centrica

2012 Preliminary Results Announcement
Presentation Transcript – 27 February 2013

Sir Roger Carr - Chairman
Well good morning everybody. It is great to see so many people here. We have got a fuller morning than normal this morning, as you know covering both results and the strategic evolution of the business. The second part starts at 11 am and it is webcast so we are going to be pretty time disciplined this morning. So we will restart at 11, following a bit of a break after the results.

It is three years since we defined our strategic objectives to build a more sustainable, vertically integrated, cost effective and customer focused business with meaningful geographic diversity. We were clear that to achieve this objective we would need to grow British Gas, acquire upstream assets on value creative terms and expand the scale of our North American operation.

I am pleased to confirm that in 2012, I am sure we demonstrated through strong operational performance and acquisitions, our considerable progress in achieving these strategic goals, delivering profits as you have seen of some £1.4 billion, earnings per share of 27.1p and a 6% increase in dividend to 16.4 pence per share.

In the UK the year brought many challenges, with periods of colder weather compared to very mild conditions of 2011, contributing to higher energy bills, and with material changes in the regulatory environment. The management team dealt with all of the turbulence with great professionalism and commitment.

British Gas took the lead in simplifying tariffs and implementing changes consistent with Ofgem's proposals for Retail Market Reform. In parallel we continued to innovate with smart metering, to help consumers manage their energy usage, and to support customers with free insulation to reduce their consumption.

A relentless focus on cost management helped British Gas implement the lowest tariff increase of all the major energy suppliers, necessitated by higher wholesale energy costs, Government driven green energy costs and the imposition of additional infrastructure charges.

Nevertheless the very real concerns of hard pressed consumers, fuelled by external commentary, has impacted public trust in the industry and in British Gas as the nation's largest energy supplier in particular.

It is important that all stakeholders understand the importance of our contribution to the UK economy through the service we provide to customers, the investment we make, the security of supply we deliver for the nation, the tax we pay to Government, the employment opportunities we offer and the rewards we deliver to our shareholders. And this will remain a key agenda item for the Company in the months to come.

Upstream we invested £2 billion in gas and oil assets. In parallel we achieved first power from our Lincs offshore wind farm and worked with our partners in extending the life of the existing nuclear fleet.

After long and careful consideration we took the decision not to participate in new nuclear construction with EDF due to higher anticipated costs and a lengthened construction phase.

Our commitment to balance sheet discipline is reflected in our decision to return some of the capital we had raised for the purpose through a £500 million share repurchase programme which will commence forthwith.

In North America, a carefully executed strategy of operational efficiencies, organic growth and customer acquisition helped us to further expand our business, putting us on track to double its profitability. With a change in the centre of gravity of our North American activities, we moved the corporate headquarters from Toronto to Houston and our ambition to further extend our role in this market remains a strategic priority.

Our overall vision, to be the leading integrated energy company with customers at our core, remains true. The way in which we achieve this however must reflect the changes in markets and sources of supply, together with a constant assessment of costs and return for our shareholders. And in the session later this morning, Sam will review in some detail our new strategic priorities, and the shape of the business that will evolve.

The year ahead is going to bring new challenges, which will demand even greater efforts from the team.

In order to ensure that the organisation of our management team is appropriate for the task ahead, with effect from 1 July, the Group will migrate from a regional structure to an international functional structure. Chris Weston will assume responsibility for our downstream operations and Mark Hanafin will assume responsibility for our upstream operations across the Group.

Just a word on Phil Bentley. After a successful career spanning 12 years with Centrica, Phil is going to be stepping down from his role as Managing Director of British Gas, and a Board member of Centrica, on 30 June and he will leave the Company by the end of this year.

Phil has made a substantial contribution to the development of this business, initially as Finance Director and for the last six years as Managing Director of British Gas. And as Chairman, and on behalf of the Board, I just want to publically thank Phil for all that he has achieved and indeed will achieve in the closing months of his tenure.

Finally, I am confident that the bench strength we enjoy, the mindset that we have, the new management structure and business model we have created will ensure we continue to deliver both sound performance and strong cashflows. This will enable us to invest in customer service, supply security and shareholder reward in the year ahead.

And with that I will now hand over to Nick.

Nick Luff - Group Finance Director

Thank you Sir Roger and good morning everybody. As usual, let me start with the commodity price backdrop to these results. Average outturn gas and oil prices in 2012 were actually very similar to 2011. However, they have been at these higher levels for longer, so the effect was felt more, both upstream and downstream, without the delay from hedging seen the year before.

Spark spreads as you know, were very much lower; much lower than in 2011, impacting the running patterns of the CCGTs, and feeding through into outright power prices. In contrast, our competitors, in the last year before the end of free carbon, did benefit from much higher dark spreads for their coal stations.

Commodity prices were not, however, the most significant external factor in the year over year performance. That as you can see was the weather. You will remember that 2011 was unusually warm. In 2012, despite a warm Q1, overall, the average temperature in the UK was slightly colder than normal. Gas consumption per customer for British Gas Residential increased by 12% as a result.

So with that background, the group performed well in 2012, delivering improved operating results in every business unit. For the group as a whole, revenue was up 5%, reflecting the higher gas consumption in the UK, and higher average retail prices here. Operating profit as you can see, increased 14%, with Centrica Energy, being helped by acquisitions, was the biggest contributor to that increase. The tax rate rose to 44%, as a result of the larger contribution from the more highly taxed upstream, leaving earnings up just over 5% at £1.4bn. That translates to 27.1 pence per share. The dividend for the full year will be 16.4 pence per share, an increase of 6%, 3% more than inflation. With the dividend paid entirely in cash, that's a return to shareholders of over £850m, adding to the £500m of cash being returned through the share buyback we announced earlier this month.

So here's the divisional breakdown of the results and you can see how each of the four business units generated additional profit.

