centrica

Centrica British Gas Investor Day

Wednesday 7th September 2011

Angela Williams - HR Director, British Gas

Good morning everyone and welcome to British Gas's flagship engineering academy here in Leicester. My name is Angela Williams and I'm the HR Director at British Gas. In addition to my role in Human Resources, I'm responsible for health, safety and environment across British Gas as well as all of our academies, where in the past year we've trained over four and a half thousand apprentices and engineers across the business, delivering 115,000 training days.

Before I hand over to Sam Laidlaw I'd like to provide an overview of our safety performance to date and procedures for the day. At Centrica and British Gas our number one priority is the health and safety of our customers, employees, contractors and visitors. Our ambition is to ensure that everyone who leaves home at the beginning of the day to work for British Gas returns safety to their families and homes at the end of the day. We have made huge progress in the past year. We have over 30,000 employees and in 2010 0.8% of our employee population suffered an injury. In 2011, incidents have reduced by over 50% and we aim to reduce this further over the coming years.

In a recent internal confidential Health & Safety Survey, over 80% of our employees strongly believed that a safety culture genuinely is in place at British Gas. We have undertaken comprehensive communication, assessments and training of all of our leaders and managers in their safety responsibilities and Health & Safety is included as a key part of our award and recognition programmes.

While employee safety is a priority and our employees are the key interface with our customers, customer safety is equally important. We are trusted to work in over 12 million customer homes each year, that's an average of up to 40,000 home visits every day; it's a huge responsibility. We start every visit with a safety briefing with our customers and constantly focus on working safely in every home, from improving engineer toolkits to how we use loft ladders, so that we protect our customers every day. Like everyone who visits us today your health and safety is a key priority, to make the day safe and successful.

While here at the Leicester Engineering Academy and later at the National Distribution Centre and our British Gas business site in Spinneyside you are kindly requested to listen and follow the safety procedures. We are not expecting a fire practice or alarms to be activated at any of the sites today, therefore if an alarm rings, if you can leave each site through the designated exits which are shown by green emergency exit signs and meet at the designated meeting points in each car park, you will be directed to these meeting points by the British Gas team.

In this auditorium the nearest exits are behind me - where you entered and at the side over there. You will receive a full safety briefing for the specific risk areas at the National

Distribution Centre on the buses as you travel to the site. I hope this is clear but if you have queries please don't hesitate to ask. Please have a safe and enjoyable day and I will now hand over to Sam Laidlaw for the formal introduction.

Sam Laidlaw - Chief Executive

Thank you very much, Angela. And good morning to everyone and welcome to those on the webcast. This is our second investor day this year following on from the Direct Energy day in June and with Centrica Energy coming in December. We've got a full agenda for you today and you'll have plenty of opportunity to meet members of the British Gas team throughout the day. Phil Bentley is going to lead the formal presentation this morning providing an update on our strategy and on our progress. Phil's going to be supported by Ian Peters and Chris Jansen, who will speak in further detail on the residential and services businesses.

We've then arranged a series of breakout sessions - a visit to our Services National Distribution Centre, the only facility of this type in our sector, and this enables us to provide an excellent seven day a week level of service for all our customers. This is going to be followed by an in depth review of British Gas business exploring the way in which we've been able to drive growth through customer segmentation, and looking at the prospects for this business going forward. We'll also be giving you a presentation on the opportunities in new markets, with a look at some of the latest developments in micro generation and home energy management.

Our strategic priority for British Gas is clear; to achieve growth in a rapidly evolving market environment. Today we'll be taking a detailed look at the prospects for growth in each part of the business.

The way our business is structured is differentiated in the sector. We have the largest market share in both gas and electricity from both residential and small business customers, which gives us the benefit of scale. We are also the only UK energy supplier with a true dual fuel hedge, the ability to produce around 60% of our gas requirements from our own resources, together with a low carbon generation fleet capable of covering the vast majority of our peak load requirements. And our business model is very much focused on the customer - in energy supply, in services and in the growing energy efficiency market.

Over the course of the day we'll give you a detailed insight into each area of performance within British Gas. The key message that I'd like to reinforce is that the business is performing very well with clear purpose and direction and good prospects for growth, albeit in a rapidly evolving and challenging operating environment.

Overall, British Gas has now a proven ability to deliver strong profit growth and cash generation through the cycle, underpinned by our scale, our service and our drive for innovation. Residential energy supply is central to the business putting us very much at the heart of Britain's homes - maintaining a competitive advantage is critical, underpinning our ability to achieve sustainable profits.

And we continue to drive for growth in Services, with an aim of delivering double digit growth even in an environment of low economic growth - through attractive customer propositions and cost efficiencies, supported by excellent levels of service and differentiated through our highly skilled and trusted workforce.

In Business Energy we've near term investment to enable us to develop longer term growth, by offering customers carefully tailored products, leveraging the systems and experience from the residential business and over time developing further channels for growth with business services. And in new markets, where we're taking the leadership role capitalising on our broad range of expertise to take advantage of opportunities that are both profitable in their own right and provide support for the core energy and services businesses building deeper customer relationships.

So in summary, we are very well positioned in the sector for further growth from our downstream activities and this of course is a key component in the delivery of our group wide strategy to drive superior financial returns.

So with that I'll turn over to Phil and Ian and Chris and at the end of their presentations we will have an overall Q&A session - we'll hopefully answer your questions before moving on to the breakout sessions.

So, Phil.

Phil Bentley - Managing Director, British Gas

Thanks very much, Sam. And thank you all for making your way up to a very wet and windy Leicester today, we appreciate your time. Over the next 20 minutes I want to cover three key areas. Firstly I want to give you a sense of where I think we are in the industry and the major trends facing us. Next I'll reflect on the progress we've made in British Gas over the past four years. And lastly I'll look forward to what the next period will bring.

In short I think we've made good progress transforming this business. I believe that our unique model and the advantaged capabilities we've built will stand us in very good stead for the future, which is why I say to you today there's a lot more to come from tomorrow's British Gas.

Let me start with our industry and let's not forget that the UK market for energy and services is both significant and attractive. The supply of energy is profitable and what's been encouraging recently is that most industry players now expect their supply businesses to make a positive margin on a standalone basis. Yes, new entrants will certainly challenge the Big 6, but this is still an industry where, given the scale of investments needed both upstream and downstream, size does matter. Where the winners are those with the scale, flexible systems and relentless focus on service.

And the market for energy services continues to grow as well, with attractive margins. Amongst homeowners there's a growing demand for peace of mind, delivered by trusted professionals. But in addition, Government policy to transform energy efficiency across Britain through the Green Deal, feed-in tariffs and renewal heat incentives offer a once in a generation opportunity to companies like ours, with a trusted brand and a range of technology capabilities.

And those technologies, combined with the roll-out of Smart Meters in every home, creates another opening to engage with customers in a way we've never done before. Moving energy from under the stair cupboard or the cellar into the kitchen, the living room and on the go with Smart Phones - strengthening those long term relationships with our customers which are the backbone to sustainable value creation. Brought together in a co-ordinated offer with energy, services will, I'm convinced, become an even more attractive market over the next five years.

Our vision for British Gas is simple; by deepening our relationships with our customers through better service, innovative products, we aim to be number one for smart energy in the smart homes of tomorrow. However, we can't ignore the economic reality we're facing here in Britain today; household budgets are stretched, company insolvencies are high hence why, as we signalled in July, realisation of some of our ambitions will take a little bit longer. But I've every confidence we'll emerge even stronger when the economy picks up.

Why do I think British Gas is well positioned in market? Well, not only do we have the largest number of energy customers - a third of the UK domestic market and leading position in B2B - but our energy services reach with over 11,000 engineers is unrivalled, not just in traditional categories such as central heating but in the new opportunities such as solar, insulation, Smart metering. All backed up by great service delivered by our own people trained in the British Gas way in academies such as these here in Leicester.

Behind great service stands a trusted, best recognised brand and positively British Gas is the brand most trusted to deliver in the world of new energy markets. You don't make 40,000 visits a day to Britain's homes without being trusted and that's a privileged position we'll continue to build upon. Brought together our market share, range of capabilities and a trusted brand create the opportunity for scale competitive advantage.

Scale to invest in flexible IT systems, scale to drive out costs and scale to manage increasingly complex relationships, not just business to customers or business to business but increasingly B2B2C. Government policies such as CERT and CESP, regional initiatives such as NEST in Wales or the EAP programme in Scotland and an increasing appetite for corporate affinity deals, such as our recent water gains, require both complex tendering and relationship management skills, as well as the wherewithal to deliver scale, whole of house technology solutions into our customer's homes.

And as the industry leader we've had the confidence to invest in the source of innovation you'll see here today - both in terms of new products as well as in new service offers, such as our reward winning website.

So what of the progress that we've made over the past four years? Well let me start with customer service where I think we've really seen a true transformation. We've seen improved affinity with our customers, high net promoter scores, the lowest churn in the industry - culminating in being recognised as being the best in the industry for service in the past two years.

But we can't stand still which is why innovation such as Nectar, with 3.3 million sign ups, and our partnership with Sainsbury's is so important, for attracting and retaining high value customers. And if you want an example of our putting customers at the heart of everything we do then consider the customer panel and board we set up two years ago. Independently chaired by Ann Robinson of uSwitch comprising a cross section of customers, not only have they helped us develop our service strategy, but they play a key role in many decisions, such as those to equalise prepaid tariffs and suspending our doorstep selling.

