Centrica 2011 Interim Results

Presentation Transcript – 28 July 2011

Sir Roger Carr - Chairman

Well good morning ladies and gentlemen and welcome to our Results Presentation. Centrica performed well in the first half, demonstrating the value of the vertically integrated international business model and the calibre of the management team.

Importantly this performance was achieved in the face of economic headwinds and climatic conditions that were very different from the previous year. The challenges facing the company were those that were general to many businesses in the developed economies and some that were specific to the UK energy industry in particular.

Pressure on consumer spending in a period of modest economic recovery constrained the pace of growth in central heating installations and other parts of our service business. Equally the tax imposed on North Sea Gas undermined forward post tax earnings and our capital investment plans. We have continued to contest both the fairness and wisdom of this tax. However the Government has shown little appetite for amending a policy decision which has both undermined economic growth and UK energy security of supply.

It is also a little regrettable that while the sharp increase in wholesale gas price necessitated an increase in our retail prices, the position has been exacerbated by the increase in upstream tax. We haven't given up, but are no longer optimistic in our thinking of a favourable outcome.

Within the company, management continued to address the cost base in order to mitigate the impact of escalating wholesale gas prices in the UK and preserve both margin and our competitive edge. These actions facilitated growth in customer numbers in British Gas in the first six months, but they couldn't offset the need to recover major commodity cost movement through the price increase that we announced in July.

The upstream business produced encouraging returns as did our partnership in the UK nuclear sector and our growing activities in North America.

The Board were pleased with the achievements of the North American business, increasing its market penetration and accelerating growth in the United States. And in the light of these developments and the simultaneous dilution of post tax returns that can be relied upon from UK upstream investments, the management team have been encouraged to look for further expansion opportunities in the North American markets.

I would emphasise however, that the financial and managerial disciplines applied to all investment that we make, whether at home or abroad, will continue to be rigorously enforced by the Board.

In the current climate, our strong balance sheet gives us the ability to take advantage of any opportunities as they arise. Accordingly I would confirm that it is our intention

to maintain this financial flexibility and reward shareholders with a progressive dividend policy and profitable expansion of our successful business model.

Looking forward, the fragility of the UK recovery, the political turbulence in oil producing countries and the aftermath of the nuclear disaster in Japan will continue to bring both uncertainty and challenge to all energy companies. In these circumstances, I can assure you that the Centrica management team under Sam Laidlaw's leadership will be alert to the issues, innovative in their planning and determined in their actions to ensure the business is correctly balanced in cost, asset base and business mix to meet the conditions that prevail.

I will now hand over to Nick to take you through the first half numbers in more detail. Nick.

Nick Luff - Group Finance Director

Thank you Roger. Morning everybody. As usual let me start with some commodity price context. As you all know 2011 has been a turbulent period for energy prices. The unrest in the Middle East and North Africa of course has pushed up oil prices. And we have seen a significant increase in global demand for gas driven by the nuclear outages in Japan and economic growth elsewhere in Asia.

Prices here in the UK, where we are increasingly dependent on imports, particularly LNG, have risen in response. And month ahead NBP prices averaged 58 pence per therm in the first six months of the year, up over 70% against the same period last year.

Power prices have tracked gas prices upwards as you would expect and with the UK system well supplied, spark spreads have remained depressed. Dark spreads have recovered somewhat albeit not to the levels we saw 2-3 years ago.

Meanwhile the disconnect of the North American market has been confirmed with plentiful domestic gas supply there, meaning there has been very little impact from the rising prices elsewhere in the world. And also in the US, reserve margins remain healthy in most areas and spark spreads remain low there too.

That commodity price environment, coupled with much warmer weather in the UK, has made for difficult trading conditions for Centrica, certainly challenging against the very strong and favourable conditions we had this time last year. Nevertheless the Group posted a good set of results as you can see here.

I will take you through the highlights. Revenue down slightly to £11.5 billion, with reduced consumption in the UK downsteam, only partly offset by higher tariffs. Operating profit came in at £1.26 billion with a significant shift away from the downstream to the upstream. I will give you a breakdown of that in a second. And that shift in mix of profits to the even more highly taxed upstream of course, has meant that our tax rate went up quite significantly to 43% and that left us with earnings of £673 million which translates to 13 pence per share.

As usual our half year dividend is purely formulaic being 30% of last year's full year, which works out at the 4.29 pence per share you see there. For the full year our policy remains unchanged, to increase the dividend by at least RPI, taking account of performance in any given period.

So here is the divisional breakdown of the results and you can see the mixed performance with downstream UK and storage behind last year, but upstream UK and North America ahead.

Going through each business unit in turn and starting with Downstream UK, British Gas. Here profits came in at £518 million. As we expected, the profitability of the residential energy supply business halved compared to the very strong result last year when we had the very odd combination of high consumption, due to the cold weather, coupled with very low wholesale prices. In contrast this year of course we have had much more normal temperatures, apart from April actually which was unseasonably warm, and higher wholesale prices. The higher retail prices following the price rise we put through in December did help to some extent, but margins fell back to 6.5%, more in line with our normal expectations.