Starting with British Gas, here profits increased by 9% to just under £1.1bn. Within that residential energy came in at just over £600m, in line with our target. The colder weather resulted in higher volumes, and higher average retail prices covered higher external costs, both commodity and non-commodity, leaving margins only slightly down at 6.6%. Residential services continues to perform well, despite tough economic conditions, with cost reductions coming through more quickly than expected, giving us 16% profit growth, ahead of our 10% target.

In contrast, we were not able to mitigate fully the impact of the difficult trading conditions in the B2B market, with lower overall gas volumes, despite the colder weather, and margins being squeezed, leaving BGB's result down at £175m.

Moving to Centrica Energy, here profits increased by over 20% to £1.2bn. Both gas and power contributed to the increase. Gas production volumes were up by 13%, driven by the assets acquired from Statoil, and our increased interest in Statfjord, both of which were owned for eight months of the year. Those additional volumes offset lower production from Morecambe where we did have some gas blending challenges in the first half you will remember, as well as seeing the continued natural decline of the field.

Liquids production was up 30%, with the increase all coming in the second half, driven by the acquisition of assets from Total, all of which are oil producing.

Hedging had held back realised prices upstream in 2011, so we did see higher realised prices in 2012, despite, as I said earlier, average month ahead prices being largely unchanged.

With less drilling success, we did take higher exploration write offs in 2012, and a write down on Ensign following poor flow results from one of the wells we drilled there. That did mean that the operating profit for the upstream business came in below the expectations we had, albeit the high tax rate meant that the affect on earnings wasn't significant.

The power result was perhaps surprisingly strong, in part reflecting the profit we recorded when we sold down 50% of our interest in the Round 3 offshore wind Irish Sea zone, bringing in DONG as a partner.

However, the underlying trading result from the CCGTs was still poor, with the fleet breaking even. Although our realised spark spread increased, as you can see, that was due to peak running and hedging, and low market spark spreads meant that we ran the stations much less. In contrast, nuclear output remained high, with slightly higher realised prices also helping the nuclear result.

Storage benefited in the second half from the higher SBU prices for the 2012/13 storage year, driven by higher seasonal spreads at the end of 2011 and early in 2012, which also enabled better optimisation performance. As a result, profit increased by over 15% to £89m. However, summer/winter spreads have narrowed more recently, and the outlook for the coming 2013/14 storage year is less positive.

In North America, Direct Energy performed well, particularly in the second half. For the full year, profit increased by 6% to £331m. Despite the expected decline in Ontario, and unfavourable weather, residential energy was only down slightly, benefiting from the three acquisitions made in 2011. The 2012 acquisition of Energetix and NYSEG has yet to contribute significantly because of integration costs.

Business energy supply continues to grow strongly, with volumes up 11%, driving a 17% increase in profit.

In a tough environment, Services performed well, increasing profits by close to 20%, driven by higher revenue and higher margins.

With North American gas prices reaching new lows in the first half, conditions were challenging for our upstream business of course. Gas production fell as we switched development activity to liquid rich opportunities. But with hedges rolling off, the switch to liquids was not enough to prevent average realised prices dropping. That did leave returns well below our cost of capital, with the capital including assets acquired some years ago, in a much higher price environment.

Turning to cashflow, you can see that cash generation remained strong, with EBITDA of over £3.6bn in 2012, and close to £4bn with the acquisitions proforma-ed in for a full year. Capex was also high of course, with the acquisitions costing £1.2bn, pushing net debt up to just over £4bn. That was lower than expectations, due to tight control of working capital and the phasing of tax payments.

Looking at capex. Organic capex was £1.5bn. The majority of that went into the upstream business. York was the largest single project, but there was also significant spend at Rhyl, Statfjord and Ensign, plus the initial spend on the Cygnus project. In power, the major part of the spend was on the Lincs windfarm. And looking down towards the bottom, 2012 acquisitions include the three major Norwegian and UK upstream deals, plus the bolt-ons in North America.

Looking forwards, 2013 upstream capex, and this excludes North American upstream, is expected to be around a billion, with the completion of York, high spend on Cygnus, and continued development at Statfjord and Valemon. In power, we expect to complete the Lincs windfarm, with the required spend there potentially offset by the sale of the transmission assets out of the Lincs joint venture. We may also invest up to £200m in Racebank, but that does depend on FID being taken, which in turn depends on the economics of the project being attractive, so at this stage, we're only including pre-FID spend in the guidance figures you see there.

In summary then, we were able to deliver earnings growth through higher profits across the group, benefiting from more normal weather in the UK, and from acquisitions upstream.

The big change in 2013 of course, is the loss of free carbon for the CCGTs which, with low spark spreads and hedges rolling off as well, will push the fleet into significant losses. In addition, the amendment to IAS 19 will increase pension charges in the accounts, albeit with no cash impact. We are looking for growth elsewhere in the group to more than offset these negatives, with a full year of the upstream acquisitions, and continued growth expected from BGS and in North America.

With that I will hand you over to Sam.

Sam Laidlaw - Chief Executive

Thank you very much Nick, and good morning everyone.

As you've heard, the business performed well in 2012 in a challenging environment, delivering year on year earnings growth and a further increase in the dividend, in addition to launching a £500 million share repurchase programme.

We invested £2.7 billion in total across the Group, both organically and through acquisition, mainly to help energy security and secure supplies for our UK customers. Downstream, British Gas had a strong year, despite facing increased costs in the supply of energy and the continued depressed economic climate.

Upstream, we saw the impact of recent acquisitions flowing through to the bottom line, especially from our new Norwegian assets.

In North America, we achieved continued growth in profits, adding more customers in the US organically and also through bolt-on acquisitions.

And we are on track to deliver our Group-wide £500 million cost reduction programme, with a clear objective of sharpening the business and maintaining our competitive edge for the benefit of customers and shareholders alike.

