20 November 2014

Centrica Interim Management Statement

Summary

Centrica today gives an update on its business performance. The Group has faced a number of challenges in the year to date, in particular mild weather in the UK and the Polar Vortex in North America, trading conditions for British Gas Services, and the impact of boiler inspections at the Heysham 1 and Hartlepool nuclear power stations. Reflecting this, full year adjusted earnings per share in 2014 are expected to be in the range 19-20p. Although the upstream business will be impacted by falling oil and gas prices, the Group still expects to deliver earnings growth in 2015. Good operational progress has also been made across a number of areas which will drive Centrica's long-term growth.

Since its Interim results on 31 July 2014 the Group has:

- returned to customer account growth in UK residential energy supply and residential services in recent weeks
- completed major systems upgrades in British Gas and Direct Energy, enabling improved customer service and enhancing our ability to offer a broader range of propositions
- continued to help customers understand and control their energy consumption through leadership in smart connected homes and innovation – the sustainable way to keep bills down; the average British Gas residential dual fuel bill is expected to be around £100 lower in 2014 than 2013 reflecting warmer weather and energy efficiency measures
- continued its delivery of cost reduction initiatives, with programmes in British Gas Business and Direct Energy on track
- seen a further improvement in sold margins in Direct Energy Business, with a strong increase in second half year-on-year operating profit expected
- remained on track with its upstream capital expenditure programme, including the large-scale Cygnus and Valemon projects in the North Sea

Earnings outlook

Full year adjusted earnings per share in 2014 are now expected to be in the range 19-20p, compared to a range of 21-22p at the time of our Interim results. This change reflects mild UK weather in the second half of the year to date, trading conditions for British Gas Services, and the impact of boiler spine inspections at the Heysham 1 and Hartlepool nuclear power stations. British Gas Residential post-tax margins are expected to be around 4% this year, lower than long-term expectations.

Looking ahead to 2015, we expect to deliver growth in Group adjusted earnings. In addition to an expectation of a return to more normal weather conditions, we expect increased underlying profit in Direct Energy, British Gas Services and British Gas Business. We will also see a first full year of contribution from Bord Gáis in Ireland. However, these improvements may be significantly offset by the impact of lower oil and gas prices on our upstream business, and a higher effective upstream tax rate as small field tax allowances in 2014 are not repeated. Both 2014 and 2015 earnings expectations remain subject to the usual variables of commodity prices, weather and asset performance, together with the downstream regulatory and competitive environment.

Business update

Group

On 31 July 2014, Moody's Investors Service affirmed its A3 credit rating for Centrica plc, which concluded the review of the rating that was initiated on 29 April 2014, partly as a result of the increased business risk in the UK. On 26 August 2014, Standard & Poor's Rating Services affirmed its A- credit rating for Centrica plc, which concluded a period of negative CreditWatch initiated on 19 May 2014. Both agencies affirmed the rating with a negative outlook. The Group remains committed to strengthening its balance sheet and achieving the revised credit metric targets from the rating agencies. The sale of the Ontario home services business was completed in October for $550 million (£300 million), and the disposal processes for our three larger CCGT power plants and our Trinidad and Tobago gas assets are ongoing. In addition, Group capital expenditure is expected to reduce from around £1.35 billion in 2014 to around £1.2 billion in 2015.

At the end of October, Group net debt stood at £5.2 billion. The Group's interest charge is expected to be around £270 million in 2014, while the Group's effective tax rate for the full year is currently expected to fall to around 36%.

The Group has now completed its £420 million share repurchase programme, having purchased 132 million shares in total. In line with our stated policy, we expect to deliver real dividend growth this year.

Following the announcement in May 2014, Chris Weston, Managing Director, International Downstream will leave the business on 30 December 2014. Ian Peters, currently Managing Director, British Gas Residential, will assume the role of Managing Director, British Gas from 1 December 2014, with Badar Khan, President and CEO of Direct Energy, reporting directly to the Group Chief Executive from the same date. As announced in July 2014, Iain Conn will replace Sam Laidlaw, who retires as Group Chief Executive, from 1 January 2015 and transition arrangements are already well underway.