We have of course put through a further price rise which we are implementing next month and that will offset the increase in wholesale prices we are seeing and we do expect a better balance between the two halves in residential energy this year.

Residential services as Roger mentioned, faced a tough environment with competitor activity and low consumer confidence. However we did continue to grow our services activities with revenue up 8%. Profits were also slightly ahead, held back to some extent by those market conditions and also by a backlog of annual service visits following the very cold winter last year. The warm weather this year has impacted business energy supply, albeit to a lesser extent than residential. But you can see the profits are down there. The economic climate is having an impact on both volumes and margins in that business.

Turning to the upstream, here profits came in at over half a billion beating what was in fact a very strong performance in the first half of last year. So a very good result overall.

With the ending of the major loss making I&C contracts, we are now reporting the upstream UK segment in two simple parts, as you can see, gas and power. Midstream and trading activities, we split between the two and allocated appropriately.

So starting with the top right, you can see gas production was down as expected with the Morecambe decline, not entirely offset by the increase in production from other fields. Oil production on the other hand, which of course is increasingly valuable in this price environment, was up, in part due to the increased interest we have in Statfjord which we bought more of last year.

You can see from the bottom left chart the benefit we had from the higher wholesale prices coming through, our realised gas price up 27%, our realised oil price up 37%. Hedging did mean those realised prices are still below today's levels, so we will see further benefit from those high prices coming through into the results into the rest of this year and the next, which will offset the rise of unit costs that we are seeing as the production shifts away from low cost Morecambe.

In power we have two quite distinct stories. Nuclear performance was excellent. Output there up over 25%, one of the best performances from the British Energy fleet for some several years. And of course that output was more valuable, albeit again, hedging does delay the full benefit.

In contrast, the CCGTs were struggling. We did manage to hold up the realised spark spreads as you can see, due to hedging and peak running, but with low market spreads we ran the fleet much less and as a result were only just able to cover our fixed costs. And as a result the power segment as a whole, despite that strong nuclear result was slightly down.

Turning to storage, here operationally Rough performed well. In fact the reservoir is today at the record level for the time of year in terms of volume in the reservoir. However spreads of course have been weak and we knew 2010/11 spreads, which locked in some time ago, were weak but 2011/12 spreads have been even lower and that would impact partly this result and also into the second half as well.

North America in contrast, did a very strong half year, profits up 25% to £174 million. Within that, residential energy was slightly down. We didn't have quite such favourable conditions as we had in the first half of 2010 when we had falling commodity prices. Nevertheless customer growth was strong in the US North East in particular and Texas operationally performed very well, albeit we were hit there by the cold weather in February when power prices spiked to $3,000 per megawatt hour. The ECPA in Ontario is beginning to impact customer numbers there, albeit the financial impact we won't see until the second half and into 2012.

Business energy supply continued to grow strongly. Power sales were up 21% and scale benefits meant we were able to widen margins further so profits were up even more, up 30% to £58 million.

Services were slightly up but the second half is much more important for that business, given its seasonality.

Turning to the upstream. Gas production was up and the profit contribution from gas production was also much higher despite the low gas price, and that was due to the Wildcat Hills acquisition which boosted production and reduced our unit operating costs quite significantly. The three Texas CCGTs on the other hand struggled and continued to make losses due to the low spark spreads, although they did benefit from that February price that hit the downstream. We do expect a similar pattern in the second half in North America, with Ontario beginning to hold back residential but the other three business units performing strongly.

Turning to the cashflow. The Group continues to convert profit to cash well. EBITDA was down as you would expect, given the reduction in operating profit. And we also had a working capital outflow as is normal in the first half. However with rising commodity prices, we had a margin cash inflow. The payments for interest and tax did go up because of the higher contribution from the more highly taxed upstream. Capex was £500 million and I will give you a breakdown of that in a second. And after the final dividend for 2010 which we paid in the first half, net debt was largely unchanged at £3.3 billion.

Here is the breakdown of Capex. As you can see upstream gas remains the most significant area of investment. In the first half the main components within that were the new developments at Ensign and York. It was lower than the first half of 2010 upstream gas, but we expect that to reverse in the second half as we step up those developments at Ensign and York. We also continue to spend on Lincs, the wind farm which is in the UK power segment there and that also will see higher spend in the second half.

Coming down to the bottom, acquisitions in the first half included the Gateway acquisition, the energy supply business in the US, Wildcat Hills, the Albertan gas business and PH Jones in the UK. Those together total over £100 million. They were offset though by the sale of Oxxio, which completed in June, leaving you with a net £26 million that you see there. We have reduced spend in the more highly taxed UK North Sea and a decision to slow down the spending on nuclear new build ahead of the final investment decision. We have trimmed our full year forecast for Capex to £1.3 billion.