With household budgets continuing to feel the squeeze, we are committed to doing everything we can to help our customers. We have made sure that the energy choices they have are simple and transparent by making our bills easier to understand and reducing the number of tariffs that we offer. And this month we've launched our personalised tariff checker, letting customers know if they're on the best value British Gas tariff for them.

We have also further improved our high levels of customer service. Our Net Promoter Score increased once again and we were awarded the top 5 star rating from Consumer Focus. In services, we improved our retention rates across the product range. We also spend more than any other energy supplier on those who are most in need of support. This winter, over 400,000 of our most vulnerable customers will again receive the Warm Home Discount, worth £130 off their bill.

And we have continued to drive our costs down across the Group, but particularly at British Gas with the clear objective of reducing costs without impacting customer service.

At British Gas, we are at the forefront of innovations which will transform the energy supply industry and improve the energy efficiency of the home.

Our improved online platform handled 13% more transactions than in 2011, achieving a better customer experience at lower costs. And we now have over 3 million online customers in the UK, with a third of all energy bills now sent electronically.

Our new 'Remote Heating Control' product is proving to be very popular and this allows customers to monitor and control their energy use when they are away from the home. Already 15,000 customers have taken this product in the first few months since its launch.

In terms of energy efficiency, we have completed over 1.7 million insulation jobs under the CERT and CESP programmes. The measures we've undertaken over the past three years alone are delivering savings of around 2.5 million tonnes of CO_2 each year, equivalent to adding 1.8GW of offshore wind capacity at of course significantly lower cost.

And we have now installed over 800,000 smart meters for homes and businesses, substantially more than any other UK energy supplier to help customers manage their bills. And already we have seen a 20% reduction in call volumes and a halving of complaints from customers with a smart meter.

Upstream in Centrica Energy, we continue to spend capital to secure energy supplies for the UK, investing £2 billion in North Sea oil and gas assets last year. Production of gas and liquids was up 18% year on year, benefiting from those recent acquisitions. And even after taking into account of production for the year, our UK proven and probable reserves increased by more than a quarter, a step change in the scale of our portfolio.

And we have also passed a number of key milestones, achieving first gas from three new developments, Ensign, Seven Seas and Atla, with first gas from York imminent and Rhyl also expected to produce in the next few weeks. And we gave the go-ahead for the Cygnus development, the biggest gas discovery in the Southern North Sea for 25 years.

In power generation we achieved good operational performance across our fleet, despite the continuing challenging environment for gas-fired plant. The nuclear fleet performed particularly well, achieving 60TWh of output, the highest level for seven years, and securing life extensions at Hinkley Point B and Hunterston B was another key milestone.

In offshore wind, we achieved first power from our Lincs offshore wind farm and expect it to be fully commissioned later this year. And we are also investing for value at South Humber, reblading the turbines to improve the station's efficiency.

Our investments in 2012 have materially increased the scale and geographic diversity of our upstream business. We are less reliant on Morecambe, which represents a smaller proportion of our total production. And Norway is now a core part of our portfolio, reflecting the acquisitions we've made and our success with the drill-bit, with a balanced portfolio of producing, development and exploration assets.

In power generation, we retain options to invest in CCGTs and offshore wind. We now have planning consent for Race Bank, our next offshore wind project, however the regulatory environment is in transition and we are currently in discussions with a financial partner and the Government, regarding the necessary economic framework to take FID. We have also established a joint venture with DONG Energy to co-develop the Round 3 Irish Sea wind farm zone, the Celtic Array.

As always, we will only invest in these projects where we see value, asigned to our core competencies. In this context, earlier this month, we announced that we would not participate in new nuclear build in the UK. Whilst we believe that nuclear power has an important role to play in the UK's energy mix, the likely cost and particularly the timescale of this project led us to conclude that it was not in the best interests of Centrica shareholders for us to participate.

Our North American business once again delivered good profit growth, despite very low natural gas prices. We are benefiting from enhanced scale and synergies downstream, with the completion of the Energetix and NYSEG Solutions acquisitions in 2012. Restrictive competition regulations however, remain in place in Ontario. This business however is no longer material, and we expect it to make up only 5% of DE Residential energy profit in 2013. We are actively managing the cost base of the business to continue serving our customers as efficiently as possible.

In DE Business, we are delivering strong organic growth, with electricity volumes up 11% last year. Direct Energy Services is also performing well, gaining market share. Services contracts were up 5%, despite a challenging market environment for the services industry.

Direct Energy Upstream continues to face a low wholesale price environment. But liquids production doubled, and effective optimisation in both gas and power enabled profits to be maintained.

We have developed a successful downstream acquisition and integration capability in North America, which is delivering both growth and efficiencies. We now have 3.5 million residential energy customers, with 1.4 million of these in the US North East.

Customer satisfaction levels have increased, and our innovation products such as our prepaid "Power To Go" product and "Free Power Saturdays", continue to attract customers.

In services, the acquisitions of Clockwork and Home Warranty of America have created the platform for us to cross-sell services to our energy customer base, and over time to also introduce service protection plans, building on our experience from the UK services market.

Upstream, although natural gas prices remain low, we now have an expanded presence, having increased reserves by around 60% in the last three years, with a more material liquids presence.

The health and safety of our staff and customers remains a core priority, to protect our employees, contractors, customers, and the wider public.

Upstream, we put particular emphasis on process safety, while Downstream, we focus on the safety of the public and our engineers through training, rigorous monitoring and assurance.

Initiatives across the Group, include reinforcing a positive and proactive safety culture across all our businesses, and they led to further improvements last year. Our lost time injury rate fell by 20% and we have made encouraging improvements in road safety and recorded no significant process safety events in 2012. We will continue to target further improvements in the year ahead.

So in summary, much has been achieved across the Group, both in the last year and since we set out the strategic priorities three years ago. We have delivered against each one.