British Gas

With warmer than normal temperatures in the year to date in the UK, compared to colder than normal temperatures in 2013, average residential gas consumption for the first ten months of 2014 was 21% lower than for the same period last year, with average electricity consumption 7% lower. As a result, we expect the average British Gas residential dual fuel bill to be around £100 lower in 2014 than in 2013.

The number of residential energy accounts on supply has fallen by 50,000 since the end of June 2014 and now stands at just over 15.0 million. However, we have returned to account growth in recent weeks following the launch of our competitively priced Sainsbury's Energy tariff in September. We have made good progress on delivering our commitments under the ECO programme and are on track to achieve all our March 2015 targets before the end of the year, having already met our obligation under the HHCRO element of the programme.

In June 2014, Ofgem referred the UK energy market to the Competition and Markets Authority (CMA). We welcome the clarity which the CMA investigation will bring, and are engaging constructively in the process. We continue to believe that there is effective competition in the UK energy market and that it brings significant benefits to consumers. Although levels of trust in energy suppliers are improving, it is important that we continue to focus on delivering high levels of customer service and helping customers understand and control their energy usage.

We believe that smart meters are a critical element of improving the customer's experience and continue to lead the industry in the roll-out of smart meters. We have installed over 1.1 million residential smart meters in the UK, and 440,000 customers now receive our unique

Smart Energy Report. We are currently trialling our smart meter enabled "Free Saturday or Sundays" time of use energy tariffs to around 1,500 customers, while sales of our Hive branded smart thermostat have increased to around 4,000 a week and we are on target to have sold over 150,000 smart thermostats by the end of the year. We are also trialling around 700 "connected boilers", where performance is monitored remotely, and initial results are encouraging, further enhancing the quality of service we are able to offer our customers.

We continued to see improvements in our net promoter score during the third quarter, in both residential energy and residential services. In British Gas Services, we installed around 2,000 more central heating boilers in the first ten months of the year compared to 2013. However, trading conditions have been challenging for our service contract business, and although we have returned to account growth in recent weeks meaning that holdings are flat since the half year, we have experienced a shift in mix towards lower priced offerings. We have now completed the migration of all services accounts onto our new billing and CRM platform, which will enhance our ability to offer a broader range of propositions and an improved experience for our customers. With innovative customer propositions, an enhanced digital platform, more flexible working practices recently agreed with our engineers and the completion of compliance training for frontline staff, we are targeting continued growth over the balance of the year and in 2015.

In British Gas Business, the number of supply points has increased slightly over the second half of the year. We remain on track to achieve £100 million of annual cost savings across the business, which will help offset the impact of our decision last year to end the auto-rollover of contracts at renewal. The cost savings will in part be enabled by the implementation of a new billing system, and all customer accounts have now been migrated onto the new platform.

Direct Energy

In North America, we have made good progress in providing a platform for growth in 2015 and beyond. We remain on track to deliver our $100 million cost reduction programme by the end of the year, while we have now largely completed the integration of the Hess Energy Marketing acquisition and the business has continued to perform well. We have also continued to build on the sales margin increases we saw in the first half of the year, with sold B2B unit margins 35% higher for gas and 51% higher for power in the third quarter of 2014 compared to the second half of 2013. Although the lower margin business written in prior years will continue to impact operating performance in the remainder of 2014, we expect much improved second half profitability in Direct Energy Business compared to the second half of 2013 and we expect to deliver good underlying profit growth in Direct Energy in 2015.