Another area I'm proud of the progress we've made is in safety and engaging our people. As Angela said in her opening comments the safety of our colleagues and our customers is our number one priority. Our lost time incident frequency rate has fallen from 1.5 per 100,000 hours work to 0.5 in 2010 from 2006 and we're targeting to halve it again this year, with year-to-date cumulative position standing at 0.26. And we've seen significant improvements in our employee engagement metrics over the past few years receiving a number of awards recognising our progress. Mostly noticeably we’ve been in the *Sunday Times* 'Best Big Companies to Work for' and the *Financial Times* 'Great Places to Work' survey now for three years in a row. Put simply, better engaged employees stay longer, give better service and attract some better people around them. And our focus on ensuring our customers get the very best level of service has resulted in our receiving a four star rating from Consumer Focus for complaint management and winning European Call Centre of the Year for two years running now.

Another area of great progress in the last three years has been our 'Planet Home' advertising campaign. Instantly recognisable with leading cut-through, a measure of advertising recall, the campaign has consistently delivered memorable advertising, and a clearly measurable return on investment for us in terms of sales and brand equity uplift, as well as winning Marketing Society awards such as ‘Brand Revitalisation’ and encouragingly, given our focus on data and insights, ‘Best use of segmentation’.

I've mentioned scale a couple of times already and it's not just about the £100 million of core cost reductions that we've delivered since 2008, in areas such as the back office where costs have fallen by 60%, but also in our improved 'right first time' performance, together with online self service which has taken out four million calls in the past three years. But it's also the scale to be a preferred partner, not only the customer facing end with deals such as Nectar or an electric vehicle charging with Nissan and Renault, but also procurement partnerships are becoming more important. For example, we've recently signed ground breaking exclusivity deals with Travis Perkins as our merchant partner, and with Worcester Bosch for boiler supply and development.

And we're increasing leveraging our internal scale whether it be engineers generating energy leads, energy call centres providing extra cover for services in winter or something as simple as BGB debt collection being provided by BGR. Internal synergies offer great potential for the bottom line. And this is increasingly in our focus.

And on systems we really do believe that with our core SAP capability we are substantially ahead of our competitors, many of whom are yet to migrate their aging billing systems. Our Nectar Loyalty Scheme for example was built and launched in less than six months. Our online functionality is second to none and is the main factor driving two thirds of our overall contacts now online. Our credit management is industry leading and we're the only company to have built end-to-end straight through processing for Smart meters.

Finally Catalyst, which you'll see just outside the coffee station, will give us new capability to combine bills and provide a single point of service across both energy and services.

Whilst British Gas isn't a large consumer of capital, we've been quietly investing in systems and in new technologies and these are beginning to pay off, with a range of innovations we'll be showcasing later today. iPhone and Android Apps, ‘track your engineer’, remote control heating, solar, insulation, electric vehicles, Smart meters - it's an exciting time for British Gas as these new technologies begin to move out from the lab and into our mainstream channels. Innovation is in our DNA today, we took the decision four years ago to step up investment in technology and innovation and it's pleasing to see these options now coming to fruition.

Next, I believe our transformation strategies are delivering. As you can see our residential energy margins are substantially above the industry norm reflecting our high levels of service and customer loyalty, our industry leading cost base and our improved debt processes. As we've previously stated, joint customers, those who take both energy and services product, are increasingly important as they generally have lower churn, greater uptake of cross sell and represent our highest value segments. And we've grown this number, on average, by 7% each year since 2008 largely through proactive marketing and up selling. But this will improve further over time as our new systems roll out allowing us to single bill and cross serve.

Financial returns have quadrupled since 2006, and 2011,whilst challenging, I think it will demonstrate that in BGR we can sustain profit even in a rapidly rising commodity market, whilst holding market share.

And a similar strong performance has been seen in both BGS and BGB.

So let me wrap up by looking forward; looking forward at the opportunities for tomorrow's British Gas and of course looking at some of the challenges we face starting with the regulatory environment, where we are seeing a more robust approach from Ofgem to compliance.

However against the backdrop of the Retail Market Review we are already directionally compliant with Ofgem's guidance. For example we're the only supplier to split out our domestic energy supply profitability. We were rated top in the industry by Consumer Focus for clarity of annual statements and energy bills. And we've the smallest number of tariffs in the industry.

However whilst we support the concept of simplicity, we believe it's important that choice still exists for customers, hence why we, along with other consumer groups, are urging a sensible compromise to Ofgem's one evergreen tariff proposal.

We also have only one open investigation pending against us, in a total of 13 being carried out across the sector by Ofgem. And we've taken the lead by withdrawing doorstep selling, something most of our competitors are being investigated for.

So what are the prospects for our four divisions, BGR, BGS, BGB and New Markets? Ian Peters and Chris Jansen will give you a more detailed update shortly on BGR and BGS, and in the breakdowns Kanat and Gearoid will explain our strategies for BGB and BG New Markets. But let me give you my summary of each one in turn.

In BGR, despite a world of declining consumption, commodity price volatility, economic uncertainty and the challenging regulatory environment, we still expect to achieve margins of around 6% to 7% per annum, equivalent to an operating profit of around £600 million a year.

We'll achieve this through lowering our cost base, further reducing churn by deepening our customer relationships through innovations such as Smart meters and Smart homes, to compliment our traditional cross-sell channels.

In BGS we will continue to grow, although at a slower rate, as we flagged in July, than originally envisaged due to the difficult economic environment. Top line growth is being affected, particularly in discretionary big ticket installations. However by capitalising on our scale, focusing on service excellence and productivity improvements, this will reduce our cost base and we still expect to be able to deliver year-on-year double digit profit growth.

In BGB, growth has been very strong. In fact we expect to achieve our 2012 profit ambitions a year early. But margins are now beginning to come under pressure as competition intensifies. To counter this we plan to invest for future growth in marketing and sales to develop new channels and tailored propositions, through leveraging our BGR systems to reduce our cost footprint; and in B2B services where the market is now beginning to take off. This may take a couple of years to come through but I am confident this opex led investment will pave the way for longer term growth.

And finally in BG New Markets we are starting to capitalise on the growth potential of this market, through our insulation business, Smart go-early and our expertise across a range of microgen technologies. Here I'm expecting a modest but increasing contribution to profit in 2012 and beyond. But just as importantly, BGNM provides additional benefits to our core business; for example in BGR we're seeing a 30% reduction in churn for those energy customers where we've installed a Smart meter. And in BGB a 40% reduction in bad debt.

So how do I sum up today's British Gas? Well I think we have done well in delivering real progress across the 'Optimise the business', 'Take the lead', 'Capture new markets' initiatives. And we've undoubtedly grown British Gas.

But as I said, I'm convinced there's a lot more to come from tomorrow's British Gas. By focusing on service excellence as a key differentiator to build trust in the industry. By pursuing customer driven strategies to ensure we focus rigorously on our most valuable customers. By exploiting our distinctive capacity to further reduce costs as our systems investments come to fruition and we leverage those internal synergies. By gaining the same leadership in the growing B2B energy services category that we have in the domestic market. And, finally by capturing the major income streams arriving from innovation and smarter homes.

Put together with the track record of the experienced management team we have here in British Gas that you'll meet here today, I think the prospects for this business are encouraging. There's a revolution under way in the UK energy industry, and Centrica and British Gas are leading it. Now over to Ian and a bit more about BGR.

Ian Peters - Managing Director, British Gas Energy

Thank you, Phil. Over the last five years we have delivered a transformation in British Gas Residential. For the first four years I was the Chief Operating Officer and for the last year Managing Director of our energy businesses. In that time we have weathered the storms of extreme commodity volatility in 2008; managed our way through the coldest December and the warmest April months on record in 2010 and '11, and are mitigating the most severe economic downturn in decades.

Our operating profit profile, which Phil took you through in his presentation, demonstrates that our residential energy business is successful and sustainable. My presentation today will address four key themes: customer growth, where we have been delivering consistently churn performance well ahead of the industry average, and our return to market share growth; the step change in our customer service to the point where we are now winning external accolades as industry leading, as evidenced by falling complaint levels and rising net promoter scores, and we are delivering this through engaged and committed people; our commitment to maintaining a competitive operating cost base, including the success of our approach to credit and debt management, with further potential to come; and the advantage position we've established from our systems investments which are enabling innovation in products and channels as well as underpinning the other themes. And finally I will conclude with a review of why I am confident in the sustainable earnings capability of the business.

Let me start with the first theme of customer growth. Since 2008 we have delivered successive years of customer account growth. 141,000 in 2009, 267,000 in 2010 and we've seen this growth continue into 2011. Customer accounts went through the 16 million threshold in May this year.

We were net takers of business from all but one of our competitors in 2009 and 2010, and last year we stabilised the long term decline in our gas customer base. As a consequence, our market share of the domestic energy sector has risen by 1% to 33.1% at half one 2011, at a time of growing household numbers.

This success has been achieved through a combination of the turnaround in service, competitive pricing, a better understanding of the drivers of customer value through our approach to segmentation, and the launch of new channels such as Sainsburys.