First, to grow British Gas. In BGR, we are delivering stable profits, through the cycle. We have taken the lead in ensuring that our tariffs and bills are simple and clear. And our customer retention is strong, increasing over the last three years to 91%, reflecting our service and competitive pricing, all underpinned by a constant focus on efficiency and costs.

In BGS, we have increased profitability by more than a third, despite the weak economy, and here too retention remains strong demonstrating the value our customers place on our products and the high levels of service that our engineers deliver.

And in BGB, we have signed our first multi-year Energy Performance Contracts, with a strong pipeline of growth for the year ahead. We are investing in our back office systems to improve service, at reduced cost. And we have a new management team in place to drive the business forward.

Across British Gas, we are on track to deliver our cost saving targets taking out £300m of costs, through a relentless focus on service and efficiency. And we have established clear leadership in systems, online and Smart, providing us with the platform for growth, through technology and innovation.

Our second priority, to deliver value from our growing upstream business. Here, we have built a significantly larger, more geographically diverse business with our record of growth in Norway as a particularly strong example.

In gas and oil, over the three years we have increased reserves and production by 50% and doubled our cash generation reflecting acquisitions and also our success in bringing new projects onstream. We have achieved first gas from 9 projects and recorded above average exploration success, with 8 discoveries out of 15 wells drilled in the North Sea and East Irish Sea since the start of 2010.

In power, we are established as a leader in offshore wind, working with key partners and enhancing our returns through efficient financing structures.

In gas fired generation, we have taken prompt action to optimise the performance of our CCGT fleet, closing loss making stations where required and investing to optimise the remaining assets, where appropriate.

In nuclear, the strong performance of the existing fleet underlines the quality of our original investment in British Energy, with life extensions adding additional value as well as helping to maintain energy supplies for the UK. And our decision not to proceed with new nuclear underlines our commitment to strong capital discipline.

Turning to the third priority, to build an integrated North American business. Here we have increased our scale, both upstream and downstream, where we see attractive value and a good fit with our core capabilities.

Operating profit is up 55% with US profits up 72%, putting us well on the way to our target of doubling the profitability of the business.

Customer numbers in our core US markets are up 75%, more than offsetting the impact of the regulatory environment in Ontario.

Profits in DE Business have more than trebled, with volumes up over 50%.

And in services, we now have a true multi-state capability, with a platform for growth through cross sell opportunities and protection plan offerings.

Our downstream business is delivering a much improved return on capital, up from 9% to 13%. And we've taken advantage of the low gas price environment to treble our upstream resource base, and increase production by 50% in North America.

And our fourth priority, to drive superior financial returns. Our EBITDA is now approaching £4 billion, up from £2.6 billion just three years ago. EPS is up by a quarter, and dividends per share up by 28%, well ahead of the FTSE 100 index and contributing to a total shareholder return of 36% over the period.

So we have been successful. But the energy landscape has changed significantly in the past three years and we cannot stand still. We have to evolve to meet the challenges of this new world. That's why we are now setting out new strategic priorities.

First, to Innovate, to drive growth and service excellence. Second to Integrate our natural gas business, linked to our core markets, and third, to increase our returns, through efficiency and continued capital discipline.

And to deliver these new strategic priorities, we are changing our management to a global functional organisation under Chris Weston responsible for International Downstream and Mark Hanafin responsible for International Upstream.

But I would like to take this opportunity of endorsing the Chairman's remarks about the very significant contribution Phil Bentley has made to the transformation of British Gas. He has been instrumental in restructuring, reinvigorating and materially improving the performance of the business by raising customer service, lowering costs and increasing productivity.

We will be expanding on these new priorities and explaining what they mean for the business in the second session this morning.

But for now, in conclusion, we have delivered a strong performance in 2012 with continued earnings growth.

We have enhanced the scale of our business upstream, with increasing geographic diversity and the capabilities to achieve future growth.

We have a robust balance sheet and generate strong cash flows, retaining a number of attractive investment opportunities for the Group.

And we are setting out refreshed strategic priorities to adapt to a new energy landscape, reshaping our management team to build upon our core competencies to ensure our future success.

So with that, I think I would now like to open it up to questions. But I would suggest that as we have a separate session later on, on the strategy, we mainly focus the Q&A session on the 2012 Results and current business conditions, although of course you know we are happy to take questions on strategy as well, but the more of those I think we will leave until after you have heard the strategy presentation probably the better.

So with that we can start the questions.

Sir Roger Carr
We have got about 35 minutes, it will give us about a ten to fifteen minute break before the next session for questions and focus on the current and past as Sam has suggested. So we will start in the middle and work around.

Questions and Answers

Q1. Jonathan Constable, Nomura

Jonny Constable from Nomura. The first question is on the financial position really. For the argument this is about where we are now rather than the strategy, but you might push back. Accounting for the expected effects of the share buy-back, how much financial headroom do you think that you have for acquisitions over the next twelve months, so an update on the financial position?

Secondly, just on the storage spreads, if we look at what you have achieved in 2012 and where you are seeing the seasonal spreads in the forwards markets, how should we think about the profitability of this business developing from 2014 onwards?

Answer: Sam Laidlaw

We will be talking in more detail John about the headroom and the opportunities that the balance sheet presents in addition to obviously the organic opportunities we see in the strategy session, but recognising that it is a critical question, I'll let Nick speak about that and then I will come back and talk about storage spreads.

Answer: Nick Luff

So Jonny, the key RCF to debt metric actually will improve in 2013 because we will have a full year of the acquisitions then of course. So if you do some simple maths against a mid 20s ratio you would come up with a figure of around £2 billion even after the share buy-back, clearly you know what you do with that headroom, the cashflow characteristics, the risk profile of whatever you spend it on would be critical in thinking about what you would spend and indeed how you financed any M&A, partnering etc would also be critical. But that gives you a feel for the scale of it.