We do have one large exceptional item in the first half. The increase in supplementary corporation tax on the upstream activities meant that we had to revalue the provision we have for deferred tax on the assets concerned, from 50% to 62%. That has resulted in the charge of £204 million, which we have taken as an exceptional item in the first half. We do expect another £60 million one-off charge in 2012 once the new legislation is in place, which will restrict the decommissioning relief to 50%. The other exceptional item in the first half, as you can see, came from the sale of Oxxio.

So in summary then, a good performance for the Group as a whole in tough trading conditions, albeit down on last year, and good operating performance right across the Group with upstream production and nuclear output being particular highlights. And good profit growth in North America. For the full year we continue to expect growth against 2010, albeit the higher tax on the upstream does mean that our expectations for growth are reduced compared to what they were at the time of the full year results back in February. The economic environment is challenging for some of our businesses, particularly services and B2B in the UK, but the higher commodity prices will benefit us upstream.

With that I will hand you over to Sam.

Chief Executive's Review
Sam Laidlaw - Chief Executive

Thank you very much Nick and good morning everyone. As Nick mentioned, the first half of 2011 has been a dramatic period for global energy markets, with of course significant consequences for UK wholesale prices.

By contrast in North America, gas and power prices have remained low as a result of the shale oil and shale gas phenomenon. Self sufficiency has disconnected North American markets from other worldwide energy markets. We are also operating in a challenging economic environment with falling disposable income and weak consumer confidence. And against this backdrop, the UK energy system is entering a period of transformational change to ensure that the country has the secure low carbon energy to meet the requirements of the next generation.

Affordability is clearly an area of close focus for all our stakeholders - politicians, regulators, consumers and businesses. But security of supply remains vital and there is much to be resolved to give investors confidence that the UK fiscal and regulatory environments will provide an attractive and stable basis for investment.

In parallel to the necessary reform of the electricity generation market, Ofgem has proposed certain changes to retail markets. While we agree with the need for greater transparency, choice and simplicity for customers, there is a risk that the current proposals may have unintended consequences. We therefore continue to engage with Ofgem to ensure the optimal design of any changes to the future market rules.

Turning now to our performance in the year to date, we continue to make good operational progress both upstream and downstream. And I think this demonstrates the resilience of our business model in rapidly changing commodity price environments. We have made further significant improvements in our health and safety record right across the Group with particularly good improvements in British Gas. And in residential energy we have seen strong customer account growth in the first half, underlining both our competitive pricing and our high level of customer service.

In our UK upstream business we delivered strong operational performance, notably with a 25% increase in nuclear output, and we are making good progress on our investment pipeline of new projects in offshore wind and in gas development.

And in North America, we continue to develop to deliver growth, building on our platform in key competitive markets.

So in summary, despite challenging market conditions, we have made considerable operational progress and remain on track to deliver earnings growth for the full year.

Turning to British Gas in more detail. In residential energy we added almost 160,000 customer accounts in the first six months of the year and we now serve over 16 million accounts for the first time in over five years. We continue to raise the standards of our customer service and recorded a further improvement in our net promoter score. And we have seen significant increase in the number of online transactions, which have doubled to over 10 million in the first half of the year alone. And this is an important trend, not only in terms of being a cost effective channel, but also because it provides more opportunities for customer engagement.

We now have made over 100,000 sales through our Sainsbury's Energy Affinity Programme, a good example of how we can acquire high value customers through attractive competitive offerings.

We are also very pleased with the successful launch of the Nectar Loyalty Programme, with over three million customers registered to date. This is helping to shape customers behaviour and to reduce our costs by encouraging customers to submit meter reads on line and to pay by direct debit with the reward of additional loyalty points.

Earlier this month we announced price increases for residential gas and electricity necessitated by the sharp increase in worldwide gas prices. We recognise the impact that this will have on our customers and continue to offer a number of ways to help them offset the rise through improved energy efficiency. We also continue to provide extra help for our most vulnerable customers through our Essentials Programme, which over the last year amounted to a discount of some £180 to those households most in need of help.

In residential services, again we have made good operational progress, benefiting from the agreement with our engineers to offer a much improved within day service. This really differentiates British Gas in this competitive market. And we have now also transferred over 85% of customer accounts onto an insurance based product, allowing us to offer a more flexible range of products.

As a result of the weak economic environment, services customer numbers declined slightly at the start of the year, but grew progressively through the second quarter

recovering the lost ground. The number of central heating installations was broadly flat with some customers deferring the decision to replace their boilers. However our services business remains well placed for further growth, albeit at a slower rate than previously expected.

In British Gas Business we continue to make progress, focusing on high levels of service tailored to the requirements of each segment of the customer base under our volume to value strategy. This led to a slight decline in the number of customer supply points in the first half. Although the economic and competitive environment is putting pressure on margins and renewables, we continue to expect profit growth this financial year for British Gas Business. And over time we expect business services to play an increasingly important role following the Connaught Services Division acquisition in 2010 generating an additional source of growth.

