Centrica Full Year Trading Update 2007

Presentation transcript

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Presenters

- Sam Laidlaw, Chief Executive
- Nick Luff, Group Finance Director

Sam Laidlaw

Good morning everybody. I am Sam Laidlaw and I have our Finance Director Nick Luff here with me. I hope you all had a chance to have a look at the statement but I would just like to say a few words of introduction to outline the key messages in the statement and then we will throw the call open to questions and answers in the usual way.

I think firstly it has clearly been a very strong year for Centrica. If we look at the year as a whole, both upstream and downstream, businesses have performed very well. However as you have seen from the statement in the fourth quarter the environment has become more challenging and wholesale prices clearly have risen. The good news I think against that background is that British Gas has continued to achieve good customer growth throughout the second half of the year and we are now back to the 16 million customers that we had at the beginning of the year. You will recall we lost a considerable number in the early part of the year and we have recouped all of those and we're now back in a growth mode.

Customer service has also continued to improve strongly in the second half of the year. We have now eliminated all our backlogs, our average speed to answer calls is down 75% on where it was in the first half and our complaints are down by over 70%, so I think we are really starting to see a substantial improvement in the customer service metrics and that is gratifying.

Clearly margins in the second half with the higher wholesale gas prices have been squeezed. British Gas will just be profitable in the second half but of course with the strong first half, full year margins will clearly be above long run expectations. The high wholesale gas prices have also helped elements of our upstream business, Centrica Energy, and here we are going to be ahead of 2006 in both gas and hydrocarbon production. I am particularly pleased with the Newfield acquisition, which is performing very well. The high wholesale prices do however of course have an impact on our I&C contracts and although these will deliver a small profit in the second half, they did move into a loss in the fourth quarter and we do expect, you will see that signalled in the statement, that loss to widen based on the current forward curve.

The rest of the Group has continued to perform very well. British Gas Services, BGB and North America are all ahead. North America is ahead of last year despite the de-valuation of the currency, of the US dollar, and I think clearly recognising in the headwind there that's an important achievement. BGS and BGB, you see from the statement, we expect very strong results.

When we look at the interest line clearly our underlying interest is currently below I think where consensus estimates were. But the interest charge includes a 40 million payment now from the Humber lease pre-payment, which we did in the second half. This was really to simplify our overall – we have a leasing structure here. It creates value but it does result in a small charge to earnings of some 0.6p.

So when we put all this together you will see stronger upstream earnings, slightly lower downstream earnings. The combined effect therefore is, at the pre-tax line, and then we also take into account the Humber lease. We are in line with consensus but the change in mix clearly means that we will have a slightly higher tax rate 39% versus 37%. So I think those are the highlights of the statement. I would summarise it as being a strong performance; particularly pleasing to see service levels improving in British Gas, the customers coming back, strong growth from BGB and BGS and North America. Clearly, as we move forward challenging market conditions, but ones I think that the business is now much better equipped to handle. So I think with that I would like to ask the operator to open up the lines for questions.

Q1. John Musk

Lehman Brothers: Hi there, I have got two questions. Firstly just on the generation, my own view of what I see on my screen is that spark spreads have been increasing in the second half. So I just want to understand how you have seen lower realised spark spreads. And also just to get an update on where you are around the potential for share holder returns given that you have not made significant upstream investments. I know we did buy some gas assets earlier in the year.

Answer: Sam Laidlaw Both good questions and let me speak to both of them. John the reason we use the word 'realised' was deliberate. In the first half we were able to take advantage of the fact that we sold the power effectively before we bought the gas in some of our contracting. So the result of that was that when the gas price fell we had unusually wide spark spreads in the first half. The second piece of this was that unfortunately the plant outages we had which were at Killingholme and Spalding occurred when actually if you look at average spark spreads the particular spark spreads at the time those plants were offline were very high so put those two together and that's why our realised spark spreads were lower in the second half than in the first half. It's not market conditions. We just had an abnormally high spark spreads on a realised basis in the first half. So I hope that answers that question.

The second question was all round shareholder returns. Of course we are very conscious of the fact that the balance sheet is improving and certainly our debt has come down significantly this year. We continue to look for opportunities to close the structural hedge and that is our first priority and we have been consistent on that and we continue to identify a number of opportunities in both gas and power which we think can help close that structural hedge. But if we cannot find opportunities for value then clearly returns to shareholders is something that with the passage of time inevitably it gets more and more attention as the balance sheet continues to improve. But we are not setting a fixed timetable on this. It will all be a function of the quality of the opportunities available on the day and we compare and contrast that with the opportunities of reinvesting through a stock repurchase or through an increased dividend.

Q2. Bobby Chada

Morgan Stanley: Morning, I just have two questions as well please. First of all on your statement about the outlook for 2008 and the tariff decision. When will you start to make the decision about what you need to do with the tariff and what are the key factors that you will kind of weigh up when thinking about that? Then secondly could you just give a bit more colour on the benefits of pre-paying this Humber lease please?

Answer: Sam Laidlaw Yes, let me take the first one and I will let Nick take the second one on the Humber lease.

