centrica

Interim Results for period ended 30 June 2010

Presentation Transcript – 28 July 2010

Roger Carr - Chairman

Good morning ladies and gentlemen and welcome to the Centrica Interim Results Presentation.

This morning I will provide a brief overview before handing over to Nick for his review of the numbers. And as I am sure you will have already seen, we have recorded an excellent start to the year illustrating the strengths of our vertically integrated model. Sam will then outline the progress that we have made on our new strategic priorities which clearly demonstrates the significant operational performance improvements that underpin these very strong financial results.

The start of the year saw one of the coldest winters on record in the United Kingdom. However the country's infrastructure, including our own power stations and storage assets performed well, satisfying the very high levels of energy demand. In the downstream business our continued focus on customer service together with a competitive pricing proposition underpinned the financial result we have achieved. As a result we were able to lead the market with a third price reduction within 12 months. Consequently whilst consumption was higher as a result of the particularly cold winter, the average customer bill was in fact slightly lower in the first half of the first half of 2010 than in the same period of 2009.

We also continued to make good progress in both residential services and British Gas business which are central to our strategic priority to grow British Gas. And as we look to the future, we are taking a leading role in emerging new markets and technologies that will help our customers reduce their energy consumption over time.

In our UK upstream business, commodity prices remained low for much of the period. However the business benefited from contributions from Venture, British Energy and from the newly commissioned gas fired power station at Langage. And we also had considerable success in our gas exploration appraisal and development activities.

In North America we have made encouraging progress with considerable improvement in key operating metrics and in the underlying profitability of the downstream business. As in the UK, the performance upstream has been held back a little by the low commodity price environment.

At both the national and international level, it is widely recognised that this is an important time for energy policy if carbon targets and security of supply considerations are to be met. In the UK, the proposals that the new Coalition Government has put forward represent an important first step towards creating a stable environment for long-term investment. We now look to government to see this positive intent is turned into equally positive action.

In conclusion, our performance in the first half has been strong and the management team understands leadership continues to demonstrate a firm grip on costs and a clear focus on delivering growth from all segments of our business model. We remain absolute in our resolve on delivering long-term value for our shareholders whilst maintaining a competitive high quality service for all of our customers.

With that I will now hand over to Nick. Thank you.

Nick Luff - Group Finance Director

Thank you, Roger. Good morning everybody. As usual, let me start with some commodity price context for you. I think as you all know UK gas prices were unusually low through last winter, despite the high demand due to the cold weather. Prices as you can see on the chart have risen since the end of winter, the curve now implying prices close to 50p for this coming winter and for 2011 implying they will average some 25% higher than they did in 2010.

And power prices did follow gas prices, although they didn't fall quite as low as coal was pushed to the margin when gas prices were quite low. As you can see from the spreads, gas is now back at the margin and dark spreads are back above spark spreads.

So with that commodity price context coupled with the coldest winter we have seen in 30 years, that led to some very strong results for the Group as a whole as you can see here. Operating profit was up some 65% to over £1.5 billion against largely unchanged revenue of £11.7 billion. We did have higher interest charges but that was offset by a slightly lower tax rate and as a result the operating profit did flow through strongly to earnings which were also up 65% to £886 million. That translates to 17.2 pence per share. The interim dividend, as usual we have set that at 30% of last year's full year dividend which works out at 3.84 pence per share.

Here is the divisional breakdown of the results, and you can see the key driver was the UK downstream of course. But all four business units reported higher results than they did for the first half of '09. So I will have a look at each of those in turn, starting with UK downstream, British gas up some 80% to £842 million. Within that the two energy supply businesses did particularly well as you would expect given the cold weather and the low wholesale price. In contrast services which is adversely impacted by cold weather of course, was slightly down.

In residential as Roger highlighted, we led the market with a tariff reduction in February and as a consequence added over 220,000 energy accounts. And that high customer count did lead to higher revenue for the business. The lower tariffs actually offset the higher consumption. And as Roger explained, the average bills actually were slightly lower in the first half of 2010 compared to 2009.

Commodity costs were lower, despite the higher volumes and that reflected the low wholesale prices and led to the unusually high margins we had in the first half. For the full year we would expect margins to be around 9%, still ahead of our three cycle target of 67, reflecting that strong result from the first half.

The services business did continue to grow, increasing revenue by 6%, but costs were higher because of the higher call out rates we had in the cold weather. As a result margins pushed down to 15%. BGB on the other hand significantly expanded margins, partly due to a move away from high volume, low margin customers, but also benefiting from the high margins on the incremental volumes they sold due to the cold weather. Revenue in BGB was actually down as average selling prices came down with the commodity prices, but those higher margins meant that we still more than doubled profits.

Turning to the upstream, here operating profit up 45% to £485 million albeit we have put significant additional capital in here of course with the Venture and British Energy deals. Within that the detail gas and oil production volumes up significantly of course with the addition of the Venture assets, but the realised price for gas was quite well down. Obviously that is the lower wholesale price, but also remember in the first half of '09 we had the benefits of forward selling that we had done in 2008 when prices were a lot higher.

Looking to the rest of the year, subject to how much we choose to run Morecambe in the second half, we would expect production volumes to be about 10% lower than they were in the first half, that is largely due to the timing of maintenance shutdowns so the upstream result will be biased towards the first half.