Johnny Constable

Thank you.

Further Answer: Sam Laidlaw

I think in terms of storage spreads, I think we did well in 2012 really picking the top of the market for a lot of the SBUs that we sold. We have seen softer recent market conditions and I think you could expect you know the storage spreads to be down by about 10%.

Further Answer: Nick Luff

Something in the 23, 24 pence per SBU for 2013/14 storage year which will mean lower profits overall.

Q2. Martin Brough, Deutsche Bank

Martin Brough from Deutsche Bank. Not to look forward at this point, but if you look backwards over the last five years from 2007 to 2012, what kind of post-tax return on capital do you feel you have got from the North American business and from the upstream business? And are you happy with that? Is that the kind of thing you would be happy with over the next five years?

Answer: Sam Laidlaw

The answer to that in a nutshell Martin, would we be happy with it? Yes. But is it a continuously improving picture? Also yes. Both in North America as I indicated in the downstream we have seen our ROC go from 9% to 13%. In the upstream piece of North America actually the investments have been closer to the cost of capital because of the collapse in the overall NBP price as a result of shale gas, but actually despite that our Wildcat Hills acquisition is still making a reasonable return and we will talk more about that in the second session. And if you look at our upstream investments, the big ones obviously being Venture and if you look at British Energy, we are above cost of capital. British Energy clearly helped by a much improved output situation, but also despite the write-off that we had to take for new build, that was more than covered by the benefits that we are seeing from life extensions on the plant that we hadn't previously anticipated. Venture - clearly, the economics of that were very severely adversely impacted by the change in taxes that we had and the increase in supplementary corporation tax in 2010. But despite that, as a result of exploration success, we are still above the cost of capital as we start to bring new fields from the Venture portfolio on, then actually the pre-productive capital starts to come down and that actually will improve our ROC as well as our IRR going up going forward - Nick?

Further Answer: Nick Luff

I think that last point is key because we are making mid-teens returns on the productive capital in the upstream despite the tax hit that Sam refers to. The challenge overall is we have got a lot of pre-productive capital at the moment because we don't have, other than Morecambe we don't have assets we have built ten years ago. And so you will see that average out as we go forwards and the overall return rises as a result.

Q3. Lakis Athanasiou, Independent Analyst

Lakis Athanasiou, Independent Analyst. Three questions. One factual. Can you say what your Moody's RCF to debt metric you calculate for the end of 2012 please? I think you gave a number for us last year. You didn't give one this year.

Secondly, on the new ECO coming in. Can you give us a feel for where you think the spending level is going to come out? Because there seems to be a lot of controversy in the industry between what the Government is estimating and what some other commentators are saying. Under the Government's estimates your share would come out at about £400 million. Others seem to be estimating nearly double that. And also are there going to be any accounting fund or is it just going to be a pay as you go type of approach?

And thirdly, you might want to leave until the strategy thing, but can you give us a bit of colour on the £1,000 million upstream spend gas and oil in the sense of how much in there is there for exploration and appraisal and how much is there for assumptions on development of non 2P reserves and also if there was any deferred acquisition cost? Because there is some sizeable stuff coming through from this year in that £1 billion number.

Answer: Nick Luff

Well if I take the first one. The RCF to debt is in the next presentation actually so it was 29% in 2012.

Further answer: Sam Laidlaw

On ECO we are anticipating, you are absolutely right, there is a range of views here. I think the industry views all believe the cost of the ECO programme is going to be rather more substantial than the Department of Energy and Climate Change. We are anticipating a cost in the order of £600-650 million. But we will be accounting for this as we spend it rather than accruing for it and I think that is the methodology that has been agreed by the industry.

Further answer: Nick Luff

And the upstream capex, within the £1 billion for 2013, between £100-150 million on exploration. Pretty much all of it is on 2P and just because it is in development, apart from the exploration piece clearly. So they are already in 2P reserves and I don't think there is any deferred acquisition cost in that billion.

Lakis Athanasiou

Thank you.

Q4. Mark Freshney, Credit Suisse

Hi, it's Mark Freshney from Credit Suisse. Just two questions. Firstly, something you said Nick, just to pick you up on that. You mentioned that regarding 2013, the financial outlook you were looking for growth. Can I just be clear. Do you expect earnings growth this year in 2013?

And my second question is, regardless of the absolute level, Ofgem have their margin guidance, or margin illustrations they give. Those show retail supply margins going up. Can I just confirm whether that is something that you are seeing and how you are dealing with that?

Answer: Nick Luff

Yeah, on earnings growth, obviously it is very early in the year to be giving specific guidance, but you know consensus is showing some earnings growth to offset the negatives of CCGT, loss of free carbon and the pensions hit. And we are comfortable with where the consensus is at the moment.

Further answer : Sam Laidlaw

Can I build on that and say that I think the year, it is very early days, but the year has got off to a good start. I think Mark in terms of, remind me of your second question?

Mark Freshney

Ofgem's rolling margin guidance.

Answer: Sam Laidlaw

I think actually there is a more comprehensive survey coming out from Ofgem that perhaps has some slightly different numbers. Clearly we are in a different position to some of our competitors as a result of the costs that we have managed to take out of the Group. And I think also you know some of the retention rates that we are managing to achieve through a higher level of service and our online and greater online penetration is giving us better than industry average profitability. And Phil?

