Group Financial Review

> "The environment was challenging for Centrica's portfolio in 2019, which impacted the Company's performance. However, performance during the second half was much improved compared to the first half."

Chris O'Shea
Group Chief Financial Officer

Group revenue

- Group revenue included in business performance reduced by £0.6bn or 2% to £26.8bn (2018: £27.4bn). Gross segment revenue, which includes revenue generated from the sale of products and services between segments, reduced by £1.0bn or 3% to £28.0bn (2018: £29.0bn).
- Centrica Consumer gross segment revenue was broadly flat as the impact of energy supply customer account growth in North America offset the impact of a lower average number of energy supply accounts in the UK and lower prices, in part due to the introduction of the UK default tariff cap.
- Centrica Business gross segment revenue fell by £0.7bn, largely due to the impact of lower wholesale commodity prices and warmer weather on gas optimisation revenue in North America.
- Upstream gross segment revenue fell by £0.4bn due to reduced oil and gas production and nuclear power generation volumes and lower achieved gas prices due to falling wholesale commodity prices.

Adjusted operating profit

£901m

2018: £1,392m ▼ 35%

Statutory operating loss

£(849)m

2018: £987m profit

Statutory loss for the year attributable to shareholders

£(1,023)m

2018: £183m profit

Adjusted effective tax rate

34%

2018: 41% ▼ 7ppt

Adjusted operating cash flow

£1,830m

2018: £2,245m ▼ 18%

Statutory basic earnings per share (EPS)

(17.8)p

2018: 3.3p

Adjusted basic earnings per share (EPS)

7.3p

2018: 11.2p ▼ 35%

Statutory net cash flow from operating activities

£1,250m

2018: £1,934m ▼ 35%

Operating profit

- The statutory operating loss was £849m (2018: operating profit of £987m). Adjusted operating profit was £901m (2018: £1,392m). The difference between the two measures of profit relates to exceptional items and certain re-measurements. A table reconciling the different profit measures is shown below.

Adjusted operating profit

- Centrica Consumer adjusted operating profit was down £245m or 33% to £505m.
  - There was a £300m negative revenue impact from the UK residential energy supply default tariff cap, including a one-off £70m impact in the first quarter due to Ofgem's revision to the methodology calculating supplier wholesale costs during the transitional period.
  - Total efficiency savings more than offset lower gross margin resulting from lower average UK energy supply accounts and a change in customer mix in both energy and services towards lower priced products.
- Centrica Business adjusted operating profit was up £142m or 189% to £217m.
  - This includes the impact of a significant improvement in power retail margins in North America and good trading and optimisation performance in Europe.
  - It also includes benefit from the decision to defer delivery of gas from 2019 into 2020 from the one remaining large legacy gas contract and strong trading and optimisation performance in Europe.
- Upstream adjusted operating profit was down £388m or 68% to £179m.
  - Nuclear adjusted operating profit was down £27m or 59% to £19m, with lower output resulting from extensions to outages at the Dungeness B and Hunterston B nuclear power stations not fully offset by the impact of a higher achieved power price.
  - Exploration & Production adjusted operating profit was down £361m or 69% to £160m, largely due to lower achieved gas sales prices reflecting the falling UK NBP price, lower volumes from Rough reflecting the field's natural decline, higher depreciation charges following 2018 asset write-backs and production mix, and field specific write-offs.

Exceptional items

- A net exceptional pre-tax charge of £1,103m was included within Group operating loss before taxation in 2019 (2018: £185m) including:
  - A £476m charge relating to the impairment of E&P assets, predominantly due to the reduction in near-term prices and long-term price forecasts and a conclusion that certain field reserves levels were not sufficient for development.
  - A £381m charge relating to the impairment of power assets, including £372m related to the nuclear investment largely as a result of a reduction in price forecasts and availability issues at the Hunterston B and Dungeness B power stations.
  - A £77m charge following the strategic decision to refocus Centrica Home Solutions activity on the UK and Ireland, largely related to asset impairments (including goodwill), inventory write-downs and onerous contract provisions.
  - £356m of restructuring charges arising from the continuation of phase 2 of the Group's cost efficiency programme, principally related to redundancy, change resource, consultancy, property rationalisation costs, and other transformational activity including member compensation payments from renegotiating UK defined benefit pension arrangements.
  - A £152m net credit relating to pension changes. This includes a £260m credit in relation to a rule amendment to the UK defined benefit pension scheme arrangements to offer members an option to level up their ongoing pension if they retire before the statutory pension age, partially offset by £108m of pension strain costs associated with redundancy.
  - A £35m net gain on disposals of the Clockwork assets, Valemon, Sindre, the King's Lynn power station (which is held for sale) and contingent consideration on the historic disposal of Trinidad and Tobago E&P assets.
- These charges in total generated a taxation credit of £116m (2018: £89m). As a result, total net exceptional charges after taxation were £987m (2018: £235m).
- Further details can be found in note 7(a).