On the power side, the gas generation fleet performed well. We had Langage of course, that came on stream fully in March. And the existing stations also produced higher volumes as coal was pushed to the margin. The power segment here of course also includes our 20% stake in British Energy. The I&C segment here, moved into profit, benefiting from the lower wholesale price and the impact that had on the timing of customer takes which were accelerated into the first half. We do still expect to record a loss in I&C for the full year, but that should be the final negative contribution from the segment as the main low price sales contracts do come to an end in the second half.

Storage performed well operationally in the first half and of course financially it had for the first four months of the half year had the high SBU price from the 2009 storage year which was almost 47 pence. As a result profits reached almost £100 million. As we have already announced, the SBU price for 2010/11 storage year is somewhat lower, just under 40 pence, that will of course impact the second half and on into 2011.

In North America, Direct Energy had a good first half, well ahead of 2009 which of course was hit by the one off bad debt charges we reported this time last year. Here is the detail on that: as in the UK the downstream energy supply businesses did well. In residential customer numbers were actually slightly down, but the low wholesale price allowed us to expand margins to over 8%. As a consequence profits were up to £110 million, and that is up over 20% even if you add back the one off charges to last year's figure.

Business energy supply continued to grow, power sales volumes up some 18% and we were able to expand margins there as well which were up to over 3% and as a consequence we more than doubled profit. Service was also ahead, but as you can see in absolute terms still quite small in this half year, the Clockwork acquisition completed in July this month, so didn't contribute to the first half, but will into the second. Upstream, as in the UK, has been more challenging. Gas production and power generation volumes were about the same as '09 but realised spark spreads for the power stations in particular were well down. As a result we were not able to cover their fixed costs and hence the segment did report a loss.

Turning to the cashflow, you can see how the strong operating results converted into strong cash generation. We had EBITDA of approaching £2 billion. Although the cold weather and the high consumption that resulted from that did mean we had a working capital outflow in the first half, the unwinding of the mark-to-market position on out of the money contracts meant that we did have a margin cashflow in, recovering most of the margin cash out we had at the start of the year. Overall then a net cash inflow for the half year of some £400 million, leaving net debt at £2.75 billion. That cashflow was after investing over £500 million into the business. Over £300 million went into the UK upstream, including on Chiswick F3-FA, Cygnus and York. Power generation also took some investment, the final stage payments on Langage being included in that £65 million figure you see there.

For the full year, the right hand column, we have trimmed our forecast for operational Capex. It is now less likely we will see any significant spend on the Baird storage project until next year, so that has come out. However against that, as you can see, we have committed close to £400 million on acquisitions, that includes the Clockwork deal that I mentioned earlier and also the Trinidad assets that we are buying from Suncor which we expect to close on very shortly. The acquisition figure is net of the proceeds that we will receive from the sale of our Spanish business. You might have seen from the Statement this morning, we have agreed a sale on that last week. We continue to work on the sale of Oxxio.

So in summary then, a strong performance for the first half, both operationally and financially. The UK downstream was the main driver, helped by the cold weather and the low wholesale price but the other business units also contributed to the increase. We won't repeat that downstream performance in the second half, but overall we are trading in line with expectations which of course have risen since we put out the IMS in May when we explained just how strong the first half was looking.

As I said earlier, the forward curve does imply some quite significant rises in wholesale prices for 2011. If prices do rise as the curve implies that clearly will have implications for retail prices. However we are confident that British Gas's competitive advantages and its service levels, its cost structure, will be sustained.

Upstream would of course benefit from high gas prices, albeit we are expecting slightly lower gas production volumes next year because we are unlikely to run Morecambe quite as hard as we did in the first half of this year. Returns on the CCGT's are more difficult to predict being dependent on the spark spreads we can achieve in the market, but clearly the nuclear and wind assets would benefit directly from any uplift in the power price. As ever there are a number of variables, the main ones being the weather and commodity prices and how those play into retail prices, but overall we are comfortable with where market expectations are right now.

And with that I will hand you over to Sam.

Chief Executive's Review
Sam Laidlaw - Chief Executive

Thank you very much Nick and good morning everyone. As you have just heard, Centrica has performed very well in the first half of this year and delivered a strong financial result. Importantly, this is underpinned by good operational performance across each of our businesses and we have now got a balanced business model which is able to perform well in both high and low commodity price environments, and we are well positioned for a low carbon future.

In the UK business, the dramatic improvements in delivering 'Best in Class' customer service together with competitive pricing have underpinned the strong financial results and growth in customer numbers. In our upstream business the assets have performed well with gas production up by 41% and our gas fired power generation fleet again achieved excellent reliability levels. Langage became fully operational and our share of British Energy also contributed to earnings.

And in North America we made very encouraging progress, reducing churn and bad debt costs across our residential business as well as achieving strong sales growth and earnings growth in DE business.

So let me now just look at our progress against the longer term strategic objectives that we set out at our Capital Markets Day. First to grow British Gas. Our customer service metrics remain strong. For example, we have continued to see growth in the number of online transactions which now exceed offline. This in turn drives lower call volumes, lower costs and improved customer service. Consequently our net promoter score, one of the key overall measures of customer service performance, continues to improve.