Further answer: Phil Bentley

Ofgem look at it in two ways. They look at it in the forward basis and also look at it historically where they have had BDO come in and do historical audit analysis. The historical audit analysis has shown industry margins between 3-4%. So that is in 2011 I think they will show they are about to produce the numbers, they will show that industry margins actually fell in 2011 versus 2010. What you are referring to is a forward projection that they use. And within that, they make certain assumptions about the model. For example, they take the average tariff price. Whereas actually a lot of tariffs are sold with discounts, dual fuel discounts, online discounts. So they don't take into any account the discounts. The second thing they don't take into account on their forward projections is energy efficiency. They are assuming a standard consumption per an Ofgem household that actually bears little resemblance today to the reality because we have insulated so many homes across Britain. And that is why systematically that model over estimates the margins. And it is something we have raised with Ofgem and they have acknowledged they need to sort of equalise the reality of the actuals with this forecast margins. It is not entirely helpful.

Further answer: Sam Laidlaw

Following on from Phil's point. You have frequently seen media commentary of average bills being £1,350 or £1,400. The actual average British Gas bill for 2012 was £1,188. And that is the result of customers going online, having duel fuel discounts, having direct debit discounts. And a number of other measures and people being on fixed price. So actually there is a significant difference if you like between the numbers that Ofgem use to calculate margins and the numbers that actually we see in the bills.

Further answer: Nick Luff

On expectations Mark, consensus for this year for BGR is around £600 million. Obviously it is very early, but we are comfortable with that at this stage.

Q5. Edmund Reid, JP Morgan

Edmund Reid from JP Morgan. Two questions. The first one on non commodity costs in British Gas Residential. They seem to have risen quite a lot in 2012. Clearly with ECO and distribution fees they will probably go up again in 2013. Can you give us any guidance on what that would look like?

Answer: Sam Laidlaw

Yes and you should have in front of you. I haven't got it in front of me actually, the famous light bulbs which show how some of those charges have moved and where it is really specifically talking ECO, it would be in the green on the light bulb. And that was CERT and CESP 2011 to 2012. Now in terms of 2013, you know we could expect just on the ECO programme alone another £20-£25 on the bill basically, depending on where the costs come out. And obviously you know, going back to the earlier conversation with Lakis, what we have agreed with the Government is that there will be a mid point review during 2013 to actually assess the value for money of this programme. Our concern being that actually if you look at this in terms of money spent on carbon abatement, actually this can end up being a very expensive programme in terms of carbon abatement reductions, possibly well over £100 to abate a tonne of carbon.

Further Question: Edmund Reid

And then my follow-up question is, will you be able to absorb all of that increased cost via reducing your controllable costs or do you think there might have to be a movement on pricing?

Answer: Sam Laidlaw

We will have to see. I mean it will depend on the other variables on the bill in terms of what happens to transportation and distribution costs, but also very fundamentally what happens to the wholesale commodity cost. I think it would be tough to absorb an increase of that order of magnitude purely with operating costs. But equally you know the point we made to all our customers is that actually as a result of energy efficiency, even if unit prices were to go up. And I am not saying that they are, then there is an opportunity to offset that with efficiency savings.

Q6. Jamie Tunnicliffe, Redburn

Jamie Tunnicliffe from Redburn. I think not that long ago you were talking potentially of investing or willingness to invest maybe up to £1 billion in the £2 billion Racebank project. And I think, as you said you are now talking a figure no more than £200 million and that seems to be an area you are willing to commit less capital to sort of offshore wind in the UK going forward. Could you just maybe sort of talk about that and why that change is coming through?

Answer: Sam Laidlaw

I think as we look at the offshore wind regime which as I indicated is under transition and we will talk about it more in the second session. I think we are, with the phasing out of the ROC banding, clearly the revenue is coming down and actually we are not seeing unfortunately, with the tapering of relief, lower revenues on the income side, and we are not seeing a corresponding reduction in unit costs, because although turbine efficiency is increasing, we are moving into deeper water and we are further away from the grid. So the economics are not that attractive now. One of the things we are of course working on is, is there the opportunity for some transitional CFD mechanism which if successful could possibly allow us to put more leverage into the wind operation because the investor is then not just taking the wind risk but is also no longer taking any of the power price risk under the CFD proposition and therefore that enables slightly higher leverage. But I think when we compare the amount of capital that is required for wind versus what it does for us strategically and what it does in terms of the returns we get with opportunities that we have got in other parts of our business and the gas value chain and in North America, it is not as important a piece of the strategy as we would have envisaged a few years ago where we saw returns higher.

Q7. John Musk, RBC

Good morning, it is John Musk from Royal Bank of Canada. On BGB, can you give us some indication of how you expect to turn around some of the declines you have seen in that business and where margins might go there? I mean is there any reason to assume they will be any different now to residential energy?

And then secondly, and forgive me a little bit on this one, the list of strategic priorities that you have run through, there are only ticks there in terms of what you have done over the past few years. Are there any crosses that should be on the list?

Answer: Sam Laidlaw

I mean both very good questions. Let me come to BGB because you would actually say that probably BGB in 2012 was a cross, in that clearly with the more depressed economic environment we had a lot of retailers in particular who were closing down or going out of business. But we also lost some customers because we actually don’t think we have as competitive a model. And we haven’t got the costs where they need to be. So we are in the middle of a significant systems upgrade. We made the big investment in SAP systems a number of years ago for BGR but we stalled it for BGB so we don’t have the SAP systems that we have for BGB but we are in the process of putting those in place and they will be in place by the end of the year. That is a major systems upgrade onto SAP, what we call our slingshot project. That will actually enable us to take significant costs out of the business. Where will margins end up? I think in this environment it is realistic to suppose that with the economy where it is, you know that I think margins are going to remain relatively tight in this business. But we think we can get back to growth over time. What we are signalling is that 2013 will be a year of consolidation and then growing from then on.