Operating profit

		2019			2018		
Year ended 31 December	Notes	Business performance £m	Exceptional items and certain re-measurements £m	Statutory result £m	Business performance £m	Exceptional items and certain re-measurements £m	Statutory result £m
Adjusted operating profit/(loss)							
Centrica Consumer		**505**			750		
Centrica Business		**217**			75		
Upstream		**179**			567		
Group operating profit/(loss)	4(c)	**901**	**(1,750)**	**(849)**	1,392	(405)	987
Net finance cost	8	**(255)**	**–**	**(255)**	(273)	(139)	(412)
Taxation	9	**(218)**	**219**	**1**	(461)	128	(333)
Profit/(loss) for the period		**428**	**(1,531)**	**(1,103)**	658	(416)	242
Profit attributable to non-controlling interests		**(9)**			(27)		
Adjusted earnings		**419**			631		

Certain re-measurements

- The Group enters into a number of forward energy trades to protect and optimise the value of its underlying production, generation, storage and transportation assets (and similar capacity or off-take contracts), as well as to meet the future needs of our customers. A number of these arrangements are considered to be derivative financial instruments and are required to be fair valued under IFRS 9.
- The Group has shown the fair value adjustments on these commodity derivative trades separately as certain re-measurements, as they do not reflect the underlying performance of the business because they are economically related to our upstream assets, capacity/off-take contracts or downstream demand, which are typically not fair valued.
- The operating loss in the statutory results includes a net pre-tax loss of £647m (2018: £220m) relating to these re-measurements, with the decline in gas prices over the period being reflected in the fair valuing of historic and current energy procurement to meet the needs of our customers.
- These re-measurements generated a taxation credit of £103m (2018: £39m). As a result, the total net re-measurement loss after taxation was £544m (2018: £181m).
- The Group recognises the realised gains and losses on these contracts when the underlying transaction occurs. The business performance profits arising from the physical purchase and sale of commodities during the year, which reflect the prices in the underlying contracts, are not impacted by these re-measurements.
- Further details can be found in note 7(b).

Group finance charge and taxation

Finance charge

- Net finance costs decreased to £255m (2018: £273m), largely reflecting the impact of a £1.1bn repurchase of gross debt which was completed in 2018 and the maturity of a bond in September 2018. There were no exceptional net finance items (2018: £139m).

Taxation

- Business performance taxation on profit decreased to £218m (2018: £461m). After taking account of tax on joint ventures and associates, the adjusted tax charge was £217m (2018: £458m). The resultant adjusted tax rate for the Group was 34% (2018: 41%). The decrease in adjusted tax rate reflects the more highly taxed E&P businesses contributing 18% of adjusted operating profit, compared to 37% in 2018. An adjusted effective tax rate calculation is shown below.

Group earnings

Adjusted earnings

- Profit for the year from business performance decreased to £428m (2018: £658m) and after adjusting for non-controlling interests, adjusted earnings fell by 34% to £419m (2018: £631m). This reflects the overall decline in adjusted operating profit, partly offset by the lower net finance costs and adjusted tax charge as described above.
- Adjusted basic EPS was down 35% to 7.3p (2018: 11.2p).