New markets also provide us with additional growth opportunities and importantly will help us to deepen our customer relationships. As such we have gone early on the Government's flagship Energy Efficiency Policy, the 'Green Deal'. Our Home Energy Plan is now enabling customers to install efficient new boilers, insulation and solar panels, all at no upfront cost. Our own in-house insulation team has now completed over 100,000 installations, just 15 months after recruiting its first employee. We are now the largest installer of solar PV panels in the UK and we are leading the installation and rollout of smart meters, having installed over 350,000 to date.

Another growth area is the provision of energy services to the social housing sector. Building on our agreement with Mears last year, we acquired PH Jones in April, enabling us to achieve a step change in our capability in this important sector.

We have also launched our electric car charging proposition and we are now the preferred supplier and installer of charging points for both Nissan and Renault and as a result expect to have a significant share of this rapidly growing market by 2012.

Turning now to our upstream activities. We achieved strong operational performance both in gas and oil production and in power generation. Overall production volumes in the first half were around 10% lower than in the same period last year and that really reflected Morecambe's running patterns. However production levels from our other fields were significantly higher with F3-FA and Babbage coming onstream and strong production from our existing assets, particularly Statfjord, Grove and Chiswick.

For the full year, despite the Morecambe shutdown, we expect total production volumes to be around 50 million barrels of oil equivalent, subject to the running patterns for the remainder of the year.

We have also moved forward a number of new gas field developments. In February we announced the decision to develop the York and Ensign fields at a cost of £450 million, which between them are expected to bring over 30 million barrels of reserves into production. In March we took the decision to develop the Rhyl gas field in the Irish Sea. And we expect to achieve first gas this year from Ensign and in 2012 from York and Rhyl.

Our drilling programme has also continued to be successful. All five of the production wells drilled so far are contributing to our production. And in exploration the discovery at Pegasus warrants further appraisal. And in May we took the delivery of the first LNG cargo under our contract with Qatargas, marking an important step in our relationship with the world's largest LNG supplier.

In power generation the reliability of the nuclear fleet was much improved. The output from our windfarms was also much better with more favourable wind conditions, particularly in the second quarter. However the low spark spread environment meant that we took the decision to move four of our older CCGTs into short-term preservation mode. This has reduced our operating costs whilst enabling us to return the units to service within a few days if commercially viable.

Turning to our investment projects, we are making good progress on the Lincs windfarm development. The onshore substation is largely complete and the first foundations are in place, and we expect to generate first power from Lincs at the end of next year.

As we look to the future, it is now widely recognised that this is a pivotal time for energy policy in the UK. Following the publication of the White Paper earlier this month, we will continue to engage closely with the Government on Electricity Market Reform, to ensure that the overall framework translates into stable and attractive investment opportunities. However there remains much to be done and to be resolved and we will only invest when it is in the best interests of our shareholders to do so with an appropriate balance between risk and rewards.

In the case of new nuclear build, following the events in Japan, it is clear that the programme will be delivered later than originally hoped and we expect to have clarity on the revised timetable towards the end of the year. New nuclear is an important option for us, but we will only invest if we were satisfied that the returns represent good value for our shareholders set against the commercial risks.

In North America, we have been able to deliver growth in the first half results against the backdrop of continued low gas price environment and less favourable residential market conditions than we had last year. This reflects both the positive impact of our investments in Wildcat Hills, Clockwork and Gateway and also the organic progress we have made, particularly in Texas. As we said at our Investor Day last month, North America presents an attractive growth opportunity for Centrica outside the UK, leveraging our core expertise.

In Direct Energy Residential, our operational performance has been strong with the Texas transformation programme in particular delivering real results. We have also successfully launched out pre-paid offering helping more customers to take control of their energy requirements. Overall we have added over 100,000 customer accounts in North America since the beginning of the year. In the US North East, we continue to enter new markets as they open up to competition. And following the Gateway acquisition, we now have 800,000 residential accounts in the North East region.

Market conditions in Ontario are more challenging, due to the introduction of new consumer legislation which makes retention and acquisition significantly more difficult. As a result, in common with other competitive retailers, we are seeing customers revert to the utility. However we are continuing to work with the Regulator and taking positive action to reduce our cost base.

Direct Energy Business continues to make good progress with electricity volumes up by over 20%. And in an increasingly competitive market we continue to focus closely on operational efficiencies and customer service for each segment of our customer base. And in Direct Energy Services, the integration of Clockwork is largely complete and we expect to see a more significant contribution from the services business in the second half of the year. Clockwork gives us a robust platform for growth through its established franchise model.

Upstream in North America the business continues to face a weak commodity price environment. Despite this, we have been able to create value with the Wildcat Hills acquisition delivering higher production and reducing the overall cost profile in our portfolio.

So in summary, we have made good operational progress in the first half of the year, demonstrating the resilience and flexibility of Centrica's business model in an environment of sharply rising wholesale gas prices and falling consumer confidence and disposable income. However given the challenging market environment and the headwinds this creates, close management focus on costs is required to ensure that we retain our competitive position.