As to costs, we remain very focused on cost control and are on track to exceed our targeted like-for-like cost production over £100 million allowing us to reinvest, to drive growth in such areas as online, customer service and new markets. In February we led the market with our third price reduction in 12 months, which made us the cheapest supplier of gas and electricity and today we remain the cheapest supplier for electricity across Britain and on average the cheapest dual fuel supplier.

Consequently we have seen significant customer account growth during the period. We added over 220,000 energy accounts in the first half, with very strong growth seen in response to the tariff reduction. Now included in this are 50,000 additional valuable joint product households who take both our energy and services products. Clearly the recent sharp upward movement in wholesale gas prices, which have risen some 50% in the second quarter, together with our price reduction, has led to significantly lower margins in the second quarter, hence our guidance that our earnings are likely to be heavily skewed to the first half of the year.

In British Gas services, the exceptionally cold winter led to a record level of callouts. Now to put this into context, our engineers were fixing as many as 35,000 boilers a day during the cold weather, around double the usual number on a typical winter's day. And I think it is a great testament to our staff that we were able to reach so many of our customers when they needed it most. Financially however, the high level of callouts did lead to additional costs for the business which is reflected in the first half numbers.

We did however continue to grow our services businesses, increasing the number of product holdings by over 100,000 to £8.6 million, and we have continued to see good growth in our sales of electrical and plumbing products. Retention has remained at high levels in our core central heating care customer base, despite an increasingly competitive market, by utilising a wide range of product offerings. We are now offering customers more flexibility through insurance based products and almost 2 million customers have transferred onto an insurance based product and we expect continued rapid conversion as contracts come up for renewal.

Our central heating installation volumes are up 17% year-on-year as a result of more competitively priced offerings, shortened sales lead times and improved conversion rates, as well as of course benefiting from the Government's boiler scrappage scheme.

As Nick outlined, British Gas business has performed particularly well in the first half. Success in this business requires a close understanding of the needs of each of our customers both in terms of pricing and service. Our retention rates remain high among the SME customer base and for multi-site customers, we have seen an increase in the average number of sites served. As with residential, our business net promoter score continues to increase. As we look to the future and our indigenous resources dwindle to be replaced by lower carbon alternatives, the UK clearly faces the very real prospect of significantly higher energy prices and this is already starting to be reflected in futures wholesale markets. British Gas therefore has a vital role to play helping customers to reduce their bills as well as their carbon footprint through energy efficiency measures and new technologies, leading the transformation to the low carbon world. We therefore very much welcome the Government's Green Deal initiative and aim to be at the forefront of delivering energy efficiency savings both in the home and for our business customers. And we are the only energy supplier to be involved in the Government's Pay as you Save pilot.

In insulation, we have now filled over 400 of the 1,100 jobs announced earlier this year as we build an insulation business of scale. We continue to build our capabilities in new technologies to allow us to capitalise on these markets as they grow. And in February we announced the go ahead for 5 bio methane demonstration projects which will be the first of their kind to enable an injection of bio gas directly into the grid.

And our existing interest in solar, bio mass heating and fuel cell boilers make us a leader in micro generation. We have installed 100,000 smart meters to date in homes and businesses to build momentum for an early nationwide smart rollout, we have now published open systems architecture standards and announced our technology partners for the initial phase of the rollout. These are important steps towards our target of installing 2 million smart meters by 2012 and to help the Government beat its target of 2020 for all UK households to have a smart meter.

We also continue to build our relationship with local authorities in the public sector where we can also bring our expertise in energy supply and energy efficiency to bear. Through out successful Generation Green Campaign, which raises awareness of energy efficiency measures amongst school children, we have now reached 10,000 schools in the UK, 750 of which will also benefit from our contribution of £15 million worth of solar panels.

Turning to the upstream, we have made good progress in our gas and power business during the first half. Despite the low gas prices for the first quarter, particularly when compared with our hedged position in 2009, the business delivered respectable returns. The integration of Venture with our existing activities has been successfully completed, greatly enhancing our capabilities. Centrica is now seen by many as the employer of choice in Aberdeen. And we have embedded the accountabilities and empowered decision making processes to enable us to capture new opportunities, whilst at the same time reinforcing the risk management and health and safety management systems.

We have had considerable success in our upstream development projects. In early 2010, we successfully drilled and brought onstream the third development well at our Chiswick Field in the North Sea with a 4th well expected to come onstream this quarter. And in March both the Eris and Ceres gas field commenced production. And work on our F3-FA platform continues to progress with platform due to be installed later this year. We have also had considerable success in our exploration and appraisal activities. Earlier this month, we announced the successful drilling of the second appraisal well in the western region of the Cygnus field, completing the appraisal of this field. The full reserve potential is now being assessed in what could potentially be one of the most significant undeveloped gas fields on the UK continental shelf.

And while on exploration, we have made discoveries at both the Olympus prospect in the southern North Sea and the Fogelberg and Maria prospects in Norway. So in total, of the 10 exploration appraisal wells drilled so far this year, 7 have been successful, 4 appraisal wells and 3 exploration discoveries, and a further 6 wells are scheduled to be drilled by the end of this year.

In LNG the business continues to grow. We expect to shortly complete our Trinidad acquisition and have so far this year taken delivery of 9 cargoes into the Isle of Grain terminal despite low NBP prices in the first quarter, and increased competition from emerging markets.