Since we announced our price increase we have seen an upturn in customer losses, but these are in line with our forecasts. And our pricing strategy is to remain competitive.

Since 2008 we have materially out-performed the industry average on customer churn. In 2010 our churn rate of 11% compared with a competitor average of 20%. Customer retention is a key driver of value in building a customer base more likely to expand their product relationships with us. It has enabled us to invest less in the higher cost acquisition channels, which attract less valuable customers, while maintaining our growth momentum.

Turning to the second theme; the transformation of our customer service experience continues. We have made great progress, but customer expectations continue to develop and we know we can deliver a further level of improvement. Better service also leads to lower costs. Morgan Stanley have awarded us the top rating in their last two surveys, and Consumer Focus have recently upgraded us to four stars, and we are touching distance of the top five star rating.

Since 2006 call volumes have fallen by 43% as we have driven out system errors, re-engineered the back-office processes, while investing in people and enabling customers to self serve through digital channels. Average speed to answer has fallen significantly over the period, and the quality of the call is much improved. Our contact NPS has accordingly seen a step change from minus 30 at its low point to around plus 25 today. And Sainsbury's Energy is up to plus 54 with its service provided entirely by our Cardiff call centre, which has won the European Contact Centre of the Year award for the last two years.

We have seen similar shifts in customer satisfaction for our other key channels and processes. Our service is in large part delivered through our people, where our commitment to be a great place to work is evidenced by some of the lowest call centre staff attrition in any industry; 7% in some sites. And a step change improvement in employee absence. These trends lower costs, and improve the quality of the service.

Customer complaints are a litmus test of underlying service quality. Across the whole of the business they have fallen by 39% since 2008, and so far this year are 11% lower than 2010. The number of complaints to the Energy Ombudsman has steadily fallen, and our share has continued to reduce to 14% today, compared with our energy market share of 33.

My third theme is our relentless focus on driving down operating costs, which we have delivered while improving customer service. This has been underpinned by our investment in systems, extensive process re-engineering and the benefits of improved retention I've previously described.

As many of you will recall, British Gas Residential had the highest cost base in the industry not so long ago. Using the latest Ofgem segmental accounts data for 2010, which do not include SSE, we now have the lowest operating costs per account.

One of the more dramatic achievements has been in our back-office. Due to a combination of successful off-shoring and system enabled end-to-end process re-engineering; we have reduced our costs for these activities by 60% since 2008. This is now a very efficient and effective operating platform and will increasingly be used to support British Gas Business as you will hear later today.

We have steadily lowered our cost to acquire new customers by switching our mix to lower cost channels. Since 2006 we have reduced our field sales channel, our most expensive, from 1,600 roles to 330, and have recently announced an intention to switch this to a more sustainable booked appointment model. This channel had fallen to only 13% of our acquisitions and had been replaced principally by online and Sainsburys, both of which attract higher value customers. And we are further using Nectar to drive cost reduction, through for example incentivising our customers to submit their own meter reads, which over 800,000 customers now do each month through our website, and 200,000 each month via our iPhone application.

A further aspect of our cost reduction has been our performance in debt management. Macroeconomic conditions have posed a significant risk to our bad debt position. UK households have seen the biggest drop in disposable income for 34 years recently. And this understandably puts significant pressure on household budgets at a time of the coldest winter on record and rising energy prices. We are successfully mitigating this risk through a combination of leading edge credit and debt management practice, and also helping our customers manage their consumption. Rising prices do not necessarily mean higher bills, more of which you will hear about in the British Gas New Markets session.

In 2008 we introduced techniques from the financial services sector in building proactive and flexible risk based credit management systems embedded into our core billing platform. And we now have a series of debt paths tailored by risk based segment.

We've also created more customer contact, and debt repayment approaches. For example text reminders, a focus on promoting Direct Debits and working with external debt support agencies. Smart Meters will offer the next step change in debt management by providing remote credit to prepay switching capability and a means of highlighting significant changes in consumption patterns.

Taken together, we have more than halved the bad debt charge as a percentage of revenue. And bills outstanding over 60 days have also fallen consistently, reflecting the improved credit profile of our base and the higher Direct Debit penetration.

My fourth and final theme is systems. We learned a great deal from our early systems investment and now have a leading edge platform and capabilities at the heart of our sustainable growth. Our billing platform is fully established, whereas others have either yet to start their modernisation or are having problems.

It is flexible, especially around its pricing capabilities; has inbuilt controls and process workflows and enables rapid time to market. For example, as Phil said earlier, we built the Nectar programme in less than six months.

The platform is the first in the industry to be fit for Smart, with end-to-end systems in place from our own meter installation and operations business through the data flows from the meter direct into our billing systems. It is built for the scale of data it will need to handle but ultimately hundreds of millions of meter reads per year.

The transformation of our back-office processes has been enabled by its incorporation in a single platform, allowing the elimination of several secondary legacy systems which have the propensity to create errors and cost. We are now half way through an equivalent re-engineering of our front offices processes, the Catalyst Programme, which we will show you later.

This will create a further level of competitive advantage through lowering costs and improving service and sales. And will also increasingly enable the same screens to be used by our people and our customers online.

Over the next two years many of the above capabilities will be directly used as the platform for British Gas Business to lower its costs and improve its customer experience. Others will be adapted for our services and New Markets businesses, to maximise reuse and lower their needed systems investment outlay.

Finally, all of the British Gas systems are being moved to a new, lower cost, more flexible and faster private cloud data centre solution over the next two years.

Our digital capability has been at the heart of much that we've achieved in improving churn, lowering costs and driving new routes to market, including our Affinity partners. It is central to the next step changes we will make in the customer proposition and how we manage the business. Online transactions have been doubling every year since 2007. Meter reads, bill payments, Direct Debit set up and amendments, Nectar registrations and product purchases, and we will handle around 20 million this year.

In January 2010, for the first time online contacts exceeded telephone calls to our contact centres. And online now represents two-thirds of our customer contact. We now have a quarter of our customers using online account management, including receiving electronic bills and with an ability to compare their energy consumption to others; and we expect this percentage to accelerate.

In November 2009 we introduced EnergySmart, a proposition with a free energy monitor, and where customers submit their own meter reads monthly to obtain accurate bills. Over one million accounts have been opened, with a profile 17% higher value than the base, and a lower churn rate.

Customers are demanding increasing ways to access us on their terms. So we have launched our iPhone app which has 200,000 users, and most recently our Android app, both of which score 4.5 out of 5 on the app feedback sites. And we're also growing our live webchat service.

Our digital platforms will be key to the Smart homes products and services you will hear about later These are fundamental aspects of the future residential energy customer proposition. Our use of social media as a source of customer feedback is also increasingly important. We track all such traffic constantly, and on the day of the price rise responded in real time to help manage the message. In this field we are now regarded as the industry leaders as evidenced by the recent E-Digital award.

Looking forward there are four challenges to sustaining profitability. Firstly, customer retention in an increasingly competitive industry. We have established a real focus on this, which has placed us well ahead. The commitment to customer driven innovation in products, services and channels will maintain this edge, increasingly over time centred around Smart meters and the Smart home where we have first mover advantage. Churn amongst our 300,000 existing Smart customers is trending one third lower than the base, with higher satisfaction levels and fewer calls. The progressive elimination of estimated reads opens up a very different customer relationship, based on added value through multiple channels.

Secondly, we need to retain our cost advantage. The relentless focus on cost will continue, with an 800 million cost base to be influenced. Our front office process re-engineering, the continued shift to digital channels, and the roll-out of Smart meters are the key enablers of lowering our cost to serve. And these are three areas where we have a competitive lead.

Thirdly, consumption of energy is declining across the industry. This is in large part the consequence of the huge investment in energy efficiency, including through the CERT and CESP programmes, through which we benefit in British Gas new markets. We expect to offset this decline through better focused segmentation on higher value customers and introducing more cost reflective and simpler tariff structures.

Finally, it is clearly the case that the regulatory scrutiny of supplier behaviours is at a new level. We will continue to engage with Ofgem and other stake holders in the various reviews, and our track record has been historically good in reaching acceptable outcomes, for example in Smart metering. Our approach is to be customer focused and fact based in shaping a regulatory framework which is conducive to a sustainable business.

I said in my introduction that I am confident that British Gas Residential has a sustainable and profitable future. This is built on the four main themes of our on-going commitment to growth, further commitments to customer service, a continuous focus on costs, and leveraging our systems for competitive advantage and innovation.

I will now hand over to Chris.

Chris Jansen - Managing Director, British Gas Services

Thank you, Ian, and good morning everyone. I am Chris Jansen and have been with the company for four years, initially as the Commercial Director and for the last 12 months as the MD of British Gas Services. Before I go through our progress and thoughts for the future I thought it might be helpful to recap on what constitutes British Gas Services.

We are a 1.6 billion business with operating profits of 241 million in 2010, employing 15,000 people, 90% directly. The business comprises four units; Service and Repair is the market leader, with over 4.5 million customers on central heating care, with a 60% market share. This business represents two thirds of the revenues of British Gas Services. The focus over the next 18 months is to lower our costs through purchasing power, reduce pension contributions, drive the efficiency of our direct labour through strong union relationships, and also develop more compelling offers to tap into new customers, including our eight million energy customers who don’t have a service relationship with us today. Also the landlord sector remains a key opportunity.