Let me say firstly that you will understand of course that we are not going to telegraph our pricing intentions for next year. Clearly that wouldn't be good commercial practice. What I can say is that I think we have demonstrated certainly over the last 18 months since I have been here that we want to balance clearly improving current returns and current profitability with also ensuring that the momentum we have got behind the growing customer base is continued. And we recognise clearly that returns to shareholders and profitability in this business is important. We are however also in a very volatile market here and at the moment we have got extraordinary high levels of demand, or certainly significantly higher than this time last year. We are at about 140 million therms compared to a seasonal average of about 125 million therms. And we've got Norwegian production that hasn't been performing at the same level that people anticipated. So we have a tight market and obviously we have to form a view as to how long that will last. And we have to clearly be mindful of the fact that we've got to get a good return and we remain very much focussed on the guidance that we have previously given of a 6 to 7% full cycle return in the residential business. That's clearly the aiming point; I'm not going to talk about how long it's going to take us to get there because clearly that's commercially sensitive information.

Answer: Nick Luff On the Humber lease. That lease is actually quite a complex structure, which imposed various administrative and even some operational restrictions on us. It also complicated the debt structure effectively being a secured piece of debt within the overall structure. So we've taken the opportunity to take it out. I mean it does result in an accounting hit, although there are benefits of earnings going forward, albeit over quite a long period of time. Net - there is a positive net present value on an after tax basis from pre-paying so it made economic sense to do it.

Sam Laidlaw: I'm sorry we can't be sort of more forthcoming I…

Bobby Chada: No, no, no I don't expect you…

Sam Laidlaw: …what everybody wants to ask of course which is pricing but I think from the statement it's pretty obvious that we haven't forgotten about it.

Q3. Simon Edrich,
ING: Good morning. First of all let me apologise if I ask something you've already said. I missed the first couple of minutes of the call but I've got three questions, if I may, the first concerning the industrial and commercial division, going forwards. That's a very volatile earning stream from that, which makes it difficult to forecast. I wonder if you could give a bit more colour on that division, going forwards and in particular when the old contracts start to unwind themselves.

Answer:
Sam Laidlaw Simon, I'll let Nick deal with that. You're right it is hard to model. The good news is that over time it's becoming less of a problem but I'll let Nick speak to it.

Nick Luff Yes, as you say it is volatile. Unlike other parts of the load book we have no pricing lever, which we can pull to adjust the profitability. So the results are what they are. Obviously the average price this year, input price, has been quite low and it's now gone up again and current prices will be quite a lot higher if you take the average across the year because there isn't the shape issues you get in the residential demand here. We do expect at current forward prices those contracts to make reasonably significant losses next year, albeit as you say, it's depending how wholesale price goes, that may change. The big ones really run off in 2010 within those contracts so you know we've got a couple of more years of the volatility that those contracts introduce before we get rid of them.

Q4. Simon Edrich: Thank you for that. Two further questions, if I may. The first is, you say in the trading statement 'in line with underlying pre tax results', your expectations and I just wondered if you could or had given quantification of what those expectations were.

Answer: Nick Luff: Yes, the consensus pre tax is about £1.89 billion and then if you take the 40 million from Humber it's about 1.85 billion, pre tax.

Q5. Ian Mitchell
JPMorgan: Morning guys. Just two quick well actually, the second one's a bit of a more waffly one but the first one is, on margins you were talking 6 to 7% long term operating margins, clearly we've heard that target before. But I just want to know you're talking more about balancing the customer growth with the margin build I mean, would you be prepared to accept margins below 6 to 7% in 2008 in order to continue to maintain the momentum on customers which you have? And then the other question is just, if you could just give us a brief bit of chat about where you're seeing the UK gas market now, clearly price is still very high, some colour on what you think the drivers are there particularly given the Ormen Lange news which Statoil came out with a couple of weeks ago would be most welcome, thank you.

Answer: Sam Laidlaw Yes well I mean I think the answer to your first question is we are still managing to the 6 to 7%. I think when we get into the fine tuning of pricing it clearly…it depends not just on what we do but clearly how the competition responds and reacts or whether they move before us and it's around relative differentials that is important. And that tends to drive customer churn and it also of course drives the number of additions that we have to our own customer base so I think the answer to your question is 'yes', that's still a target for 2008 but it will be a competitive market place.

The second question is all around the gas market and what colour can we add and as I said earlier in Q&A we are in a situation at the moment where we have demand above the seasonal norm. The seasonal norm would be around 125 million therms at this time of year; it's running around 140. Against that Norwegian production which we had anticipated to be at about 40 million therms and therefore an important contributor, is only running at about 30 million therms, essentially because Ormen Lange they've only got three wells on stream and the fourth well was due to be tied back on 1st December and hasn't yet been tied back. That will add 3 million therms. So there is a lot of gas coming out of storage at the moment. The question clearly is will the weather pattern stay colder than norm and how will long will it take Norwegian production to be restored to expected volumes, and you know none of us got a crystal ball on this here. But I think those are the big moving parts at the moment.