In power generation, our CCGT fleet has continued to show excellent reliability at over 99%, with gas fired power stations displacing coal fired generation for much of the first half, low factors were relatively high at 59%. However spark spreads have remained tight in a well supplied market. Our new 885 megawatt gas fired station at Langage entered full commercial operation in March and is now established as one of the most efficient power stations in the UK merit order.

In offshore wind, we completed the joint venture agreement with Dong and Siemens for development of the 270 megawatt Lincs project. All major contracts for this project have now been awarded and onshore contracts and cable installation have commenced.

In nuclear, our 20% share of output from the British Energy fleet in the first half of the year was 5 terawatt hours, having been adversely affected by lower output by Sizewell B which has been offline since March for inspection and repair. This station is however expected to return to service later this quarter. In nuclear new build, engineering studies continue. We welcome the recognition from the Government that appropriate mechanisms will be required to enable investment in low carbon generation, including a floor in the carbon price. And we will engage closely with Government to ensure that an economic solution is reached.

In gas storage, Rough continues to achieve excellent operational performance with reliability over 99% in the first half. Rough performed a particularly important roll during the cold weather in January, helping to maintain supplies during periods of record demand for gas. The capital programme of the last few years has further enhanced the withdrawal and injection capabilities of the asset, as you can see on this chart. Following the narrowing of winter/summer spreads, the average price we achieved for the storage standard bundle units, as Nick mentioned, has declined. This potentially impacts both the level of underlying returns achievable from Rough, but also the economics of our 3 potential new storage projects. The first of these, Caythorpe, will be able to achieve substantially faster cycle times than Rough and therefore take advantage of short term price volatility. This project is therefore less dependent on summer/winter's price differentials and complements Rough's seasonal profile. We have recently, however, heard from Ofgem, that they are minded to consult on revoking the existing exemption from third party access for this project. Naturally, therefore, until the terms of such third party access become clear, and we are convinced we still have a strong economic case, we will not be bringing this project forward for sanction.

As to our two other gas projects, Baird and Bains, engineering studies continue, although these are complex offshore projects which have slower cycle times and further work is required to ensure the satisfactory returns on investment can be achieved. Decision on both these offshore projects is now expected in 2011.

Turning now to the North American business. Our aim is the double the operating profit of this business over a 3-5 year timeframe, through a combination of organic growth, enhanced business performance and selective acquisitions. With our new management team in place, I am pleased to report that we are making good progress in all these areas. However, weak commodity prices and tight spreads have continued to impact our North American upstream business, holding back the overall result. We expect that the soft price gas price environment in North America may continue to be with us for a while and therefore while our strategic goal remains to increase our upstream hedge position, we will be very focused on ensuring that any upstream investment is robust in a low price environment and indeed we are examining some opportunities at the moment in this context.

Looking at the North American downstream business in more detail, both residential and business energy supply have performed well in the first half. As Nick mentioned, the underlying profitability of the residential supply business is much improved, up 25% in constant currency terms. Our focus is on both improving returns and growing the scale of the downstream business.

In Texas by tightening our customer acquisition criteria and focusing on retaining the most valuable customers, we have achieved a reduction in churn, improved retention rates together with lower bad debt costs. A tight focus on cost reduction has also helped sharpen the organisations profitability. We have also launched a prepayment product, a new concept in the Texas market, to enable customers to join us without the need for a significant upfront deposit.

In the North East, the focus is on customer retention and acquisition in the most valuable segments. While in Ontario where recent legislation makes new sales more difficult, we have both cost reduction and customer retention plans in place to mitigate the effects of this new legislation.

Our North American business energy supply division has performed extremely well. We saw higher electricity volumes and improved focus on sales channels which have resulted in strong growth. Further benefits were achieved through a highly disciplined approach to customer acquisition and more focused pricing to reflect credit and collateral utilisation. And in North American services, our acquisition of Clockwork materially increased the scale of the business in a cost effective way, whilst also providing a platform for growth through its established franchise model. The transaction also enhances our ability to offer combined energy and services product in a greater proportion of the key deregulated markets in which we operate up from 35% to around 55%. By leveraging our experience from the UK services business, the transaction marks a further step in the delivery of our strategy to build a larger, more vertically integrated energy business with a strong energy services offering and is very well positioned to take advantage of new energy efficiency legislation in the US.

In conclusion, we have had a very strong start to the year and both through our operating performance and the investment choices we are making, we are delivering against our strategic priorities, including our 4th priority to deliver superior financial returns. The combination of robust organic cash generation with the optionality of a range of investment choices provides a sound platform for delivering both growth and returns. And we now have a balanced business, positioned for growth in both high and low commodity price environments and leading the transition to the low carbon world.

So thank you and with that, I think we will open it up to questions.

Roger Carr

Very good, we have the top team here as well, Phil, Mark, Chris and Grant. So as usual press the button to speak and if you could say who you are. And we will start on the far left.

Questions and Answers

Q1. Lawson Steele – Execution Noble

Hi it's Lawson Steel from Execution Noble. A couple of questions: could you comment on the tariff outlook for the second half, given the increase in gas prices and perhaps changes in the competitive landscape? And could you also comment on the market share outlook in services and perhaps in this context if some competitors are going for a franchise system or what you might think of that? And then in generation, you mentioned obviously that gas prices have gone up and that is an impact of the merit order curve. Perhaps you could give an outlook on that and where you think things might be going? And then finally implications of what the Government were saying yesterday from the Energy Policy and how you think that might pan out for your guys? Thank you.