Central Heating Installations is the only national boiler installer. Clearly this is a challenging sector right now and we will need to respond to the market by reducing our operating costs using our scale to establish strong industry partnerships and also developing more segmented value-driving propositions.

Electrical Services has grown strongly over the past few years, servicing the two million British Gas domestic customers for home electrics, wiring and kitchen appliances.

Our focus is on developing new capabilities and propositions within the low carbon economy, for example, electrical charging points and solar panel installations. Also continuing to win new corporate business, such as the recent servicing contract we secured with a leading white goods manufacturer.

Dyno is a franchise operation which is a leading national provider in the plumbing and drains sector. Around 70% of Dyno volumes currently relate to the two million British Gas contract customers. We will continue to focus on both developing our on-demand business by investing in the Dyno brand, and also offering a broader range of services to help establish partnerships within the water industry.

Let me now turn to what I see as important in the services market. Clearly we are facing challenging economic headwinds, given the discretionary nature of our products. Phil mentioned this earlier. However, while in the short term this alters our focus more towards cost cutting and efficiency rather than top-line growth, the market fundamentals remain strong. In trying to give you a brief sense of the market, we know that customers want a high quality service, but of course this needs to be delivered in a way that clearly demonstrates value for money. But this is not always solely about price. Increasingly customers want choice and flexibility in the products and services that they buy. Simply, they want to select products on their terms. But they will make these decisions in an increasingly informed way: they want brand differentiation to justify the products they buy, such as service, trust, and increasingly technology. Finally, the channels through which customers browse and buy are ever-increasing, as the market gets more diverse.

In response to these customer requirements and trends we have identified five key strategies. Firstly, service excellence is critical in this market and will remain at the heart of our offer. We don't have a focus on just making the sale, because when customers have a problem they want it fixed immediately, with the least fuss, by a trusted professional. And this is where British Gas excels.

Secondly, we need to seek continuous efficiencies so that we can make savings from our 1.2 billion cost base. Today's economy demands this and we remain confident in our ability to extract further savings. In effect this will become the predominant driver of our double digit profit ambitions in the short term.

Our third strategy is to grow the range of our products and services. Our insurance capability is a big enabler here, and gives us considerable advantage. This has also included the introduction of lower price point products to allow us to compete in the growing lighter cover segments. The breadth and depth of our product range is unsurpassed across our markets and we will be increasingly communicating this externally to raise awareness and consideration. This will in time drive revenue growth.

Our fourth strategy is to continue to invest behind the British Gas brand, and along with the rest of the organisation we see Smart innovation and new technology as critical in this regard. We are building new online tools and systems capability which will enhance the experience to retain more customers.

The fifth and final strategy is to look to drive revenue through new channels and markets, with a focus on commercial partnerships, building on the early successes of our Sainsbury's and Nectar relationships.

Let me now share with you some of the specific detail on each of these five strategies.

Our national base of over 9,000 highly trained engineers is a unique and vital differentiator. The nearest competitor has less than one tenth of this direct workforce. Engineers lead our frontline customer service and it is encouraging to see that net promoter scores for engineer visits have been rising steadily across the business. And at +59 it's five points higher than two years ago. Service excellence drives NPS, and we know that a higher NPS reduces churn.

Our core homecare proposition includes several features which our smaller scale competitors cannot match, including unlimited call-outs with all parts and labour included, 90% same day service for breakdowns, and the ability to order spare parts up to eight o'clock at night for delivery anywhere in the UK by 7:30 the following morning. You will have the chance later to see the National Distribution Centre.

Over the past 18 months we have continued to enhance our proposition, most notably by agreeing terms and condition changes with the GMB, the detail of which I will cover later. The net result allowed us to improve our response rates last winter, despite experiencing the coldest winter for over 100 years. In December alone we fixed 500,000 boilers.

Customer retention is a key focus for us and we are pleased that churn has reduced from over 19% in 2008 to 16.7% in 2011. Again, a positive performance, especially considering the current economic and competitive environment. This progress can be tracked to a number of factors. Consistent with service excellence, the quality of our work continues to improve. You can see this in the positive trend for both complaint volumes, which have fallen by over one third since 2008, and the number of breakdowns which are being resolved at the first visit. The first visit metric is both important commercially in terms of efficiency, but also drives customer satisfaction. Our first time fixed rate has increased from 64% in 2008 to over 70% today. One driver to this has been a smarter approach to van stock. Over the past year we have re-profiled 6,000 vans and now when a repair requires a part 57% of the time it is already on the van, which is up from 41% three years ago.

Looking forward, we are now taking delivery of 2,000 new Maxi vans, which you may have seen outside. These vans hold 40% more stock than the Caddy vans they are replacing. In this van buy we've pushed Volkswagen to agree the same price for the Maxi as we had previously paid for the Caddy. This is good commercially, as bigger vans with more stock will improve our first time fix rate.

Finally you can see on the right hand bar chart the impact of speed of response on customer churn. Simply, if we get to customers in the day that they call us then they churn at a rate of 8%. You can also see from the red line on the chart that we deliver this for 60% of all jobs, but for priority work, where the customer has no heat or hot water, this increases close to 90%. However, when it takes us two days then you can see churn leaps to above 13%. So speed of response is vital to customer satisfaction, and underpins service excellence. These churn numbers are lower than the total churn as they exclude electrics, plumbing and appliance care, where the churn is higher.

Service excellence is also critical to growing our installations business. The economic climate has been particularly adverse for large consumer purchases, and we estimate that the overall boiler installations market will fall by at least 20% in 2011. Against this background we have managed to grow our installations volumes very slightly in the first half, and we increased our market share to over 15% from below 12% in 2009.

Our installations propositions focus on the thoroughness, quality and peace of mind that you can expect from British Gas. We are the only supplier who guarantees to honour the quote under all circumstances, and this is a key differentiator versus the habits of the local professional. At +77 the net promoter score in CHI is the highest in the business.

We are also driving sales through a regular programme of eye-catching offers, which can be very effective in this market, supported by above the line marketing. Our scrappage campaign across June, July offered a £400 discount off a Worcester Bosch boiler, jointly funded by the manufacturer, which increased weekly sales by 65%.

Looking forward, we are developing more bespoke offers for discreet customer segments, ranging from lower cost value propositions to an emergency installation where speed is of the essence, through to prestige and new technology propositions including remote diagnostics and boiler controls, which you will see later.

Given the economic context, we continue to be very focused on tight control of costs and operation efficiency. In the service and repair business engineer productivity measured in terms of jobs completed per day has recovered from below seven, at the height of the extreme winter, to 8.2 today, which is 5% higher year-on-year.

Engineer productivity is an important and sensitive financial driver in services. We will continue to drive productivity through engineer training, for example we have recently created a success coach role to raise performance across the workforce, and also further improvements in planning and scheduling of jobs that will reduce idle time and travel between visits.

Also, as you can see from the chart on the left, the first half of 2011 was marked by an 80% reduction in the backlog of annual service visits which arose as we prioritised breakdowns during the extreme winter. As well as offering an important safety benefit, annual service visits reduce by 14% the likelihood of a breakdown over the following 12 months.

Finally, in the installations business we have seen an 18% improvement in the efficiency of our engineers as we have reduced job times and maximise our own labour resource before employing contractors. This also has a bearing on service excellence, as the quality we deliver with our own team is much higher than that of indirect labour.

We have also focused on maintaining or reducing our material costs through creating closer working relationships with key industry partners. In April this year we began a five year relationship with Travis Perkins to be the sole distribution partner for our central heating installations business. We previously had three merchants, which had prevented us from integrating our supply chain to create efficiencies. Over the course of the next five years we will save £25 million from our supply chain. As part of the Travis Perkins relationship we are also exploring opportunities to source directly from China to further lower our costs. We visited China together over the summer and have identified the first few items to jointly source.

We are also in an advanced stage in creating a five year strategic partnership with Worcester Bosch. This will include excellent commercial terms for boilers and spares, joint product development, with a particular focus on innovation, and of course our cooperation on sales and marketing will continue.

Over the past 18 months we have built a very collaborative relationship with the GMB who represent over 85% of service engineers. This positive relationship has enabled us to implement very substantial changes which are leading to transforming the business and facilitating growth. As you will be aware, last year we successfully negotiated the most significant changes in engineer terms and conditions for the last 15 years. These changes increased our guaranteed winter resource by over 500,000 hours, or an additional one hour per engineer per day. We also agreed increases in evening and weekend working, compulsory overtime, and the removal of previous working time restrictions. The terms and conditions changes allowed us to launch our customer promise, under which we committed to visit customers the same day if they call us with a boiler breakdown prior to 1:00pm. This was a successful campaign which drove contract growth over the winter and provided a rallying cry to the business. More recently we have secured the support of GMB for changes to our engineers' final salary pension schemes. GMB's support for these changes is vital to releasing the anticipated savings from our annual pension costs.

As an insurer we can offer a broad range of more flexible products, which is critical given the current market trend towards lower entry price points and the use of excess payments. This has allowed us to develop new services, such as a boiler cover for just £4.00 per month, with a £100 excess, as well as other new breakdown-only services, such as water supply pipe cover, both of which are helping to drive additional growth.