The number of residential energy customer accounts fell by 99,000 in the third quarter of 2014, reflecting the roll-off of aggregation customers and competitive market conditions in the US North East. Against this backdrop we continue to focus on delivering high levels of customer service, increasing our acquisition margins and developing innovative product offerings that are attractive to more valuable customer segments. We have sold over 130,000 bundled energy and protection plan products, and over 25,000 smart thermostats through our partnerships with Nest and Honeywell. We have completed 351 residential solar installations following the acquisition of Astrum Solar in July 2014, 77% more than Astrum installed over the same period in 2013. In Direct Energy Services, we completed the disposal of the Ontario home services business, as we focus on delivering growth in Alberta and the United States. We now have 265,000 protection plan customers across the country, having already exceeded our year-end target of 250,000.

Centrica Energy

We expect total gas and liquids production from our international E&P business to be around 80mmboe in 2014. This is lower than our previous expectation and primarily reflects gas export pipeline constraints affecting the Greater Markham Area in the Netherlands sector. Combined with a lower commodity price environment, this is expected to result in lower 2014 operating profit than previously expected, but with limited impact on post-tax earnings due to the benefit of hedging, small field tax allowances, and strong midstream contract optimisation performance. However, current lower gas and oil prices and the non-recurrence of tax allowances will result in a significant reduction to E&P and midstream gas earnings in 2015, and have the potential to impact on the carrying value of our E&P assets.

We remain on target to incur E&P capital expenditure of around £1 billion in 2014. The large-scale Cygnus and Valemon projects in the North Sea are well advanced and remain on schedule, while we have now produced first gas from an additional well drilled at Grove and a fourth well at York. We expect capital expenditure to reduce to around £900 million in 2015 and potentially further again in 2016, with Valemon due to produce first gas early next year and Cygnus expected to come on stream around the end of 2015. In exploration activity, we made a gas discovery at our Pegasus West prospect in the Southern North Sea and are currently drilling the Ivory well in Norway. We continue to consider options for the sale of our Trinidad and Tobago gas assets. In LNG, Federal Energy Regulatory Commission (FERC) approval for the fifth train at Cheniere's Sabine Pass export facility is anticipated in the first quarter of 2015, and the project remains on course to enable the first commercial delivery through our contract in September 2018.

In UK power generation, our share of nuclear output in the first ten months of the year was 9.6TWh, down 4% compared to the same period in 2013. This reflects the impact of the four reactors at the Heysham 1 and Hartlepool power stations being shut down for a period to allow a detailed programme of boiler inspections to take place, following the discovery of a crack on a boiler spine at Heysham 1. All boiler inspections have now been completed, and no further defects have been found. As a result, three of the reactors are due back shortly, while the reactor affected by the boiler spine crack at Heysham 1 is expected to return to service around the end of the year. All four reactors are expected to run at 75-80% power until modifications are made to the boilers during standard maintenance periods in 2015 and 2016 to allow a return to full power.

In gas-fired generation, generation volumes are slightly higher in the year to date compared to 2013, although low market spark spreads continue to make the operating environment challenging, with the forward market currently showing little sign of recovery in 2015. All six of our operational power stations as well as our mothballed plant at King's Lynn have pre-qualified for the 2018/2019 capacity auction, which will take place in December this year. The disposal process for the three larger CCGTs in the fleet is ongoing. In wind, the sale of the Lincs transmission assets under the OFTO regime was completed in November 2014 and we are continuing to look at options to release further capital from our wind portfolio.

Centrica Storage

In Centrica Storage, the Rough gas storage asset reached its highest ever net reservoir volume in October 2014, reflecting the warmer than normal weather and good asset reliability. Summer/winter gas spreads have also improved slightly over the course of the year, however this will only have a modest impact on 2014 profitability. We continue to make good progress on our £15 million cost reduction programme, in part through continued capital discipline, while keeping a sharp focus on safety.

Centrica is due to release its Preliminary Results for the year ended 31 December 2014 on 19 February 2015.

Enquiries

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An interview with Jeff Bell, Chief Financial Officer, is available at www.centrica.com