We continue to have an attractive range of investment options across the Group, although in the UK greater clarity is required so that investors can have confidence in the fiscal and regulatory framework. It remains our priority to put capital to work with a clear focus on risked returns, to create value for shareholders.

Thank you and with that we will open it up to questions.

Sir Roger Carr

Very good, thank you Sam. We have got the whole team here as usual. So on the front row we have got Phil, Mark, Chris and Grant, who can pick up some of the detailed questions but obviously Sam and Nick will lead. So who would like to ask the first question? If you could press the button and just say who you are and where you are from for the benefit of the team.

Questions and Answers

Q1. Martin Brough, Deutsche Bank

Martin Brough from Deutsche Bank. Just a quick question on the 'Green Deal' Particularly around any visibility you may or may not have on the financing of it at this point. I understand that the Green Investment Bank does not see itself has having a role in funding stuff downstream. I had heard some discussion of having some centralised agency to manage the creation of the loan book rather than having it appear on retailers' balance sheets. Do you have any visibility on that yet or timetable for that?

Answer: Sam Laidlaw

Let me make a few introductory remarks and then I will hand over to Phil on it. I mean, in our £30 million pilot project going early, we actually have Barclays providing the financing for that and that is up and running. My understanding in recent discussions around the future of the Green Investment Bank (GIB) is actually they will be looking at downstream activities including the 'Green Deal'. But Phil you might want to talk a little bit more on that?

Answer: Phil Bentley – Managing Director, British Gas

Yeah. It is critical that there is the financing provided by the capital markets and obviously this is a new asset class, because you are lending to a property without a record of repayments. But as you know, they have attached the repayments to the bill, so it should have the same recovery performance as an energy bill. We have had a lot of conversations with DECC and with Number 10 as well about the importance of getting the funding up and running, because clearly none of the energy companies have the balance sheet to finance this. And I think they are certainly

open to the idea that maybe the GIB will provide a role at the start point of warehousing loans before we can put them out into the market, because I think we need to be able to fund in size, and someone needs to be able to hold them in a holding pen if you like before putting it out to the market, and creating the asset class. So you know, I think we all recognise that it is absolutely critical to getting the 'Green Deal' off the blocks and I think Government are minded to get it right. So we remain optimistic that it will still happen and the start date officially is the end of 2012.

Q2. Mark Freshney, Credit Suisse
Hi, it's Mark Freshney from Credit Suisse. You seem to have a lot of caution surrounding the state of the UK economy, like many companies. But practically in terms of the data points - bad debts, debtor days, customer churn and so forth, physically what are you seeing there?

And in terms of your 2012 overall target for the British Gas, i.e. downstream UK, does it stand at I think it is £1.2 billion?

Answer: Sam Laidlaw
Let me speak to the first one which is around what practical evidence we are seeing in terms of consumer sentiment and the economy. Actually if you look at our bad debt performance, I am pleased to say that it is broadly flat year-on-year. That is in part because, and that is both in our residential customer base and also in BG - our SME and business customer base. And that is, in part, because 50% of our customers are now direct debit, but we also have about a little over 10% who are on pre-payment meters. And I think our systems have improved a lot, but I think underlying we can get some comfort from the fact that it is flat year-on-year. In BGB, actually the quality and the volume to value strategy and the quality of our credit vetting has also improved significantly. So that is not necessarily reflective of the underlying overall economy. We are probably doing a bit better than the underlying economy there.

Further answer: Nick Luff
You can see it in the volumes of BGB if you look at the volumes per customer. There is a lot going with weather and volume to value, but you can see it with volumes per customer and you can see it in the forward order book as well for installations for example and services.

Further Question: Mark Freshney
And on the targets for British Gas as a whole in 2012?

Answer: Sam Laidlaw
Well 2012 is still some way away as you know, this is a business that is still subject to big shifts in weather and big shifts in commodity prices. So I think it would be inappropriate to comment on 2012.

Q3. Lakis Athanasiou, Evolution Securities
Lakis Athanasiou, Evolution Securities. Two questions if I may, one in North America. You mentioned your ambitions for expansion there. And I think something was touched on in the North American Day, but I would like to ask the question again. Do you see increased power generation capacity in Texas or elsewhere as a strategic necessity for North American downstream expansion, even in the current market conditions or when reserve margins tighten? i.e. can you live without it if you had to?

And a second question for the other side of the pond. Could you give some colour on the pressures you are seeing in British Gas Services across the three different segments in terms of, I mean, are the pressures coming through margin pressure or is it volume? Where are you seeing the main competition coming in? You mention an increase in competition pressures?

Answer: Sam Laidlaw
Both good questions Lakis, let me take the first one which is around the strategic need for power generation and perhaps Phil if you could pick up on a little bit more granularity on the services business.