Answer: Sam Laidlaw

Some broad questions there. Let me take the first one which is outlook and I take it you are talking about outlook for retail prices for the second half? Well clearly as I think we have been very clear, we are still buying gas for the winter. If you look at the forward curve, the long-term trend is up, but you know equally we have demonstrated I think a positioning to be competitive on our prices and we are growing customers and we want to continue to do that, but we are not going to signal our intentions around future prices because I think that is a) premature given where we are at this stage of the year and given the uncertainties around the weather for the winter.

In terms of market share on services, I am not sure whether that was, and the talk of the franchise model, I am not sure whether that was directed at the UK or directed at the US?

Response

UK

Answer: Sam Laidlaw

In terms of market share on services, we have within the services business obviously a service and repair business, a central heating and installation business, an electrical and plumbing and drains business and a kitchen appliance business. And the market shares are different for each of those. I think we are seeing particularly strong growth as I indicated in my remarks in the electrical and plumbing and drains business. The service and repair business we are actually converting a lot of customers over to insurance and I think that will give us more competitive offerings too. And in central heating and installation, we are actually seeing a growth in market share, helped as I mentioned by the boiler scrappage scheme, but also helped by the fact that our costs have come down in that business and we are pricing much more competitively.

Your third question I think was around, if I understand it correctly, around whether coal is going to be at the margin? Is that the question? Spark spread outlook. Nick do you want to take that or Mark?

Answer: Mark Hanafin

I think the spark spreads are obviously bouncing around with the gas prices. We have seen a lot of volatility in the last few weeks and we have seen the marginal plant being gas, the marginal plant being coal, depending on what is happening. Next winter with higher gas prices, gas is back on the margin. And essentially the bottom line is we are seeing £6.50/MWh clean spark spreads looking forward, that is what the market is telling us. And as we have discussed here a number of times before, when spark spreads are down towards the £5-6/MWh level, they are not particularly attractive, they are not the sort of numbers we would be rushing to lock in. So that is what the market is saying we will hope for, higher numbers before we look to sell.

Further answer: Sam Laidlaw

I think your final question was around energy policy from the new Government and how we feel about it? I mean the short answer is generally we think the policy is going absolutely in the right directions. If you look at what is being sought in downstream, whether it is through the Green Deal and the green investment bank, both of those initiatives I think are very positive and we intend to take a leadership position in those and of course with our services capability we are very well positioned to do that, probably uniquely so. And in terms of the smart meter rollout, that is also something that we again want to take the leadership position. As I mentioned, we have installed 100,000 meters already and we are leading the way there with a data of architecture and protocol I think that a lot of our suppliers are now coming on board for too, so I think that is good to see.

In terms of the renewables programme, I think continuing to build that is very positive. Obviously there is going to be an electricity market review and reform that we will be engaged in consultation on. And I think we all recognise that the current electricity market which was designed for generating fleet, that was low fixed cost, high variable cost, high fuel cost, may not be appropriate in a new world of generation coming from nuclear and renewables that is high fixed cost and low variable cost. And therefore there is going to have to be some form of reform, whether it is through feed in tariffs or capacity payments or whatever, to encourage new investment in low carbon technologies and we will be participating in that. But I think the recognition from the Government that you know a carbon floor is needed for all low carbon technologies, including new nuclear is again positive. Now a lot of this, the devil is in the detail and a lot of work needs to be done to make, whether it is the Green Deal or whether it is the carbon floor or whether it is reform of the electricity market a reality, but I think the direction of travel is the right one.

Q2. Bobby Chada – Morgan Stanley

Morning, it is Bobby Chada from Morgan Stanley. Two quick questions I think. First of all, can you give us some comment on churn please? Earlier in the year you talked about it being below 10% on a run rate, is that still where it is or has it continued to improve? And secondly, the North American business energy margins have improved materially, they have more than doubled. I think that puts them now kind of at the same sort of ballpark as your big competitors in that business. What did you do to improve the margins and is the 3.3% something that you think is a sustainable base from here?

Comment: Sam Laidlaw

I will let Phil handle the first question on churn in the UK retail customer book and perhaps Chris if you can pick up the DEBs business?

Answer: Phil Bentley

Yeah I mean the churn as you say, has been running below 10% which is the lowest it has ever been. We saw a slight tick up in June but we had half a million long-term contract customers coming and rolling off at that time. And that tipped it up slightly above into double digits. But we actually retained 95% of those long-term contracts where on average customers were seeing increase of over 40%. So I think we feel quite pleased about that. There is still a bit of churn in online pricing. We think some of our competitors are selling online at a loss. And we aren't prepared to do that. So it will be quite interesting to see how online pricing evolves in the next few months. You will probably notice Scottish and Southern have bumped their online price up by over £80 on a dual fuel bill, which is a big move up, which I think is probably a good signal there.

Further answer: Chris Weston

In Direct Energy business, 18 months ago when we saw the credit squeeze, there was a lot more talk and understanding in our customer base about the importance of credit and cost of collateral. We have been through a very disciplined process of ensuring that was reflected in our pricing and that was accepted by our customer base and that continues now. So they understand the importance of it and I am confident we will continue to price it through.