Part of the move to insurance has involved an increased sophistication in how we price customers at renewal. Specifically our risk based pricing takes into account breakdown frequency, boiler reliability, and age, which results in more reflective prices to protect margins. Aligned to this we are seeking to further improve our customer communications so that we reinforce the benefits of our products to customers.

We also see an opportunity for services in the UK private rental market, which is forecast to grow substantially, and where we are under-represented today. We estimate a potential addressable market for landlord services of 3.3 million properties, of which our current share is around 6%. Our customer research suggests that landlords would welcome a stronger British Gas presence in this marketplace.

Finally, we will continue to target the eight million energy-only customers with preferential offers such as our exclusive energy extra bundle that has seen good growth over the last 18 months. We now have almost 350,000 customers on this product. The introduction of our new systems through Catalyst that Ian talked about earlier will facilitate more bundling and joint propositions.

In Services we are starting to focus our advertising on the unrivalled breadth and depth of our product range. This is a key competitive strength of British Gas, but consumer awareness of all of the products that we offer and the comprehensive cover we provide can be improved further. Therefore, as part of the strategy to raise consumer awareness, yesterday we launched a major new campaign across TV, radio and outdoor media under the theme of 'Our cover covers more', and I would now like to play the ad to you.

(Playing advert twice)

We liked it so much we thought we'd play it twice!

Developing our online functionality has been a key focus of our customer service strategy since 2009, when we first launched the ability to book an engineer using our website. Since then the number of jobs booked online has increased from just over 200,000 to an expected one million in 2011, or 14% of total jobs. We intend to increase this by 50% to 1.5 million job bookings in 2012, and to that end we are planning new functionality to improve the online customer experience. At the same time we will see a reduction in operating costs by driving up our online capability. In November we will launch 'Track your engineer', which through the use of email, SMS, and an online status bar, will give customers more information and reassurance about the progress of their job.

As I touched on earlier, we are also developing remote boiler controlled functionality, which will enable customers to control their central heating systems from outside the home using their computer or Smart phone. The concept of 'never come home to a cold house' is compelling, and through our investment in AlertMe we have an exclusive partnership to develop this market-leading technology. My colleague, Gearoid, will show you this later.

Finally, we have been exploring new channels, adjacent markets, and commercial partnerships to create new revenue streams for the longer term. Our partnership with Sainsbury's is a good opportunity, and we expect to start exclusively selling service products through the Sainsbury's Energy channel later in the year.

A significant amount of new activity has been in the water sector, where we see attractive growth potential from working with water companies on a broad range of activities. We have invested considerable time in understanding the dynamics of the sector and remain in discussions with a number of water companies. Our initiatives and relationship building here are beginning to bear fruit. Specifically we have recently agreed an affinity deal with Wessex Water. This will provide us access to almost 600,000 customers, of which more than 50% don't have any relationship with British Gas today. We anticipate signing more affinity partners in the future.

A further example of progress is that we have been awarded contracts from five water companies to date for work relating to DEFRA private sewer transfer and we are in negotiation with other companies. We also have consumer trials in place with five companies, with three more to come, based around water efficiency, an area of joint interest for water and energy companies.

We have also been reviewing opportunities in financial services, especially the provision of home insurance. Consumer research indicates that British Gas has the scale, brand strength, and unique assets, to be a credible provider of home insurance. To this end we are in discussions with a number of insurers around a potential partnership.

To summarise, we have five clear strategies to build on the great strengths of British Gas Services and to benefit from the changes in the marketplace, notwithstanding the challenging environment. Service excellence is and will remain core to the British Gas proposition, underpinned by the quality of our highly skilled engineers and the scale of our operations. We believe that despite the economy we can retain more customers through our high standards of service.

Secondly, we will continue to drive continuous efficiency and cost control, with a focus on labour productivity, purchasing power and pension costs. Given competitive and economic pressures we plan to reduce our 1.2 billion cost base further, even after taking into account inflation and any material cost increases.

Thirdly, our broad product range will continue to evolve and we will increasingly target specific customer segments with tailored propositions, taking full advantage of our insurance capability, positioning ourselves well when the economy recovers.

The fourth strategy of leveraging the power of the British Gas brand will raise awareness of our competitive product range. Also our online and Smart innovations will enhance the customer experience, further helping to reduce churn.

Finally, we are developing commercial partnerships to open up new channels and markets, and drive longer term revenue growth.

In summary, therefore, we believe that with our unique and powerful assets, and a clear strategy, we can deliver continued double digit profit growth for British Gas Services into the foreseeable future. Across 2011 and 2012 our cost-cutting and efficiencies will be the predominant driver behind achieving our double digit profit ambitions. Looking to 2013 and 2014, our breadth of product range will position us well and create the platform for top line growth as the economy recovers.

And now I'll hand over to Phil. Thank you.

Phil Bentley

Thanks Chris, and yes, I enjoyed the ad as well, so look forward to seeing the pickup of that in the comments from the media.

So let me sum up before we turn to Q&As, and I think we are well-placed to take advantage of the opportunities in each part of the business. In BGR we will maintain profitability of the business leveraging our competitive advantage in terms of costs and customer loyalty. In BGS, as Chris said, we'll target double digit profit growth, even in tough market conditions, by offering attractive customer propositions as well as maintaining tight cost control and driving productivity improvements.

BGB will invest for long term growth, sharing costs with our residential energy business and over time developing our business services offering. In the new markets, we now have the expertise across a wide range of technologies to capture growth in these exciting new markets, underpinned by government policy and the drive for energy efficiency.

I think what's equally important though in our four divisions is the growing interdependence between each of them. And that's not just in terms of the significant internal cost synergies I've referred to earlier. Take just one example, electric vehicles. We're winning all the corporate deals with motor manufacturers, but it's our electricians that fit the charging points, and by installing a Smart Meter we offer an overnight time of use tariff for cheaper recharging. In short, an integrated solution built around the customer's needs. This is very much part of our integrated vision for an energy company of the future, and for tomorrow's British Gas.

So now we'll turn onto Q&As. I think we've got a good session to come before we break for coffee at the back, so I'd like to invite Nick and Sam up, and Ian and Chris, and we've got Alisdair Cameron, our Finance Director, Gearoid Lane who'll you'll be meeting later on in New Energies, and Kanat, also mic'd up on BGB and BGNM. I think we've got roving mics around, I think we're still being webcast, so if you would just speak into the mic and just say which company you represent, that would be good for the webcast. Thank you.

Question 1

Martin Brough – Deutsche Bank

Can I just ask about the growth in the new market stuff, so Smart metering, the Green Deal, insulation, solar, and obviously you've got a good opportunity there to help government to try and meet its targets. But the government targets are pretty ambitious, and some of the underlying assumptions in them are already being questioned, and you don't have to sign on to that to make profits out of delivery, but how do you, as Senior Management, control what people are selling on the doorstep to the customers, in terms of what solid wall insulation would deliver or what solar panels will actually produce, or what Smart meters will produce? And if there is push-back from customers in three or four years down the line how do you stop the British Gas reputation being on the line in terms of the way it's been sold?

Answer: Phil Bentley

Yes, it's a very good question, Martin. I think if you unpick it a little bit, do we think the government is committed to the Green Deal? Yes, we do. We've had meetings with Number

Ten quite recently on the Green Deal and we've got follow-up conversations with them about how to make that happen. The primary legislation enabling it is already in place and secondary legislation is following it. So I think the intent is there to make it a success.

The second point you made is around the reputational damage potentially of mis-selling in the home. And I think we fully understand that and want to ensure that good standards of installation and protocols are in place. For example we talk about MCA accreditation of our work, and that is something we're encouraging all installers to adhere to. We're also developing with consumer groups protocols and agreements for selling or lead generation. I think what you've picked up recently is this idea that somehow by doing Smart meters in the home, we somehow won't leave the home until we've got a sale. And that's not at all what the intent is. In terms of British Gas, our Smart meter installers are engineers to fix, to replace a meter, and all we say is, let's just ensure our customers understand how to use the meter, how they might consider making their homes more energy efficient, and let's not waste that opportunity to have that conversation, provided you're not doing direct selling, and if there is a follow up it's something that the customer has specifically asked for.

So, I think we can deal with those concerns and still give a good experience for what should be a very important initiative that will drive significant investments in that new market's world.

<u>Question 2</u>

Jamie Tunnicliffe – Redburn

Following on from that, what things have got to be done to make sure that Smart meters don't end up being an expensive billing system?

Phil Bentley

Smart Meters don't end up being more expensive?

Jamie Tunnicliffe

No, an expensive billing system.

Answer: Phil Bentley

Well, you're right to raise that point, because essentially you would go from three or four meter reads a year, if you're lucky, to 175,000 half-hourly meter reads. I think the point there is that scale of systems are important behind that.

The meter itself is a little bit more expensive because you've got all the protocols of sending the GPRS messages. But for the industry as a whole and for customers as a whole we still think it's going to be a positive saving because of lower debt, less calls for estimated reads, and all the on costs of poor service that estimated reads give us.

Ian, do you want to comment on how we think the savings will come through?