Q6. Jamie Tunnicliffe

ABN Amro: Yes good morning. I just wondered if you could give a little sort of comment on I suppose the state of your CCGT fleet. You've had over recent years sort of a few unexpected outages, so it's obviously aging. What are doing on that front in terms of trying to improve availability?

Answer: Sam Laidlaw Yes I mean availability for the year as a whole is running at 94%. Not where we'd like it to be and we can do better than that. And we have brought in some additional organisational competence, it's all part of Jake Ulrich's Group in Centrica Energy. But we brought in some new people with I think very good power expertise. As we speak at the moment all the fleet is up and running with exception of a planned maintenance schedule on Killingholme at the moment, but that will be back up by early middle of this month, middle of December. So you know I think we certainly recognise if you go back to the beginning of this year and last year the up time of the fleet wasn't where it should have been. I think we've taken a lot of corrective measures both in terms of preventative maintenance scheduling, but also a lot of work has been going on in terms of operational processes, which we hope will deliver results. We are not unduly concerned by the age of the fleet, and I think that we should achieve better up-time going forward and certainly that's the intention.

Nick Luff: Jamie I think I would add that one of the outages was during those floods we had in the summer so if they don't repeat themselves that will help.

Q7. Simon Edrich

ING: Follow up question if I may? Obviously very good volumes out of the upstream gas this year. I wondered if you could give some flavour on what the potential for volumes going forwards is, if you wanted to maintain that kind of volume level.

Answer: Nick Luff Obviously looking forward you've obviously got the decline of Morecambe which will eventually have an impact on the overall numbers, but we are, certainly for 2008, you know we have enough new fields coming on, no pun intended. Newfield itself of course adding to the non-Morecambe volumes such that depending on what prices do so we could well see similar volumes in '08 even if Morecambe comes down a bit.

Q8. Edmund Reid

Cazenove: Hi there good morning guys. I have a few questions. Firstly do you have any guidance on the likely tax rates for next year given potentially the change that's made again? And then my second question is just, I understand the sort of commercial issue around the price rises, but I just want to get your feel on given that you are sort of just profitable in British Gas in the second half. I'm assuming that in Q4 you're probably loss-making, and with Q1 2008 wholesale prices sort of higher than Q4 then I guess in Q1 you could be quite considerably loss-making. How long would you be willing to continue with the loss-making business?

Answer: Nick Luff You keep asking that question in different ways and we're going to continue to answer the same. Obviously the tax rate issue depends on the mix of profits. I mean this year, certainly from the first half, has been heavily biased towards the downstream. If you, when you adjust for I&C contracts, which is at normal tax rates and counts as part of downstream, then you know you are likely to see a higher tax rate, certainly based on current forward prices, you would see a shift in profits back towards the upstream and hence the higher tax rate; you know in the mid 40s – that sort of territory.

Sam Laidlaw: I think you said it all Nick. You know we are not going to tell you how long it's going to take and obviously we watch it on a daily basis.

Q9. Ian Turner

Deutsche Bank: Morning gentlemen can I ask you what you think has been going the right way for you in terms of customer numbers other than just price. What are you doing in the market to pick up? What is it that's… what's working?

Answer: Sam Laidlaw I think there has been a lot of training on the sales force. There has been also I think much better targeting of the sales force. There's been I think also more selective pricing on electricity which has helped. And I think there is also no doubt that the improvement in the service levels will start to have an impact on notifications, but also I think people recognise that they are getting, people are getting through to the call centres much quicker. And that enables us to connect people much quicker and bring them online much quicker. So it's a multitude of small things quite honestly. There's no one silver bullet and you know we talk about the transformation of British Gas it really is that. If you go and visit any of our call centres today they are a different place than where they were a year ago. Just in terms of employee engagement if you visit our sales force it's the same thing, and I think that is having an impact.

Q10. Bobby Chada
Morgan Stanley: I just wanted to ask what you thought was the biggest driver of the improvement in the Services business. You seemed to hint that it was having a particularly good year. Is it through additional revenues from new products or is it more sort of cost out-performance?

Answer: Nick Luff It's a bit both Bobby. There has been some good volume growth in that business, they've continued to drive sales hard and as they've grown they've managed to get some efficiency savings in spreading the overhead, in particular, over greater volumes. So we are pleased with that.

Sam Laidlaw: I think also Bobby I'd say that a lot of the process redesign that they did last year has meant that operating efficiency has improved significantly. We see that with productivity in the field as well as I think some of the service levels in the call centres.

Sam Laidlaw: If there are no further questions I think we can wrap the call up and can I just summarise for everybody. I think this clearly has been a record year for Centrica. As we look forward clearly it's going to be a more challenging business environment with a higher wholesale price, but I think with the significantly improved underlying performance of the business upstream downstream and the growth in the growth businesses, we are very well positioned to take advantage of that. Clearly you know the higher gas prices create a challenge for the business but I'm sure that the team are up for it and I think that we will continue to deliver strong results.

So I think with that, thank you all very much for your interest. Thank you for your support, and I'd like to wish you all a Happy Christmas. Thanks a lot.