Group statutory loss

- The statutory loss attributable to shareholders for the period was £1,023m (2018: profit of £183m). The reconciling items between Group profit for the period from business performance and statutory profit are related to exceptional items and certain re-measurements.
- The movement to a statutory loss, compared to a statutory profit in 2018, is due to the reduction in adjusted earnings and the increase in the exceptional charges and loss from certain re-measurements, all as described above.
- The Group reported a statutory basic EPS loss of 17.8p (2018: profit of 3.3p).

Dividend

- In addition to the interim dividend of 1.5p per share, the proposed final dividend is 3.5p, giving a total full year dividend of 5.0p (2018: 12.0p).

Group tax charge

Year ended 31 December	2019 £m	2018 £m
Adjusted operating profit before impacts of taxation	**901**	1,392
Add: JV/associate taxation included in adjusted operating profit	**(1)**	(3)
Net finance cost	**(255)**	(273)
Adjusted profit before taxation	**645**	1,116
Taxation on profit	**218**	461
Share of JV/associate taxation	**(1)**	(3)
Adjusted tax charge	**217**	458
Adjusted effective tax rate	**34%**	41%

Group cash flow, net debt and balance sheet

Operating cash flow

- Adjusted operating cash flow, which is reconciled to net cash flow from operating activities in the table below, fell by £415m or 18% to £1,830m, largely in line with the reduction in adjusted operating profit after accounting for the increase in depreciation.
- Net cash flow from operating activities decreased to £1,250m (2018: £1,934m), which reflects the reduction in adjusted operating cash flow as described above, higher pension deficit repair payments as agreed with the trustees as part of the triennial review, increased exceptional payments largely relating to the Group's restructuring programme and an inflow of margin cash compared to an outflow in 2018.

Net cash flow

- Net cash outflow from investing activities decreased to £503m (2018: £1,007m) primarily due to the Clockwork disposal proceeds, reduced capital expenditure and lower acquisition spend.
- Net cash outflow from financing activities fell to £1,077m (2018: £2,540m) largely reflecting lower repayment of borrowings due to the debt repurchase programme and a bond maturity in 2018, and a slight reduction in cash equity dividends paid reflecting the rebasing of the 2019 interim dividend paid in November 2019.

Net debt

- Reflecting all of this, and the Company adopting IFRS 16 which increased opening 2019 net debt by £394m, the Group's net debt increased by £525m to £3,181m in the year (2018: £2,656m), including cash collateral posted or received in support of wholesale energy procurement.

Balance sheet

- Net assets decreased to £1,795m (31 December 2018: £3,948m) driven by the statutory loss made in the year, net actuarial losses, exchange differences on translation of foreign operations and dividend payments made during the year.

2019 Acquisitions and disposals

- On 1 July 2019 the Group acquired SmartWatt Energy Inc., a leading energy services and solutions company in North America, for consideration of $37m (£29m). There have been no other material acquisitions during the year.
- On 30 April 2019, the Group disposed of Clockwork Home Services for a gross consideration of $300m which, after deal-specific adjustments related to working capital, resulted in a net consideration of $279m (£215m).
- The Group also disposed of Norwegian exploration and production assets, Valemon and Sindre, during the year. Proceeds of £33 million were equal to the carrying value of the assets disposed of subsequent to the recognition of an impairment charge of £49 million. The impairment charge is included in net gain on disposal programmes within exceptional items.
- Further details on acquisitions, assets purchased and disposals are included in notes 4(e) and 12.

Events after balance sheet date

- On 23 December 2019, the Group agreed to sell its 382MW King's Lynn combined cycle gas turbine power station to RWE Generation for headline consideration of £105 million, adjusted for final working capital, based on a valuation date of 31 December 2019. The deal completed on 12 February 2020.
- Further details of events after the balance sheet date are described in note 26.

Risks and capital management

- The nature of the Group's principal risks and uncertainties are largely unchanged from those set out in its 2018 Annual Report, with two changes to note. The Information Systems and Security risk has been separated into two principal risks, enabling more focused conversations on our digital transformation and ongoing security. A new principal risk, Regulated Insurance and Services, has also been identified.
- In addition, there continues to be a high degree of uncertainty surrounding the future relationship between the EU and UK including trade agreements and the supply of electricity and gas.
- Details of how the Group has managed financial risks such as liquidity and credit risk are set out in note S3. Details of the Group's capital management processes are provided under sources of finance in note 24(c).