In terms of other areas where you know I think we would have wished to do better, I think we have had strong growth in the services businesses. I think we would have liked to have done more of the cross selling to, and that is something that is going to be a key focus area for the new organisation going forwards to see if we can increase the bundling between services and energy. We are just completing the systems upgrade that really enable, which is our catalyst project which you may have heard us talk about before, which actually enables all our call centre agents on a single screen to actually see the account of a customer and with a very clear series of scripts as to what products to offer the customer. And I think that will start to hopefully increase the cross sell. Well that programme probably took a little longer to roll out in BGB than we would have liked. In the upstream, as I have already mentioned, I think the tax hit was a significant hit to the business in terms of the upstream overall. And you know I think in North America the Ontario market and the closure of the Ontario market to competition, clearly has been a drain on the business as has been the collapse of the wholesale price as a result of shale gas. But that is something I think we have adapted our business to and are now moving forward from.

Further answer: Sir Roger Carr

At least one cross. The other thing I think I would comment on, is we actually referred to it in the opening script is for all the good the business is doing, I mean we have yet failed to persuade the media that energy is very important to this country and that the contribution of this particular company is an important constituent part. And you will probably see at the weekend you know the results of the work that was done in Oxford where we are seeking to ensure that the people do understand that this is a real force for good and it is not a rip-off industry. But I think we have got a long way to go. So it is certainly something, marks out of ten this time next year.

Q8. Bobby Chada, Morgan Stanley

Thanks, it’s Bobby Chada, from Morgan Stanley. A couple of questions. The first one is directly related to the comments you have just made. Without trying to predict what our tariff increases are going to be, it does seem pretty much certain that unless commodity prices fall substantially, all the other factors mean you have to keep putting prices up. And it seems like the political and regulatory backdrop even if you put the press to one side, has deteriorated a bit. No one seems to be admitting that the reason for retail prices rising is not your margins or commodity prices, it is other factors. So maybe this is part of your strategy and we will hear about it at 11 o’clock, but how do you propose to manage that risk because it seems to me to be bigger than it has been.

Answer: Sam Laidlaw

I think you are on a very good point and I will take that question and then come back to the others. But you know in a world of low economic or no economic growth and lower disposable income, you know it is natural that this is going to be a tough message for us to get across and for politicians to get across. What we are doing about it is on your British Gas bill now, you see what is in the light bulb basically. So our customers are, I think, increasingly aware of what the drivers of the bill are. And whilst nobody likes it, I think people are starting to understand it. And I think there has been a bit of a sea change actually. You don't possibly see it when you pick up the tabloid press, but when you actually talk to customers I think we are not seeing you know some of the hostility because I think people are actually starting to understand what is in the bill but this is an education. In an environment where you have got a large sector of the population who work in the public sector who have got 1% pay increases and you have got another sector of the population who are on benefits who are also going to get capped at 1% pay increases. You have got 60-70% of the population capped at 1% and you have got bills, not just for energy but for lots of other things going up by more than that. And that is a general tough message. But I think the other piece of the equation is helping people understand that we have to invest to keep the lights on. And that message I think, you know obviously you saw the Regulator's comments last week. The message about the need for investment is also getting out there. And that message is becoming more urgent. But it is a continuous education Bobby and you know it is not easy.

Further question: Bobby Chada

On upstream, you give some three year averages for success rates and F&D costs, but it does seem 2012 was substantially worse than 2009, 2010 and 2011 both in terms of success rates and also commercial developments. A couple of things were either late or lower flow rates. Can you give us some context as to why these are one-offs and we should expect things to improve?

Answer: Sam Laidlaw

I think that is a fair observation. Firstly on exploration success, we had a couple of wells last year which both found hydrocarbons, but not commercial flow rates which is very disappointing because they were quite significant wells, the Bligh well and the Cooper well. And the good news is that actually 2013 has got off to a much better start. We have had two discoveries already this year. One in Norway and one in the UK which we will talk about. So I think that is positive. But it is in the nature of the exploration business that actually, and I don't know any company that has a continuous track record of success. You will have periods that are more successful than others. I think you have to measure it over the long-term. And I think we still think our model is working and it is working well and I think that is sort of validated by the recent successes that we have had.

In terms of bringing onstream new developments, you are absolutely right. I think we had a number of specific instances last year. The first one and I think the most significant one was the Ensign development where actually we had mechanical difficulties drilling the wells, the reserves are still there, but we just couldn't drill the wells. And that resulted in us writing off and we took this through the left hand column of our accounts, you know some £70 million for Ensign last year. So that was clearly a disappointment. And I think that we have learnt lessons around well completions, a more conservative approach to well completions. I think we were attempting to do this in the most cost effective way. And I think those lessons have been learnt. But Ensign is now producing and it is producing at a reasonable rate, although we won't recover all the reserves that we had first hoped.

The second area I think was genuinely not within out control which was Seven Seas where actually we had been working with the operator of the host platform BP for a number of years to try and bring that field onstream. But they had a lot of mechanical, engineering and frankly management challenges with the host platform.

And that resulted in that being delayed. I think what we did Bobby, is recognising those difficulties in the early part of last year, we set up a new project management capability called our Pace Team, led by Sarwjit Sambhi. We brought in some very good people from across the industry to actually really strengthen our project management capability. And that is starting to deliver some very strong results. Now I mentioned that York development which is due on stream literally imminently. I think it is actually going very well as a result of the interventions by that team and are Rhyl development which is going to be bigger than we first thought in terms of reserves, is also going well. So I think we are on top of that problem, but I certainly acknowledge that in the first half of 2012 we had some issues.

Further answer: Mark Hanafin

Obviously the success or failure is quite lumpy in exploration. So if you look back over the last three years, we have put in place 103 million barrels of 2C reserves over those three years through the exploration programme. 2012 was lower, it was a bit disappointing, there was only 16 million barrels of reserves added as a result of drilling, some corrections in terms of the overall reserve accounting, but with the drill bit, 16. And as Sam said, the first two wells that we drilled in 2013 have been successes. So I think the track record is still a strong one, 2012 was a bit down.