Further answer: Ian Peters

It's just to build on that point really. So – and you'll hear about it in the BGB session this afternoon – call volumes, because estimated read is the route of most calls, will drop right out, and we've seen that in BGB already. Cancel re-bills where, particularly in the corporate sector, there are queries over bill accuracy, have dropped by about 60%. And I alluded in my presentation to the savings we can make on bad debt. So, while it is true in a very marginal sense that the aggregate cost of metering will go up slightly, in the aggregate, looking at the net, it is a significant cost saving to us.

But the customer benefit also needs to be recognised here, and Gearoid might talk about it in his session later. Consumer benefits in terms of lowering average consumption, because that is visible in the home, are also very tangible. And that's one of the main reasons churn is going down.

So, you have to look at this thing in the aggregate rather than single KPI measurement.

Further answer: Nick Luff, Group Finance Director

The other critical thing about Smart meters, of course, is the enabling technology for everything else that we want to do, whether it is electric vehicles, micro generation in the home, fuel cells etc. So, it is for us, if we can make it cost neutral or thereabouts, then it becomes the enabling technology for everything else that we want to do.

<u>Question 3</u>

Verity Mitchell – HSBC

I've got a question about BGR and politics. Given what happened in the budget with the North Sea tax surprise, how are you, I suppose, ramping up the political risk protection, BGR and I suppose to a wider extent in the Group, given that economics and politics are very highly charged at the moment?

Answer: Phil Bentley

Yes, it's a good question about the amount of lobbying and the discussions that we have with Government. It is something that we are clearly sensitive to. But as we said, I think our margins compared to other industries are some of the lowest that I can think of. And what we are encouraging within government is for what Sam Laidlaw has called for before, which is an honest conversation about the challenges facing the industry, the huge investments that are required upstream in terms of security of supply and low carbon technologies, and what the inevitable consequences are downstream. So, I think Number Ten are certainly up for a wider discussion so that we are all on the same page when it comes to understanding what the implications are.

Having said that, the cost of the bit of the green investments that are related to feed-in tariffs and Renewable Heat Incentives, are actually a small part. Most of that cost you read about in the press this week, for example, comes from things like the carbon tax and the upstream support that is needed.

Further answer: Sam Laidlaw

I think the question is a very good one. Clearly there is, as you rightly say with energy bills going up, with lower disposable income and low economic growth, it's a matter of great political concern. But I think we are fully engaged in that discussion, in all dimensions of it, whether, as Phil says, it's in the upstream around the necessary contracts for different price to promote low carbon generation and the reform of the electricity market, or whether it is in the mechanisms downstream that are encouraging energy efficiency. I think the important thing is that a lot of the measures that we are supporting and that create good value propositions for our shareholders in the downstream are all around driving energy efficiency and actually lower bills. And you see a lot of the work that we're doing in insulation, the installations of condensing boilers, and the straightforward pieces of the services business that you'll see today, are actually helping customers reduce their bills. And actually that's a very important offset to the fundamental issue with lower carbon generation being higher cost than high carbon generation.

<u>Question 4</u>

Mark Freshney – Credit Suisse

Just two questions. Firstly, it's interesting that you mention that one of your competitors is a net winner of customers from you. It's also interesting that someone with even more access to fixed cost generation than yourselves, EDF, hasn't yet raised prices. How much of a risk do you see them as a competitor? And that they potentially are much more interested in a route to market for power than margins?

Secondly, one of the key points that I think came out of your first-half results presentation was that the number of boiler contracts you had was flat for the first time in some time, and we've yet to really see fiscal austerity measures and what's going on right across the economy really start to kick in. If the number of boiler contracts you have comes down, what else is there that you can do to protect margins and keep that double digit growth within BGS?

Answer: Phil Bentley

I'll let Chris deal with the second part of the question around CHI. But remember we were lacking within the previous year, 2010, the government boiler scrappage scheme that had been very rich and had increased demand for boilers quite significantly. But I think it's a good question, I'll let Chris come to that in a second.

The first part of the question is more complex. Clearly competitors, we aren't complacent about our competitors. The competitor I referred to who we had lost, the only company we had lost share to, has clearly subsequently changed its selling practices, because we are no longer losing share to them. I think that was a moment in time, I'll leave it to Ofgem and the process they're going through to conclude why that might have been happening.

The EDF question again I think is a good question. You look at their share price and it's fallen significantly, and it's not for me to comment on where their thinking is. I do know that they are going through a significant migration of their billing systems at the moment, and it is quite complex to put pricing changes through when you're going through that sort of massive data change – and we know that from our own experience. I can't comment any more on their own thinking, obviously we want to remain competitive.

Further answer: Chris Jansen

On British Gas Services, I think that actually we are seeing the impacts quite significantly of the economy biting. We talk to our partners all the time, Sainsbury, Worcester Bosch, Wolseley, Volkswagen, and they are really seeing a reduction in spending in their areas, particularly Sainsbury – and that has publicly been stated. So, we are seeing it definitely.

I think what our focus is on is very much our service excellence, because we track all of the performance of ourselves and obviously our competitors in the delivery of the service that we're providing, and we have by far the highest net promoter scores in terms of the actual service that the customers receive. And I think that's really important because what will happen is they are discretionary products, and churn will increase if the utility that the customer is not getting doesn't justify the price that they're paying. On our boiler contracts we see every customer annually anyway, and the average call out – some customers see us more often – but 67% to 70% of the contract base call us out averagely across the year. So, customers are getting quite high utility from the product.

Conversely with those in some other sectors, water supply pipe, where the utility isn't that great and the call out rate might be very low, those are the kinds of areas where you may see churn increase.

So, we are cautious about the economic outlook, and therefore that's why our top line revenue growth assumptions are conservative, and therefore we're focusing very much on cost efficiencies.

Further answer: Phil Bentley

I mean, as well, just to pick up the point that Chris made in his presentation, is around segmentation, because there's a cheap end of the boiler market and there's a more added value. I think it's fair to say that without the boiler scrappage stimulus, we probably don't want to play at the very cheap end of the boiler market, we're much more segmented on the added value service.

Further answer: Chris Jansen

Yes. A very simple analogy, we're selling a kind of BMW service into new installations where we do guarantee the quote, we have warranties and cover for customers, so we offer a very, very good service. And there are segments of the market that really like that and will pay slightly more for that service. So, there's no point kind of selling a BMW service at Ford prices, that's not what we're trying to do.

Further question: Mark Freshney

Just as a follow on, it's interesting that you mention conservative revenue growth assumptions, can you share those with us?

Answer: Chris Jansen

What do you think, Nick?

Further answer: Nick Luff

What year by year, month by month, Mark?

Further answer: Chris Jansen

I think it's sensible within the current economic context to be prudent. Obviously we're trying as hard as we can to drive the revenue and the growth, but the other thing is not to overly push the sale of the products. I think that some of our competitors have very sophisticated sales and marketing operations, which is great, but we tend to be much more focused on the delivery of the service to customers and making sure that we're selling the right product to the right customer. Because in time if you sell the wrong product to the wrong customer or you don't deliver the service it catches up with you. And so you might have great growth rates, but you'll see the churn increase.

And so I'd rather we looked after our existing customers and accept that we might grow at a slower rate in the current economy than we would like, but position ourselves well for when the economy recovers.

Further answer: Nick Luff

To achieve that double digit profit growth we'll need some revenue growth, but a lot of self-help too with the cost efficiencies that Chris talked about.

Further answer: Phil Bentley

The water business that Chris touched upon, these new affinity deals that should drive some top line. Of course, a lot of the other top line growth where we have seen a substantial increase in turnover is in Gearoid's new markets. And we haven't really pulled out that turnover, but this year we're up, what, 250m this year of sales, from a business that two years ago was turning over hardly anything. So, when we segmentally report externally that turnover gets lost in BGR's huge number. But I think that's where you will see really good growth. And we've lined up some good contracts with whether it's Scotland, Wales, whether it's the new local authority deals, whether it's PH Jones and the Mears' transaction, that's all going to give really good top line growth in BGNM.

Do you want to say a bit more about that?

Further answer: Gearoid Lane, Managing Director, British Gas New Markets

Well, we're going to pick up a bit more on that on the next session in the breakout, so I probably won't give away too much of their thunder. But we've grown from last year 130m to somewhere approaching 300m this year.

<u>Question 5</u>

Ian Turner - RBS

Can I ask about the demand decline? And do you think that's been caused by everybody using a bit less, or is it individual people making a big effort as they get insulation and whatever fitted? And therefore do you think it kind of bottoms out? Or does it carry on declining into the future?

And do you think your mitigation strategy of targeting high value customers, given your very large market share and given presumably the idea that everyone will try and target those customers, do you think it's likely to be successful? Or what are the barriers you see to achieving that?

Answer: Phil Bentley

Yes, Ian, I'll turn it over to you in terms of how we're seeing demand decline. I mean, recognising we've had cold winters, we've got the economy, you've got to unpick all that. But we are definitely seeing those where treatments have taken place in the home doing more than those who haven't done anything. And so I think we'll see a continuation of that decline.

I think the higher value segment we would argue, as we've tried to today, that the relationship is built from not just one product and not one touch point, the relationship for the higher value customers is built around the service Chris offers, the ease of billing that Ian has, the innovation that Gearoid is bringing to bear. And that's a breadth of touch points, backed up by Smart Meters, where we are targeting installing those in preference to the higher value, which we think gives us an unrivalled position for those higher value customers.