Q3. Mark Freshney, Credit Suisse

[Inaudible] go up slightly there? Secondly, just to be clear Phil, I think you have already answered this question, but I think the acquisition of customers within British

Gas, the run rate fell down in the latter part of the second quarter. I think in your IMS, you mentioned you had won 200,000 customers and at the half year point it came in at 230,000, is that just because of the churn issue? And just to elaborate on an earlier point on the CERT obligation, do you see the Government recommendations from yesterday as changing the plans within British Gas services, in order to capture some of that benefit? Thank you.

Answer: Nick Luff

The I&C statement, having had low wholesale prices as we did, that and the profit we made in the first half and given the way the customers reacted and took gas early, we should do a bit better than that. So the loss of £50m maybe half of that now, maybe even a bit less for the full year.

Further Answer: Sam Laidlaw

And I think your second question Phil largely answered in that the increased churn was largely a result of those fixed price customers coming off in the second half. So that slowed down the rate of it.

Yes there was a third question around CERT and I think yesterday's statement. I mean the CERT programme has been confirmed to stay in place, if that was the question.

Further Answer: Phil Bentley

Just to build on that, what I think the Government is focused on is you have got the Green Deal which will be a green energy maker for all homes, but the CERT is going to be focused on the really low income houses and I think it plays to some of our strengths that we are building in the local authority market. As you have seen, it is traditionally British Gas focused on home owners alone who actually we have been expanding a lot of effort into building relationships with local authorities. We are winning quite a lot of quite big contracts now. And of course a lot of that CERT will be channelled through relationships with local authorities and that is why we are keen to grow in that space.

Further question [inaudible]

Answer:

You have got £100 billion potentially over the next 10 years going into the Green Deal so we see that as a mega trend that we are well equipped to take advantage of.

Q4. Ajay Patel, UBS

Ajay Patel from UBS. Two questions please. Firstly on British Gas Business: is there any way you could maybe segment what portion of the margin was derived from better volumes and what proportion is more on the fact that you are focusing on the high value SME customers and the multi site segments? And secondly, was on if you could give us just maybe broad brush commentary around Venture and given we have seen quite a lot of movement around commodity prices, how is that performing against its cost to capital so far? Thanks.

Comment: Sam Laidlaw

Phil do you want to touch on the question of how much of the improvement is just due to weather and higher demand and how much is due to the multi sites and the cost reduction programme that we are delivering?

Answer: Phil Bentley

Yes, we have got a new strategy in BGB which is really focusing away from high volume, single site large industrials, where the margin is very low into SMEs which is still quite a big part of our profits, but increasingly the multi site opportunity and what we have seen is new customers that we are adding have more outlets per customer. So I think we have doubled the number of outlets, over 30 now, the average new acquisition of sites. So at the moment, a lot of our profits still do come from the smaller SME, but I think in time we are seeing a switch towards the multi site. We never made a lot of money actually in the I&C so losing that volume is probably enhancing our margins actually. And what is important on the multi site is that we build to contract. A lot of times we have not always been utilising some of the contract terms that ensure that we maintain margin. So that is something that we have worked harder on as well. So I think we are on quite a good trend now because that strategy only really kicked in at the beginning of the year and we are seeing quite good returns in margin maintenance as well as building that relationship with multi sites.

Further answer: Sam Laidlaw

I think your further answer Ajay was around Venture and how is it performing - generally I think production levels are actually ahead of our investment case. And the production has been performing extremely well in the first six months of the year. We will have some maintenance in the second six months of the year. As I have said, I think the development of existing gas fields particularly in Chiswick and Eris and Ceres and F3-FA is going well and the exploration portfolio is also I think delivering good results. It is, even with the relatively low gas price we had in the first quarter, actually if we look at the six months, on the whole it is delivering a return at around our cost to capital.

Q5. Lakis Athanasiou - Evolution Securities

Three questions. One on British Gas Residential. It looks as if, given that your household were flat in the grossing accounts, that you have been adding electricity to existing gas customers, is that a correct interpretation? And I get very much the impression that either forced or perhaps even managed reduction in gas customers seems to have now flattened out and you are in a position now of consolidating and pushing electricity and dual value customer. Is that a correct strategic interpretation? And second question, you mentioned you are actively now looking at upstream acquisitions in the States, I won't ask about that because you probably won't answer anything, but have you looked elsewhere in the world, establishing vertically integrated positions where your skill sets can come into use? I am thinking of other free markets like Australia for example? And thirdly on spark spreads, you seem to be running very high load factors on your new and more efficient plant in gas and quite low load factors in your older plant over the first half. Is that going to change much in the second half despite where the spark spreads are going or is it dependent on the position of the dark green spreads versus spark spreads? And lastly on load factors in wind, obviously these were very low, this has been flagged up by other companies. What are your expectations for the second half? And could you also give us a feel for onshore, offshore first half second half splits on load factors over longer term assumptions?