In terms of power generation in North America, clearly with a world that is well supplied with gas and where reserve margins are currently in most markets pretty ample, there is less of an absolute strategic need but we still have periods, and we have seen them in Texas and we have seen them in the North East markets, where you have big intraday volatility and managing that shape gives us, or would give us, a source of competitive advantage. And we are now also competing against a number of big retailers who are going for the integrated model and therefore there is no doubt in my mind that having integration in power in North America is an advantage. Is it an absolute must do at any price? No. And therefore we have been very focused on value. We have looked at a considerable number of power opportunities and actually haven't made the numbers work. Now at some point, whether it is through capacity margins or whether it is through an improvement in the underlying spark spreads, that will change, but at the moment we are being patient. But it is something we would like to do, but it is not something we have to do is the answer.

Further Answer: Phil Bentley
I think on services, obviously it is a discretionary purchase, it is not like energy and therefore household budgets are pretty tight and I think what we are seeing is probably an uptick of cancellations and we are having to work hard therefore to look at new channels for bringing in new customers. The pressures I would say are around certainly around our cost base, because as Sam mentioned we had to, we chose to catch up on a backlog of annual service visits. This is after the winter where we hadn't got out to the, sort of, renewal date quickly enough and therefore we caught up some 400,000 jobs. Now that is at a significant cost to us that isn't generating immediate revenue. I don't think we will see the same effect in the second half of the year.

The second point though to make is we are still up and growing in turnover terms, but I suppose we would have liked to have probably pushed price up a little bit more. We now do risk assessed, risk based pricing around the likelihood of more callouts, but I think the competitive pressure is stopping us from lifting pricing a little more aggressively than we would have hoped. I think they are the two points that I would make.

Further question: Lakis Athanasiou
Is there a segmental differentiation on the competitive pressures between installations and services?

Answer: Phil Bentley
I think, the one point that was picked on is within central heating installation, we have actually, you know, year-on-year, we have held volume when we had, last year,,,, we had the Government boiler scrappage incentive. So in that regard we have held volume but in a falling market and we are seeing a huge number of customers choosing not to replace systems because they simply can't afford it. Equally more

customers now, I think it is about a third, are actually using financing for their purchase which we haven't seen as a phenomenon before. So I think that would be one part where you absolutely have seen the economy restricting growth.

Q4. Nick Hyslop, RBC
Nick Hyslop from RBC. You have given us 50 million barrels of oil equivalent as guidance for this year. I wondered whether the update you have given us on the drilling programme and Ensign and York and Rhyl, whether that is changing your sort of outlook as we look forward maybe 2,3,4 years out on production? If you could give us an update on whether that curve stays roughly at 50 or moves up or down?

Answer: Sam Laidlaw
The short answer Nick, is that actually it stays broadly the same at the 50 million barrel level. In any one year of course it depends much on the running patterns of Morecambe, but we are designing the programme if you like to deliver good value and good returns at reasonably steady stake levels of production, rather than trying to drive production growth and risk over investing.

Q5. Edmund Reid, JP Morgan
Edmund Reid from JP Morgan. Two questions. Firstly on gross churn. Clearly lots of moving parts at the moment. You have got rising prices, but also some of your competitors are closing down their direct sales business. What are you seeing in terms of gross churn in the residential business?

And then secondly, a question for Sam. I think you have talked about the issue of affordability of the Government's targets, I was just wondering if you could go into a bit more detail with regard to what you would like to see in terms of fuel mix and energy mix going forward?

Answer: Sam Laidlaw
I will start on churn. I mean we saw last year churn come down a little bit. Every time we have a price move, and obviously we are in the middle of price moves at the moment, you know churn ticks up. But Phil, I don't know whether there is any granularity you want to add to that?

Answer: Phil Bentley
No I think the main point is, versus the industry churn we are significantly lower, probably about 5-6 percentage points lower than industry churn. And things like Nectar, we are already seeing a lower churn in Nectar customers than our core base, so that is a real positive. I think it is too early to call what is happening if you like on the street yet because there is a delay in industry transfers of what we call notifications which are around a 28 day delay. So we have seen an impact of slightly lower sales obviously when we put up prices, but as you said Ed, we were probably losing a lot on the doorstep to companies like Scottish and Southern and that channel for them has now closed because they haven't invested in the technology, the hand held terminals, that ensure that customers get the right price quoted to them on the doorstep, which is something we pride ourselves on doing.

Further answer: Sam Laidlaw
And I think your second question Ed was around what do we think is the optimal fuel mix to both meet our climate change objectives and also deliver this in the most affordable way? And I think really the big debate is for the period beyond 2020, you know, at the end of the day we feel that the optimal fuel mix is clearly a combination of wind and renewables, nuclear and gas. We would actually see some advantage in the period beyond 2020 in having more gas and probably less wind, but we need to

have the nuclear at least to replace the existing nuclear fleet which is obviously coming off and we think that has probably got a bigger role to play too. It will depend of course in terms of affordability, that will all depend on where the price is set through the contract for differences too. And I think in the next, hopefully in the next few months, we will start to get more visibility on where these price levels are going to be, which will actually inform us on what the best choice is from an investor perspective. And what the best choice is for the UK from a consumer perspective.