Q9. Gus Hochschild, Mirabaud Securities

Gus Hochschild, Mirabaud Securities. Two questions if I may please. In the first in terms of BGR numbers, a slight decline. So hitherto you have put much store in smart metering etc. etc. So if you could give us perhaps a little colour of how you expect to arrest that decline-grow that number and how that compares viz a viz the competition?

And then rather more anally if I may please, the load factors at Lincs and also across your CCGT fleet please?

Answer: Sam Laidlaw

So if I understood the first question correctly, it was around margins or customer numbers? Customer numbers. So yes you are absolutely right. We lost about 1% of our customer numbers last year. And you know for the early part of the year we weren't as competitive on price as we need to be. Now since the last round of price increases we have actually been adding customers and if you look at this year, we have been adding customers, so we are getting back to growth because our price increase you will recall at 6% was lower than all our competitors and so actually we are moving forward. But I think it isn't just about price, it is also about service and differentiation through measures such as online, where I think we have a better offering. It is around you know the smart meter installation which is also adding customers and helping retain them. And I think it is increasingly around other energy devices you know linked to the home and the smart connected home which we will talk more about in the second session.

Phil do you want to...?

Answer: Phil Bentley

The only other thing to think about is the value of customers. I mean we have seen SSE launch some very deep discounted offers which actually they are now withdrawing. But they then argue those were likely to not create any value at all. So we look at the value of our customer base and we know that if you have got a smart meter, if you have got services, then actually your likelihood to leave us is particularly low. Now if we take this year, we have been winning share against all of the big five. The only people we are losing share against are those who are exempt, the small suppliers who are exempted at the moment from the Government and social obligations. And I don't think that is a situation with increasing costs of those obligations that is sustainable for them actually. So I think as long as we are on a level playing field, we are very confident we can compete and retain high value customers.

Further answer: Sam Laidlaw

And your second question I think was around the load factor of offshore wind generally and Lincs in particular I think, Mark do you want to touch on that?

Answer: Mark Hanafin

Yes, the load factor across the portfolio fell a little bit in 2012. We had 36% in 2011, we were around 32% in 2012, that was due to some problems at LID earlier in the year, some maintenance issues. We think this year we will be back up to around 36-37% load factor. And I would say that when Lincs comes on we are expecting higher load factors from that farm, potentially to around 39%.

Q10. Ashley Thomas, Societe Generale

Ashley Thomas from Societe Generale. Just a quick follow-up on Ontario. You have given us the context now for Ontario within DE supply. Could you perhaps do the same for DE services and just update us where we are with the competition bureau penalty?

Answer: Sam Laidlaw

Well clearly as a business it remains that our services business in Ontario remains a much more significant business and is an important business. On the competition inquiry, obviously we are participating and co-operating fully in that inquiry. We don't, it isn't just us. It is launched against all industry participants and we don't believe there is a case to answer, but obviously we will participate in the investigation. And I don't think that there is a suggestion that even if the findings were to go against us that this is going to be a very significant event for us.

Q11. Iain Turner, Exane BNP Paribas

It's Iain Turner from Exane. If I have got two minutes maybe I can ask two questions. On the CERT scheme, I think a lot of companies have been having trouble targeting the right kind of customers, sort of on the socially deprived side of things and haven't been able to do that. Can you just talk us through where you are on that?

And then secondly, you have made some quite important decisions about management and new nuclear and things over the past few months and they all seem to have leaked into the press. And I was just wondering if you have a comment on that please?

Answer: Sam Laidlaw

I will deal with the first one. Obviously we were disappointed about the leaks and we will have an investigation under way to make sure it doesn't happen again. I think on the CERT scheme, this was a very ambitious scheme. We said at the time that actually when it was launched it would be difficult for energy suppliers to find, not necessarily the total number but actually some of the super priority groups to which you are referring, even the Government were having difficulty finding them themselves. So I think Phil if you want to touch on where we have ended up, but I think we have ended up in a good place and done a lot more than other suppliers.

Further answer: Phil Bentley

Yes, obviously given our scale, we have the biggest obligation. If there is a finite number of super priority group then we have got to work hard to get them. There were two schemes at the end of the year, CESP which was community based and CERT which was individual household based. We have fulfilled our obligation on CESP fully and on CERT there is a small delay between jobs that we have booked and actually having them fulfilled. So there was quite a rush at the end of the year. So we are confident that we will have fulfilled our obligation, it is a question of what leeway will Ofgem give us for the, if you like, the programme coming to an end. Now our interpretation is that they will give leeway. For example they were quite late in approving some of the schemes we did. So in fact some element of delay there wasn't part of our management.

I think the other element then is of ECO, it is going to be the same problem and more some because we have got to find for example under 'Affordable Warmth' boilers that have broken down, that cannot be repaired, that are from a low income family and you have got to do it in a certain period of time. So you can just imagine those are the sort of golden tickets for us to try and execute. So and that is one of the reasons why there is a discrepancy in our view of what it will cost, not necessarily to do the jobs, but just to get the leads to fulfil the obligation under ECO first is what DECC are assuming and which is why we have got agreement that after six months, they will step back and just look at, are we really getting value for money per carbon tonne abated. Because all the easy jobs have been done and so the cost of carbon abatement is going up materially in the ECO programme.

Answer: Sam Laidlaw

Coming back to your first point. I think we would also just make the point that on nuclear, the announcement about stock repurchases was kept completely tight. But the announcement on nuclear, we did have a lot of stakeholders to manage and I think actually recognising that this was very sensitive, we wanted to be clear with our partners, but also with the Government and other interested parties what we were doing beforehand. And I think in those circumstances it is always difficult to keep it tight.

Sir Roger Carr

But you did not see the strategic presentation that you are about to see in the Sunday papers. So we must have made some improvement! Which should encourage you to come back at 11 am sharp. And thank you so much for the discipline of the morning too, that was very good. Thank you.

End of Presentation