Accounting policies

- UK listed companies are required to comply with the European regulation to report consolidated financial statements in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union. The Group's specific accounting measures, including changes of accounting presentation and selected key sources of estimation uncertainty, are explained in notes 1, 2 and 3. Changes include the presentation of the income statement for energy derivative contracts following an IFRIC agenda decision on the recognition of fair value.

Operating cash flow

Year ended 31 December	2019 £m	2018 £m
Net cash flow from operating activities	**1,250**	1,934
Add back/(deduct):		
Net margin and cash collateral inflow/(outflow)(1)	**46**	(57)
Payments relating to exceptional charges	**298**	248
Dividends received from joint ventures and associates	**1**	22
Defined benefit pension deficit payment	**235**	98
Adjusted operating cash flow	**1,830**	2,245

(1) Net margin and cash collateral inflow includes the reversal of collateral amounts posted when the related derivative contract settles.

Our view on taxation

The Group takes its obligations to pay and collect the correct amount of tax very seriously.

Responsibility for tax governance and strategy lies with the Group Chief Financial Officer, overseen by the Board and the Audit Committee.

Our approach

Wherever we do business in the world, we take great care to ensure we fully comply with all of our obligations to pay or collect taxes and to meet local reporting and disclosure requirements.

We fully disclose information on ownership, transactions and financing structures to the relevant tax authorities. Our cross-border tax reporting reflects the underlying commercial reality of our business.

We are committed to providing disclosures and information necessary to assist understanding beyond that required by law and regulation.

We do not tolerate tax evasion or fraud by our employees or other parties associated with Centrica. If we become aware of any such wrongdoing, we take appropriate action.

We ensure that income and costs, including costs of financing operations, are appropriately recognised on a fair and sustainable basis across all countries where the Group has a business presence. We understand that this is not an exact science and we engage openly with tax authorities to explain our approach.

In the UK we maintain a transparent and constructive relationship with Her Majesty's Revenue & Customs (HMRC). This includes regular, open dialogue on issues of significance to HMRC and Centrica. Our relationship with fiscal authorities in other countries where we do business is conducted on the same principles.

We carefully manage the tax risks and costs inherent in every commercial transaction, in the same way as any other cost. However, we do not enter into artificial arrangements in order to avoid taxation nor to defeat the stated purpose of tax legislation.

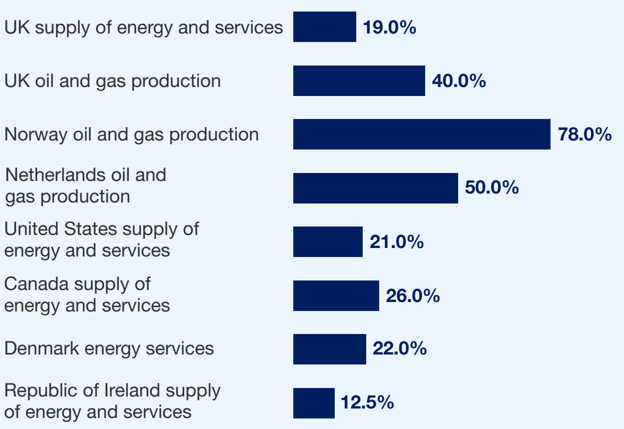
We actively engage in consultation with governments on tax policy where we believe we are in a position as a Group to provide valuable commercial insight.

The Group's tax charge, taxes paid and the UK tax charge

The Group's businesses are subject to corporate income tax rates as set out in the statutory tax rates on profits table. The overall tax charge is therefore dependent on the mix of profits and the tax rate to which those profits are subject.

Statutory tax rates on profits

Group activities



Tax charge compared to cash tax paid

	Current tax charge/(credit) £m	Cash tax paid/ (recovered) £m
UK	1	(111)
Europe	131	193
North America	57	46
Total	**189**	**128**

For details on the Group's effective tax rate see pages 29 to 32.

Further information on the tax charge is set out in note 9 on
Pages 135 to 137

Our Group Tax Strategy, a more detailed explanation of the way the Group's tax liability is calculated and the timing of cash payments, is provided on our website at
centrica.com/responsibletax