Further question: Edmund Reid
Can I ask a follow up? I think in the renewables road map, the Government talks about levelised costs for offshore wind potentially reducing from sort of £117 per megawatt hour to around £100 per megawatt hour by 2020. Is that something you think is possible?

Answer: Sam Laidlaw
I think at the moment it is aspirational. You know I will let Mark speak to that because we are clearly doing a lot of work with turbine manufacturers and the whole of the supply chain to see what we can do, but you know that is a sizeable step reduction in costs and Mark you might want to….?

Further answer: Mark Hanafin – Managing Director, Centrica Energy
So I think there are two opposing forces here. One is we are going into deeper water, obviously Round Three is much deeper water than Round Two. That is pushing costs up. And then you are trying to get new technology, new ideas into the supply chain about how you can drive costs down, so those are two opposing forces. I think the £100 per megawatt hour is not based on any sort of science, it is an aspirational number that the Government have said, if it was that level we could build more. So it is a heck of a challenge and it will take a number of years to figure out whether Round Three costs can come down significantly or whether the deeper water and the bigger challenges will keep them at the same sort of level.

Q6. Bobby Chada, Morgan Stanley
Thank you, it's Bobby Chada from Morgan Stanley. Two questions. One is on Capex. You talked about moderating this year's capex budget down to £1.3bn. And you have set out lots of investment opportunities, but many of those appear to be getting pushed further back. So where do you expect capex to be for the next couple of years and how much of that is committed?

And then the second question. You talked about community initiatives of £100 million. Is that an order book of £100 million and how quickly did you build it up?

Answer: Sam Laidlaw
Well firstly on capex, as Nick mentioned in his presentation really, the two big moves this year are about £100 million less in the North Sea, largely driven by tax changes in the UK North Sea. And then also some slippage in new nuclear. If you look at the forward expectation, the £1.5 billion still remains a reasonable number, given, and that assumes of course that we get the ROC regime and we get wind projects moving forward and so forth. So I think that is still a good number going forward.

Further answer: Nick Luff
Do you want to tell us how much is committed next year? About half of that is committed. The main items being Lincs and the in-flight upstream projects. If you get beyond 2012 there is not much committed.

Further answer: Sam Laidlaw
So then your second question was around the £100 million and that is an order book. A big piece of that is a large contract we had with the Welsh Assembly. But actually if you look at our community business, it is actually growing at a very rapid rate. Phil, I don't know if you want to talk about the order book overall?

Further answer: Phil Bentley
Yeah it is probably larger than that now. As Sam said, we won the Welsh Assembly Government. We already have the Scottish programme. We have won a number of quite large community housing schemes now in the last couple of years. So you know, I think in what we call our new markets, if you include new markets being solar and all the communities, I mean the first half turnover was about £100 million. So that is new business that we didn't have a year or two ago. So that is rapidly rising. I think we can get to a forward order book £200 million - £250 million quite quickly this year. And then of course the trick is converting the top line into bottom line because as you know the margins are a lot thinner to be competitive in that sector. And that is why acquisitions like PH Jones, who are a supplier of labour to these local authorities, are absolutely critical because we can see how we can manage our costs the way that they do to compete.

Q7. Jamie Tunnicliffe, Redburn Partners
Jamie Tunnicliffe from Redburn Partners. Just wanted to follow up on EMR and affordability. Could you maybe lay out where you think there is the most to go for from a Centrica perspective on what is still up for grabs on EMR?

And then just whether you agree with affordability analysis within the White Paper about the impact on customer bills, whether EMR and under the 'business as usual' comparison?

Answer: Sam Laidlaw
Well I think we would make the important general point that actually directionally we think the EMR is absolutely right. It also is helpful to our business whether it is a contract for differences for nuclear which provided it is set at the right level and provided it has the right counterparty and right tenure, is clearly going to enable new nuclear to proceed and us to make an investment in it. Or whether it is capacity payments, provided they are broadly auctioned and not restricted to one part of the generation fleet. We think that that is very sensible as well. And of course we have also had the carbon price floor, not part of the EMR, but I think a welcome development for our business. So I think directionally and we will have new ROC banding due to be announced probably in the next couple of months which helps renewables in the short term. So I think our business is well positioned to take advantage of all the things that the EMR is seeking to promote. The second part of your question Jamie was I think around affordability?

Further question: Jamie Tunnicliffe
In the EMR White Paper there is a comment on affordability and customer bills?

Answer: Sam Laidlaw
Exactly. And that all depends on two big variables really. One is what your gas price assumptions are going forwards and also what your assumption around energy efficiency that can be achieved in the home is. And the Government have argued that actually, you know. oil and gas prices are going to go up and therefore the cost of low carbon technology is less than people think because the alternative is going to be more expensive. That in my view doesn't actually address the question of affordability because it is relative, but actually in absolute sense the customer is still

going to be paying more whether it is as a consequence of the wholesale price or whether it is a consequence of the low carbon supplement.