Further answer: Ian Peters

On consumption decline it's quite hard given the extreme weather conditions of the last 18 months to really get to the true underlying trends. But there is a combination of... I mean, there was clearly some turn-down going on, but it's very hard to calibrate exactly what that is but there was this huge investment in insulation particularly, powered by certain sectors, which is driving some of that, and the work that we're doing on the likes of Energy Smart and providing in-home displays is helping customers change their behaviour.

Net-net the underlying trend in gas which is going on across the industry, it's not unique to British Gas, is probably in the order of 3% or 4% per annum would be the guidance on the underlying trend.

On power it's much narrower than that, our indications are that the underlying trend might be 1%, possibly 2% down. But on the flip the gadget economy is driving power consumption up, electric vehicle charging will take it up higher than that. So, the outlook on electricity is much flatter I think over the medium term than it is on gas.

<u>Question 6</u>

Lakis Athanasiou – Evolution Securities.

Going back up to the previous question on central heating installations and see if I can pin you down a bit more. I seem to be reading from what you're saying that you anticipate a decline in installations this year, but with margin expansion, because you said you're focusing on higher value installations, would that be a correct reading? Is that an ongoing feature?

Secondly, more general, are you picking up a change in Government attitude? I thought the so-called leak from the Prime Minister's office in *The Telegraph* beginning of this week was quite telling, it talked about 15% operating cost and margin in residential sales, suggesting that is this something Government should be really focusing on to target its competition, pushing through into residential, a big focus that politicians should be driving for. And also, not to do with this conference, but seems to be also be turning to an anti-offshore wind tone to it.

And the final question, very different again, you touched on different parts of the presentation about your churn. Could you just enumerate why you believe your churn rates will stay low in residential energy sales, why you would retain a sustainable competitive advantage in order of importance?

Answer: Phil Bentley

On CHI I think you're right, what Chris has touched on, I think we probably will see a second half softer because we haven't got the sort of stimulus from the economy. But the flip side of that is AOV, average order value, it will be higher.

I've forgotten the second question now. Go on tell me what it was again?

Lakis Athanasiou

The second question was...

Phil Bentley

Number Ten.

Lakis Athanasiou

I thought that was a significant leak myself?

Answer: Phil Bentley

Look, you don't know, I don't understand the world of leaks and what's intentional and unintentional. We know Ben Moxham very well. He's a sensible guy, he came from BP. And we think he's trying to open up the debate. Slightly controversial, but there are elements within DECC who would have you believe that prices are going to fall. And we don't think that's right, we think it's the more we encourage an open conversation the better the media understands it and the politicians as well. So, behind the intent there, we believe, was an opening up of the fact base. And I think, as Sam said before, let's call for an honest conversation.

In terms of the numbers I didn't recognise all of the numbers, some of the numbers we recognised, but I didn't recognise the 15% supply margin. I'm not sure I even recognised…

Lakis Athanasiou

I think it meant operating cost end margin being 15%, which is about right I would have thought.

Further answer: Phil Bentley

Yes, it's probably about right. But it was written as if that was all, operating costs were low and most of that was profit.

300 quid a customer, I don't think we think it's as big a number as that. You know, in terms of the upstream side of it there is certainly support for new nuclear in there.

Further answer: Sam Laidlaw

Yes, I think that's clear. I think what was being suggested and I think the conversation is really not so much around the policies that are in place to meet our renewables target that we already have, and have signed up to, in common with a lot of other European countries but what happens beyond 2020.

Further question: Lakis Athanasiou

The third question was churn. I think the key thing for you is in maintaining a sustainable gap in British Gas Residential on churn. You touched on it in different parts of your presentation, but can you just list, in bullet point form, why you think you will retain a sustainable advantage on churn.

Answer: Ian Peters

From a residential energy point of view, not in any sequential order, but we have to maintain the discipline on costs in an increasingly competitive market, excellence of service, I think the Smart meter, Smart of the Home transformation that we are leading the way in is driving a step change in churn. And I think those three, combined with continuous innovation of products and propositions, that's changing us to a more value added relationship over time than a commoditised one, I think. All of those we are demonstrating success to date, and we have to keep on that pace over the next two or three years.

Further answer: Phil Bentley

You've got Nectar, 3.3 million customers signed up with Nectar. We're now the second largest Nectar partner from a standing start at the end of February. That is clearly driving loyalty as well. Clarity of bill online, you can flex your DD payments online, you can put in your monthly meter reads and pages for what you use. There is a huge amount of functionality that goes behind the bald statistic of lower churn, but it is all intentional. As well as targeting the right offers, I touched on segmentation. Some customers are more sticky than others, inevitably. And there is a subtle point about field sales that Ian was making, those are the people who will traditionally buy from the doorstep, and therefore have a high propensity to switch. So, if we can attract customers through either events, green events, or other types of deals which are really focusing on the higher value, lower churn customers, that is what our segmentation analysis is directed at; which means we're using different channels to attack with different products to attack different segments.

Further question: Lakis Athanasiou

So it's not so much a legacy issue, but trying to build more stickiness through new customers as well?

Answer: Phil Bentley

To my mind the legacy is an old story today, because we have 43% or 44% of the gas market, which by definition means 50% odd have switched, and of that 44 probably half have rejoined us. So, there's probably been 80% switching in totality. So I don't think the legacy is the big story there.

<u>Question 7</u>

Edmund Reid – JP Morgan

I have only three questions. The first one was you mentioned higher value customers throughout the presentation in various parts of the business. I was just wondering what metrics you look at when you decide on the value of a customer? Is it volume used or churn? Just because I think it's quite an important concept in terms of the sustainability of the business model?

Second question was on pensions; you talked about the pension negotiations I was wondering if you can give us some idea of the magnitude of what that could mean both sort of P&L and balance sheet?

And then the third question is, and I'm sure Nick won't like this one, but commodity exposure heading into the winter for British Gas Residential there's been quite a volatile wholesale price for this coming winter and I just wondered how comfortable you were with consensus for BGR for this year?

Answer: Phil Bentley

Chris will deal with the pensions and Nick will work on that, the last one. The point about segmentation and this is without giving all our secrets away, we're quite proud of the segmentation model that we apply. And it's based on a number of factors not just one. So sociodemographics, there's consumption, likelihood to churn and loyalty, propensity to take other products, credit risk, whether you're a homeowner or a tenant, whether you're in social housing or not, so it's a sophisticated mosaic that then gives us, I think, seven segments. And we then... those segments you get a different type of service; you can get a different letter, you can get a different type of offer in terms of whether it's relevant to you or not. When you ring in the call centre depending on the value, the value is known to the agent, the segment is known to the agent so that will prompt, what we call next best action. So with one particular segment a next best action might be to promote something. For another type of segment the next best action might to say nothing because they're not the type of people who have any propensity to be cross sold to on the phone. So that is the key to value, our customer driven strategies and I touched on that at the end because I think that... I think we think there is still quite a long way to go on exploiting that segmentation with a range of products that we've got in a consistent way across the customer base.

Further answer: Chris Jansen

On pensions, these changes will roll across Centrica. 90% of the pension costs on an annual basis are within British Gas, 70% of those pension costs are within British Gas Services because of the tenure of our engineers principally, so 70% of the pension costs on an annual basis, we're looking at savings in the region of about £15 million obviously recurring each year. And that's the annual servicing costs.

Further answer: Nick Luff

In terms of balance sheet, obviously the wonders of IAS19 you've got all sorts of different assumptions moving so I'd hesitate to say what the impact on the deficit might be. But the way the accounting does work you could end up with some large credits, treated as exceptional, in the year you make the change.

Further answer: Chris Jansen

The detail is we move to a capping of the final salary pension scheme at the 2% level versus assumptions that are quite different to that in terms of RPI plus 1. So it's quite a significant change. And actually it makes a material change to an individual's pension, that's why we're dealing quite sensibly with it and obviously the support of the GMB is critical to that.

Further answer: Nick Luff

And, Ed, your last question about commodity exposure. By this time of year we've largely bought for the current year, other than what we do to manage the variability from weather, which is obviously quite complex, and does typically end us with having short at this stage a little bit, but we're largely bought. So from here the weather is a bigger factor than the commodity price.

Question 8

Ashley Thomas - MF Global

Just two questions, we're diminishing in number. On British Gas Services, now that you've transferred most of the customers over to an insurance product is there a risk as the Government seeks to raise more revenue, that the rate of IPT starts to move up over the next few years?

And my second question is on the overall British Gas profitability targets, 2012 compared to the guidance given last year. I don't know whether it's by design but there isn't any sort of specific reference to that. Given that the guidance that you have given 600 million broadly for BGR, the double digit for BG Services, it would seem to come out at around 1.1 to 1.2 which would be lower than the historic 1.3? So I don't know whether... would you like the opportunity to dissuade me from that and reconfirm the historic guidance that was reaffirmed back in February?