Answer: Sam Laidlaw

Well let me take the first one which is around the customer numbers and the addition if you like of more electricity customers to our existing gas customer base. Yes you are absolutely right, the majority of the growth has come from gas customers who are now taking our electricity. And we have had stronger growth on our electricity than we have on gas numbers. But if we go back to our Capital Markets Day presentation, what we said was clearly customers who are dual fuel are more valuable and more valuable still are those who buy dual fuel and services. And therefore 50,000 customers that we added who are both energy and services are particularly valuable. And that is part of the strategy. And we would like to continue to grow gas customers as well, but what really matters is the overall value proposition of the customer.

I think your second question was, have we looked at other markets where we can replicate our deregulated, integrated energy market? There are not many of them, Australia is one of them, but at the moment we are very focused on the UK and North America. And we think there is lots of opportunity in the UK and North America, so I think that is where our focus is.

In terms of spark spreads and when we look at load factors, I will let Mark answer that and also answer the question about load factors on wind too which we have done quite a lot of work on.

Further answer: Mark Hanafin

I guess the way I look at it is that the relationship between coal fired and gas fired, is determining what the clean spark spread is. And that really determines what is running, what the work factor is. But £6.50-7/MWh type levels you are going to see the picture that you painted with the Langage and the Humber's running and some of the lower merit order plants not running. So that is you know, given current forward spreads, that is likely to continue.

As far as wind is concerned, we have seen low yields, that is not a Centrica phenomena, that is a weather phenomena across the UK. We have done a lot of work on that and looking at the weather factors behind that. There is not a discernable pattern of change, but what you do see every number of years is a very different type of winter and it is to do with the North Atlantic oscillation which is a pressure system and it produces cold windless winters occasionally. So it doesn't change the overall view, the planning view, but it did hit us hard this year.

Further Question

Is there a discernable H1/H2 split on the long term basis onshore and offshore?

Answer: Mark Hanafin

I think, as I say on CCGT, on wind specifically, yeah I guess there is a slight bias to first half versus second half, given the expected wind resource in the first quarter of a typical year. But as I say, I think 2010 is an anomaly. It doesn't mean that 2011 isn't. This is just a statistical thing but it doesn't change the multi-year planning we have in terms of what we are seeing.

Further Question

And the outlook for the second half?

Answer: Mark Hanafin

The Met Office can't tell you whether it is going to rain tomorrow, so that is a tough one.

Comment: Roger Carr

You can imagine the challenge Mark has at the Board Meetings when he is asked all of these questions. But the summer looks good I am told Mark, is that right?

Answer: Mark Hanafin

The summer looks good and the weekend looks good.

Q6. Edmund Reid, JP Morgan

Edmund Reid, JP Morgan. I have 3 questions. Firstly, I was wondering if you can give us an order of magnitude of the incremental costs in the services business in the first half? The second question sort of has been asked, but I will re-ask it. British Gas business I think historically has been a sort of 4-5% margin type of operation. Is there going to be a step change by the focus on multi site clients? And then the third one is given the strong cashflow in the first half of the year, how do you expect net debt to evolve for year end? Obviously assuming no further acquisitions or anything like that.

Comment: Sam Laidlaw

I will let Phil take the first two of those and Nick will take the one on net debt for the end of the year.

Answer: Phil Bentley

To the point, I think about incremental services, you are thinking about all the extra jobs we had to do. I mean 1.6 million breakdown and callouts in the first 6 months which is probably about 120,000 more than we would normally do. So all in costs of repair probably a hundred quid. So £12 million, something like that, was the knock on effect of the winter. Yeah I think BGB has got good potential to push its margins up and that is why we got out of the low margin business and got into the higher value where we can either reduce costs for the small enterprises or add value to service offer with the multi sites. So I think there is some margin improvement still to come. But I think we know we said that this first 6 months was particularly cold, so we have seen a boost, because as you know, we were able to buy the marginal demand at a low marginal spot price and that is what pushed the net margins up to 9.5%. So I think you could model you know gradual improvement from last year's levels of margins, but not at the 9% level.

Answer: Nick Luff

The net debt question, our guidance for year end would still be about £3 billion. Clearly as you say, subject to acquisitions, but also subject to margin cash. Because that clearly could swing about depending on what the curve does towards the end of the year. So that will be a good number.

Q7. Iain Turner - RBS

Thanks, it's Iain Turner from RBS. Can I ask in terms of Storage, how much of the investment programme in total that is kind of in the balance at the moment and what you think fundamentally is driving this narrower seasonal spread in gas prices?

Answer: Sam Laidlaw

Yes, to scale this it is probably about, of the £15 billion over 10 years that we have talked about and £1.5 billion a year, about 10% of that would be storage because we would anticipate also some partnering around storage projects as well. So we have to be comfortable. We have got two different types of storage project as I mentioned in my remarks. Firstly, Caythorpe which is designed to capture short-term volatility and we still see considerable short-term volatility in the market, so subject to getting clarity around the third party access regime whether one is required or not and if one is, what the terms of that would be then that project should proceed. But the offshore projects do rely more heavily on the winter/summer differential, although some of the extrinsic value of the volatility you can capture with those as well. And what is driving the fundamentals there? Well in part the winter/summer differential has compressed purely because the gas price has been low. What we don't yet fully I think understand, we probably need to see another winter's experience, is what the long-term impact of LNG and a much softer gas market in the US will be on those winter/summer storage differentials. And that is something that I think we are doing a lot of analysis on as we are in terms of doing further engineering both to reduce cost and derisk those projects.