And on energy efficiency, you know we are doing probably more than anybody else to promote energy efficiency and you heard about the 100,000 insulation jobs we have done. And we are giving those away for free in some cases, but we are still having difficulty as are other suppliers in getting the energy efficiency levels that I think the Government would like to see. And therefore I think we may be being over optimistic about what can be achieved in energy efficiency and that is something that obviously we are talking to Government about.

Q8. Iain Turner, Royal Bank of Scotland

Iain Turner from the Royal Bank of Scotland. Can I just ask how much you have spent so far on the nuclear new build activity? Presumably that is on the balance sheet rather than expensed? And what you are committed to going forward? And just in terms of stations, whether you have actually signed up for any of them yet or when you would expect to?

Answer: Sam Laidlaw

You know the short answer is we have spent just over £100 million. We have, you know, and expectation that to get to FID it will, and we don't have a commitment to spend any more than, the £200 million in total, we have an option at that point whether or not to continue to invest. And you are correct, that is on the balance sheet. So I think when we get to that point in time and there are a number of things that need to come together here, obviously there is planning. We welcome the national policy statements. There is a local planning hearing going on in West Somerset today. We will see what the outcome of that is, which would be the first step in enabling site works to proceed. There is all the EMR framework has to be put in place. Now the expectation is that that is not going to be on the statute book before 2014 and therefore there will also have to be some form of transitional arrangements if we were to sanction anything before 2014 that were truly robust and gave us confidence that we had the necessary contract for differences over a long period of time. And we have to have the right counterparty.

And then of course, you know very importantly, we are going to have to incorporate all the results of Mike Weightman's final report in terms of design and be satisfied that the supply chain can deliver, the project management is robust, and there are adequate contingencies in this. So there are a lot of questions yet to answer but we are capped at that level of expenditure.

Q9. Andrew Mead, Goldman Sachs

It's Andrew Mead at Goldman Sachs. You mentioned in the opening remarks and in your conclusion on cost reduction - is there any further detail you can provide at this stage as to what you are looking to achieve or what areas you are looking at?

Answer: Sam Laidlaw

Andrew, we are not providing specific detail at this stage. I am sure that by the time we get to the end of the year we will provide more detail. But you know, it is in the nature of this business, and if you look at what we have done over the last few years, in taking £300 million of costs out. If we want to provide a really competitive offering to our customers we need to continue to take costs out. We are doing a lot with technology. Whether it is driving more customers online, and you heard that for the first time ever we have more online transactions now than we had through our call

centres. And we have a big investment going on to actually connect our services call centres platforms with our energy platforms, so that actually again we can reduce costs. But also offer our customers, I think, a much better service, where they have one number to call and they will have one agent who can deal with their entire account which isn't the case at the moment. And also in North America we have got a lot of platform and systems integration going on as well. Then there is a big piece around supply chain which we are also working on and whether that is in some of our long-term capital programmes like wind that we talked about or whether it is in some of our offshore gas and North American operations.

Further answer: Sir Roger Carr
I think the point of that is to make the point that market conditions may be challenging, but the management as ever are not asleep at the wheel. And they are looking at it very positively to make sure the business remains healthy and strong and growing.

Q10. Lakis Athanasiou, Evolution
Lakis Athanasiou from Evolution. Just a quick question on nuclear. Is it too early to draw any conclusions from what can come out of Weightman in terms of the probability of impacting on lifetime extensions, or is it just we have to wait and see what comes out?

Answer: Mark Hanafin
I think the answer is yes it is too early. The initial comments from the Office for Nuclear Regulation were measured, they were balanced, they didn't point to any great concerns with this existing EGR fleet. I think the big question is in terms of new nuclear, will it require small changes in design or will it require bigger changes if it is bigger, then clearly that is quite impactful. So we really don't have an idea at this point. It is due in the fourth quarter and we can take stock at that point.

Q11. Iain Turner, RBS
Could I ask one more question please, it is Iain Turner at RBS. This relates to the changes in the upstream taxation in the UK. And that has clearly had an impact on your investment programme going forward. But has it had an impact on your appetite for acquisitions of fields? Is it just a question of changing the price, because the cashflow valuation is different or does it actually make you question whether you want to make further acquisitions in the UK North Sea because of the tax really?

Answer: Sam Laidlaw
It clearly has an impact on valuations of prospective acquisitions and you will have actually seen that a number of assets that are on the market have sort of failed to trade at the moment. And we continuously look at all of them.

In the sense that it has increased an element of sovereign risk in our cost of capital, it makes us more cautious, but it doesn't mean that we wouldn't continue to invest if the price was attractive enough.

Closing Comments: Sir Roger Carr

Okay I think we have exhausted you. So thank you all very much for coming and for those who are getting a break, have a good summer. And for those that aren't, there will be a lot here working at Centrica too.

So thank you very much indeed. Thanks.

End of Presentation