash flow question?

Ashley Thomas

The 2018 projection, is that comfortable for the RCF?

Jeff Bell

So certainly with the repayment of debt over the next three years, we would expect by 2018 that those metrics are in line with Moody's thresholds.

Iain Conn

There's one more here and there are two here.

<u>Question 11</u>

Iain Turner, Exane

The segmental results at the back show you're making basically zero margin in electricity residential and about just under 12% in gas. I just wonder if that's a very sensible position to be going into the CMA review. It's the wrong number in both really, I guess.

Iain Conn

We've been traditionally very aggressive on our gas pricing and we have been offering a high price position on gas before, but don't forget the market is principally a dual-fuel market and everyone's got different positions. But Mark, is it sensible?

Mark Hodges

It's where we are! I think you've answered the question, to keep it reasonably short, and we can have a longer philosophical conversation, but it's mostly a dual-fuel market, we have been traditionally cheap on electricity. Gas margins are higher, which is why we've been bringing the gas prices down. And you can see in terms of the results from customer numbers, it's not having an enormous detrimental effect. But certainly over time, I think we need to be rational in our thinking about individual products, individual fuels, and make sure they can make a return. So I think it's one of those things that we'd want to sort out over time.

<u>Question 12</u>

Dominic Nash, Macquarie

Just one question please on the link in which operating cash flow and the dividend policy. Can I just clarify that you're underlying is £1.7bn, you're basically saying that you think you can raise it by the higher end, or even greater than the 3% to 5% over the medium term, which I guess is then linked to the dividend policy? But next year, we're likely to have a lower operating cash flow than we had this year, will you be overlooking potential dividend cuts or do you think you're going to try and have a floor on the dividend?

Iain Conn

What we said last year in our dividend policy, it's not mechanistic. It's really, really important that it's not like in any period you take the operating cash flow and you calculate a relative and that immediately translates into a dividend change. That's not what we're saying.

What we said is, the dividend, the progressive dividend is based on our confidence to grow operating cash flow, and we've indicated confidence to grow operating cash flow at at least 3% to 5% from where we are today. So you should assume from that that we are hoping and confident to be able to grow the dividend at a rate comparable to that; but clearly any dividend decision at any moment is a matter for the Board and we'll take it each period. But we are committed to a progressive dividend, not a mechanistic dividend.

And just the last inferred point in your question. We didn't say that operating cash flow in 2016 is going to be below operating cash flow in 2015. We just said operating cash flow in 2016 is going to be above £2bn, as was operating cash flow in 2015.

So you'll have to wait and see what operating cash flow is going to be this year, but again, it is also about our underlying operating cash flow growth that's really important. And to Lakis' question, we're going to have swings of working capital, but when we have unusual working capital releases, we'll obviously put it into the balance sheet and pay down debt with it if we have that ability, but this is about underlying operating cash flow growth and our confidence in it, which will translate into a progressive dividend policy.

Dominic Nash

Thank you. So just to clarify, if you have a lower base and a potentially higher growth, we could look forward to a higher dividend growth as well?

Iain Conn

That is clearly conceivable within what I've just said, but I'm not going to clarify it any more than I already have, so thank you very much.

<u>Question 13</u>

Deepa Venkateswaran, Bernstein

I have two questions. So one is on BGB. Can you quantify what were the one-off charges this year relating to bad debt and extra customer resources, etc?

And the second one, I think coming back to the dividend policy, if I look at chart 33, so if you lived in the 35/35 world, would it then be fair to say that in that world, given that your underlying cash flows will largely be flat, going from the 1.75% to getting to 2+%, would it then be fair to say that in that world your dividend would be flat in absolute terms versus today's level, rather than progressing at 3% to 5%?

Iain Conn

I think you've asked the same question in a slightly different way to the last one. It's very simple, that if our underlying cash flow at the operating level is growing, and we are confident of it continuing to grow, we will be confident about a progressive dividend. And so it's not mechanistically tied to reported operating cash flow in any particular year, and we will guide you about how our underlying operating cash flow is getting on. And you'll find one of the KPIs that we are going to be giving you in the summer is underlying operating cash flow. And obviously the complexity in all that is environment and rules of thumb, and hopefully that we're not going to have an environment quite like we had this last year, which does make calibration a little bit difficult. But you should all assume that provided we are confident in delivering underlying operating cash flow growth, that that will translate, subject to my Chairman and the Board support, into a progressive dividend.

Now the first part Jeff?

Jeff Bell

So in terms of BGB, we would put roughly half the cost or change in profitability down to a combination of bad debt, probably two thirds bad debt and additional operating cost investment, because we needed more people to handle customer service and handle the migration. And then clearly there was an element of lower supply point and it made it difficult, as I said in my presentation, to be acquiring customers when the systems weren't working, so there is an element of just lower margin from those supply points as well. So kind of a third, a third, a third.

Iain Conn

Ladies and gentlemen, it is 11.30 and thank you, you've been very patient for two hours. I'd just like to thank you all very much for coming. On behalf of the Chairman, our Board and all of my colleagues, I hope that's been useful and I hope you now understand that Centrica has been resilient in this environment, but also it's going to be very resilient in this environment, and we have confidence in ability to pay for all of our needs from cash flow out of our own cash flows, and we have confidence in our ability to pay our current level of dividend, and we have confidence in our ability to grow underlying cash flow.

And by inference to the last two questions, we have a high degree of confidence, therefore, provided we do it of course, of delivering a progressive dividend. And I think that the combination of all of those factors means an investor proposition of returns and growth from here, in this environment.

And finally, we've said that if the environment worsened, we would still be able to stick to the strategy and balance our sources and uses of cash with our current level of dividend and look to continue to grow the company.

Thank you very much indeed for coming and I look forward to speaking to a number of you on the road. Thank you.