Q8. Peter Atherton, Citigroup

It is Peter Atherton from Citigroup, a couple of questions. Firstly on the 50,000 new joint, joint, joint customers. A useful number, but given the size of the two businesses, still actually a very small number. Where do you see that going to and what sort of step up can we expect over the next year or two and what measures you are putting in place as you drive that? And secondly on smart meters, your 2 million rollout, could you just take us through the costs of that and also how you are going to get paid? And is there any chance, the fact you have pre-empted like the main rollout programme, that you end up with effectively stranded assets?

Answer: Sam Laidlaw

Yes, let me deal with the first one, the smart meter one and the one you had before Peter was, sorry the aim on joint customers and we expressed this at the Capital Markets Day. We currently, if you step back and look at the business, we serve 12 million homes and of those 12 million homes, 10 million buy our energy approximately and 2 million buy, well 4 million buy services and 2 million buy both, if you like. So the current overlap is only 2 million of the 12 million homes. Now our aspiration here is to get that 2 million to 4 million over a 3-5 year time frame. That does mean we have to step up the rate of penetration of those customers who are both dual fuel and services and with new propositions that we are launching with the smart meter rollout with a lot of the insurance products and so forth, we think that is an ambitious target, but I think an achievable target. Because to your point, those are the most valuable customers.

Further answer: Phil Bentley

At the moment, our systems in services are not as flexible as they are in energy, so what we are doing is building new billing systems in services that will allow for joint bundle bills. And I think once we have got a single billing relationship, I think it is going to be a lot easier to package those pieces together. So I think that should open up the opportunities. And we will probably be ready to launch that early next year.

Further answer: Sam Laidlaw

And I think your second question was around, is there any risk of a significant cost being stranded in the smart meter rollout? And I think we were very much encouraged by yesterday's announcement that actually there will be a small amount of cost this year, but by next year the type of meter and the protocols and systems that actually we are investing in, our third generation meter, which is going to be available later this year, will basically comply with the protocols that are being suggested by the Regulator. So I think that risk is significantly diminished.

Answer question:
So the smart meters installed in the next 12 months, how will you actually get paid?

Answer: Phil Bentley
We get paid by the meter financer. So the meter financing is in the regulated asset base and they pay us to install. And we collect the income through the bill. So we are not shelling out all the money for the meter. It is the meter asset provider that does that.

Further Answer: Sam Laidlaw
In the same way, remember we are replacing a lot of dumb meters if you like at the moment and we are continuing to do that because not all the meters we are replacing are yet smart meters and it is the same financing model.

Q9. Bobby Chada, Morgan Stanley
You talked about 9 LNG cargoes that you brought in in the first half. Have you already contracted for more cargoes in the second half?

Answer: Sam Laidlaw
We have contracted for a few more, yes.

Further question:
And are you seeing any relationship between the frequency with which you bring in cargoes and what happens to the UK gas price?

Answer: Sam Laidlaw
I think what we did see in the second quarter particularly was a lot of maintenance programmes going on simultaneously from LNG producers which actually meant that the availability of LNG cargoes, not just for the Atlantic basin but also for the pacific and Asian markets as well was reduced. And that meant there was less LNG coming into the UK and that undoubtedly was one of the factors together with some Norwegian production outages and I think a view that the Asian economies were recovering a little bit, that all led to firmer gas prices in the second quarter. But I don't think it was the only factor, Mark.

Further answer: Mark Hanafin
We contracted for 9 first half, we contracted for 6 so far in the second half. I think what I would add to Sam's comment, to 2009 you saw some of the sellers at least interested in locking in forward prices and you know from that point of view we were able to sell quite a few months ahead. What we have seen so far this year is sellers with low prices just very reluctant to commit. So they are waiting 1-2 months before and then committing. I think as Sam said now, some of the maintenance appears to be coming to an end, we are seeing a lot more interest so I am hoping we can, despite this hand to mouth, I am hoping we can actually build on those 6 cargoes.

Further question:
And you are still buying essentially at NBP linked prices?

Answer: Mark Hanafin
Yes we do.

Q10. William Claxton-Smith, Insight
You have had an exceptionally strong set of first half numbers, very good set of numbers. And some people are a bit surprised you have not raised your full year guidance. From that should we read just an inbuilt conservatism on your part or are

you alluding to an exceptional winter that is unlikely to be repeated again? Or is there some concern that the growth in services in the US is not sustainable into the second half?

Answer: Sam Laidlaw

It is certainly not the last point. I don't think there is a concern out there. I think we are just at the joint in the year when we don't know what the winter is going to be like. We have not yet bought all our gas and we are clearly I think erring on the side of prudency.

Further Answer: Nick Luff

Let me just add to that. If you look at where we outperformed in the first half against consensus, we were up on the I&C segment which is a really is a phasing issue as we explained, we are up on oil and gas production which again is partly a phasing issue. We talked about the timing of maintenance shutdowns etc. I think I would expect to see consensus rise for some of the trading businesses such as in British Gas, but not all analysts have got in things like the joint venture tax and discontinued items right, but I think the underlying message on the trading is strong.

Closing Comments: Roger Carr

Okay, well that looks like it. Thank you all very much indeed for coming. We wish you a good summer. Thank you.

End of Presentation