Answer: Phil Bentley

Yeah, I mean, I think I mean the first point on IPT, we certainly aren't hearing anything that would suggest that they're going to close the gap with VAT, and obviously that's a huge implication to the rest of the financial services industry. I mean there is an advantage of the insurance as well not just from a tax point of view, tax differential, but also in the range that we can offer, much more flexibility about excess charges, for example, and actually in terms of treating TCF, treating customers fairly, which is a FSA type of concept regulation, it's actually good practice that we're rolling out across the rest of the business. So I don't see that as a major downside.

I think in terms of the guidance big picture, we're probably about 1.2 billion if you add up the numbers give or take weather and how much, we might come through a little bit more, maybe stronger on the growth in new markets margins which we wouldn't want to bank. And it is a little bit lower than where we were a couple of years ago in terms of the outlook for 2012 and most of that is actually, as we've touched on, is in Services. BGB were already there, BGR we're pretty locked down and where we are, and we're happy with the progress we're probably making faster progress in top line in new markets than we thought we would be a couple of years ago. So it's really, it's the economy, the impact on discretionary purchasers in BGS I think would be the only thing that would be of concern. And I think we've already clearly flagged that at the half year, we're not flagging anything new today in that regard.

Question 9

Yohann Terry - Exane

I've got two questions. First one, the Investor Day in 2010, you're insisting on the competitive edge and return coming from the lower gas prices. Now the gas prices are starting to pick up, the gas price margins went down and dark coal margins went up. I just wanted to see if there would be a risk that your competitors, which are more exposed to coal, could gain again a competitive edge from that?

And the second question is more general. What would be, in your view, would be a threat to BGR margins over the next couple of years? Thank you.

Phil Bentley

What was the last question, what would be the... ?

Yohann Terry

Biggest threat.

Answer: Phil Bentley

Threat. Okay. So I think you touched a little bit on margins. I think 2011 will show for us that in a rising market we can hold margin and that's certainly our belief and you've seen us pass that through, and our margin for this year will be probably a little bit higher than average through the cycle. So I think we're at the top end of where we'd want to be through the cycle even in a rising market. That would be 2011. If you look forward to 2012 our competitors, bar one, have already put similar prices through, so we're back at parity in the main there.

The coal thing, yes, dark spreads are high at the moment and clearly there's a little bit of an advantage to the coal generators - remember we have some coal exposure with our Drax contract. But ultimately large combustion plant directives, these coal plants are going to be closing in the next year or two, so I see that as pretty short lived.

Further answer: Sam Laidlaw

The only thing I'd add to that is the coal generators will see the disappearance of the free carbon allowances and they'll see the introduction of the carbon floor. And when you put those pieces together the opportunity to cross subsidise into retail supply is significantly diminished.

Further answer: Phil Bentley

And I think in terms of margins...

Further answer: Sam Laidlaw

And that happens in 2013 before the plant closures that Phil's talking about.

Further answer: Phil Bentley

And we have the benefit of nuclear of course which is doing well. Threats to margins, it's a competitive market, and as we always emphasise, let's not forget that UK gas prices are the lowest in western Europe, so competitive markets deliver choice and value, consistently - and whilst there are more extreme commentators out there, I don't see that fundamental attack on a competitive market shifting.

Question 10

Fraser McLaren - Merrill Lynch

Just on labour relations, I guess there was some resistance to the new work regime where introduced. How much more than expected did you have to give in order to achieve resolution and how restricted are you now in making further changes, either in the terms or in overall workforce numbers?

Answer: Phil Bentley

Yes, it's a good question. I think Chris has, Chris has done a great job building the relationships with the GMB. It's fair to say a year and a half ago they were not in a great place, but I think we've been, on the basis of respect and honesty and openness, we've moved the conversation in a level that we have not seen in British Gas for many, many years. So, we are in a good place in terms of relationship.

Further answer: Chris Jansen

Yes, and actually as Phil said a lot of it is due to the respect that we give the GMB, they're an important stakeholder in the business. The other thing is understanding the psychology of the workforce, in that 85% of them are represented by the GMB and the GMB have an incredible sway and voice in that business. But at the same time they are actually sensible business people in terms of recognising that the business had to change.

We did put significant changes through last year, and actually we didn’t pay more than we expected. In fact, if anything we paid slightly less and I think what we've done with the GMB is like any other partner; when we sit down with Sainsburys or we sit down with Travis Perkins, we say look this is the opportunity or this is the issue, and this is what we're trying to tackle. And I think what we said to the GMB is the market is really tightening, we're under competitive pressure, of course, our direct labour is one of our greatest strengths, but it is expensive, and we need to make sure that we find a way of getting the most out of that capability. And I think they were very responsive.

What is interesting last year in terms of the relationship, because fundamentally as I mentioned in the presentation, it's that frontline contact. Our engineer delivers the service in the home to the customer. So they have to be well catered for and looked after so when they deliver that service experience it is fantastic.

So last year we did agree compulsory overtime, and in the event that weather was very extreme, we could say to all our engineers' right you've got to go and work overtime. And what was interesting is last year, despite how extreme the weather was, we didn’t have to use our compulsory overtime at all. In fact there was a real virtue that we didn’t, and it points to the relationship with the union and with the workforce that everyone came out and worked, and we delivered the highest level of service that we've ever done across any winter, given it was the worst winter in 100 years.

Further answer: Phil Bentley

I think the other point here as well is in the other parts of our business, we've got different cohorts. For example, Smart meters, insulation installers and now P H Jones; so you've got different cohorts with different terms and conditions and that's absolutely a fundamental principle that the union respect on our side, that we aren't going to change that into some collective bargaining across the whole. And as long as that continues to be a core principal for us, we're quite happy with the relationship we have.

Further answer: Chris Jansen

And I think that it is that respect - the National Secretary of the GMB, Gary Smith, is a sensible union leader with a very clear commercial head on himself. And so we sit down, Phil talked about the stopping of field sales well we talked to Gary Smith about that and the implications it had on some of his members within that section, and it's just a way of dealing in a very collaborative way, as in the same way we've approached pensions. And it's turned out well so far.

Phil Bentley

Probably got time for a couple more. Obviously we've got the stands out there, the coffee and everything else, so we've got plenty of time. We're with you all through the day, so probably a couple more? Andrew?

<u>Question 11</u>

Andrew Mead - Goldman Sachs

I just had two questions, one was on the British Gas Services. You got this, I think, earlier on about the joint customers, and I think you said last you gave an expectation of what you thought that joint customer base would grow to; could you give an update as to what it is now, given in view of the economics of the country?

And then the second thing was on the British Gas Residential cost base. British Gas Residential has had a lot of investment in it, obviously helping out some of the others with British Gas Business, British Gas Services; does the operating cost per customer reflect any of that benefit of the cost being served with the other divisions?

Answer: Phil Bentley

Okay I'll take the first and Ian take the second on the cost side of things. Joint customer numbers, it's a sort of long term aspirational target for us, with the more we can bundle products so we can add a service product on an energy bill, the more that drives loyalty. And that's what EnergyExtra is about. It's a notch up on your energy bill. Green Deal and the recoveries of that will be a notch up on your energy bill.

So you need the sophisticated billing, cross billing capability across services and energy that Catalyst, that you'll see later on, delivers. And I think that with the Smart meter engineer in the home, the surveys, 300,000 surveys we're doing in the home, to drive all the new energy, that's all part of growing those joint customer numbers. So I don't want to give a short term target, but it's a long term aspiration that directionally we'd like to see significant increase, and we believe we've got the wherewithal to do that.

Further questions: Andrew Mead

Just in terms of the scope though rather than the actual timing, I think before you said you were going to double it from 2 million to 4 million; is that still the potential?

Answer: Phil Bentley

Yes, I think we've got - well we've got 10 million energy customers, we've got four million services of which two take energy. So I think it's the right aspiration, that with all the new activities, with all the new Smart Meters going in, that we can get from that two to four over time.

Further answer: Ian Peters

On the cost side there has been obviously a significant investment into BGR which is entirely justified within BGR and you've seen the consequence of that in terms of falling cost to serve over time. We run our businesses in a separate stand-alone basis so at the moment we haven’t, and there's no intent currently to attribute any of that investment into BGB, as we leverage that. The biggest benefit of BGB is simply the equivalent transformational journey will be done at marginal incremental spend because the core's already sunk in BGR. But I don't want to start massaging the numbers between the two businesses in that sense, they'll stand on their own merits.

Further answer: Phil Bentley

The other follow up then is that the IT investment in BGR is declining now, because we've spent money and we're happy with the system now and it's flexible to move things forward. So, that's gone.

Further answer: Ian Peters

The last piece of that investment you'll see out there which is expense in 2011, which is the Catalyst programme.

Further answer: Phil Bentley

And then the other side of Catalyst which goes to your first point Andrew, is around joint service. Because at the moment we have - here in Leicester we have a services call centre and in Leeds we've got a energy call centre, but part of what Catalyst enables is an integrated service for services and energy based on high value customers. So we'll change our call centre footprint to reflect better customer's needs, and I think that's going to give us a boost as well on customer numbers, joint customer numbers.

Good, so thanks for that, and we've got coffee over there, there's a demonstration on Catalyst which is Will the very tall chap you'll see in the back. And have a good day, we'll catch up with you later.

Sam Laidlaw

And thank you all for very good questions and for those on the webcast I think that's where we conclude proceedings, thank you all very much.