Centrica plc November Trading Update – 10 November 2022

Transcript

Chris O'Shea, Centrica
Good morning, everyone. Thanks for joining at such short notice. I'm joined on the call today by our group CFO Kate Ringrose. It feels a bit like the Today programme. It's Chris O'Shea in London and Kate Ringrose in Windsor. This is our second call in less than two weeks. As you can see, we're making a habit of it, but hopefully not too many going forward. We don't like to disturb your morning when you're very busy. We'll move on to answer your questions shortly, but first, I'd like to just take a few minutes to make some introductory remarks.

Hopefully, by now, you've seen the trading update this morning. Our performance since the Interims has been very good overall. We've seen strong volumes from the electricity generation and gas production businesses that we've got, and that, alongside the reopening of Rough as a storage facility, plays an important role in strengthening the UK and Ireland's security of supply. Our Energy Marketing & Trading optimisation and route-to-market activities also continue to perform very well. These play an important role in storing, transporting and balancing energy supply and demand across Europe. This is a really important profit stream for us. We plan to hold a virtual teach-in for you on the Energy Marketing & Trading business in early December, just to show you a bit more of the quality, both of the people and the business that we've got there and to let you see a bit more as to how repeatable those earnings really are. We'll obviously give details about how to join that in due course.

In the retail businesses, we've seen high inflation and broader economic weakness having an impact, particularly in the British Gas Services & Solutions business. Now, this is to be expected with inflation running where it is, then people are looking through, and they're reviewing all of their different expenditure decisions. We've seen that impact on customer numbers in there. We're also not passing on inflation in our core services businesses to customers. We're absorbing the impact of that.

Warmer weather also in October. You'll have noticed that it was unseasonably warm in October in the UK and Ireland. That's impacted volumes and profits also in British Gas Energy. When you see the warmer weather, you see lower prices into which you sell volumes where you may have over-hedged. As a result of both of those things, we expect lower operating profit in the retail division than we did at the time of the Interims.

We remain acutely aware of the difficult environment facing many people, many of our customers, and we're committed to doing what we can to support those most in need. I'm really pleased that today we're also announcing an additional £25m help for our customers. That takes the amount we've invested in voluntary customer support this year to £50m. A lot of companies are announcing support packages which are actually amounts that they are mandated to pay under the supplier licence. We want to do the right thing for all of our stakeholders, so we put £50m in over and above what we're mandated to do.

I just want to touch on the share repurchase programme. We said at the Interim results that we'd continue to make efficient use of capital, and that includes the potential return of any surplus structural capital to shareholders. I'm really pleased that given our good performance and the strong balance sheet that we've got we're now in a position to be able to announce plans to commence a share repurchase programme, where we intend to buy up to 5% of the issued share capital of the company. We plan to get going on this ASAP.

This doesn't impact the ability to invest for future growth, either in flexible generation, in opportunities to repurpose some of our infrastructure for net zero activities, such as Rough and Morecambe, or in things such as hydrogen production, but it is evidence that we're going to be disciplined with our capital. I've said this on many occasions to you, here in Centrica and in other companies, that it's very clear to me that we work for our shareholders. We deploy the shareholders' money, and when we've got excess, we give that back to the rightful owners. I always like to do what I say I'm going to do, so I am particularly pleased about this. I know it's not been the easiest ride being a Centrica shareholder, it's been hopefully a bit better over the last couple of years, and this is maybe a sign that you can see that your money is in safe hands.

With that, rather than me droning on, we'd love to get your questions.

<u>Question 1</u>

Pavan Mahbubani, JP Morgan
Thank you for the update and for taking the call. I have three questions, please. Firstly, on services, how are you looking to mitigate the negative impacts? Because it feels like the weakness is looking to be more structural. By that, I mean you're losing customers. How are you mitigating the impact in the near term? Do you think you can get those customers back?

Secondly, looking at supply, is the main driver of the weaker result expectations this year just lower volumes? Is there anything we should be aware of?

Finally, in terms of when you think of your outlook, and you're clearly quite confident to be doing a buyback heading into this winter, my question around that is, have you taken any view on upcoming windfall taxes or an announcement? What's your latest thinking around that, please?

Chris O'Shea, Centrica
Thank you very much for the questions. I'll try and do my best to answer all three of them. I'll take the last one first. We've not taken any view on that. That's for the government to decide. Obviously, we're subject to a windfall tax already in our gas production business in the North Sea, but we've made clear our view to government about how you encourage investment and how you discourage investment. We leave that up to them to make their decision.

On supply, obviously the warm weather has impacted on the quantum of gas use. This is more of an issue on gas, but there's two things. One is you get lower volumes consumed, but then as a responsible supplier, we obviously hedge our books so that when we make a commitment to sell to somebody, we've locked in that price. There's always a weather risk in this business. When it's too warm, you may be over-hedged because the demand is low, and you have to sell that back into the market. We've seen softness in the front end of the curve. Obviously, where we've bought gas at X, we may be selling at X minus because we sell into the within-day market. That's the same for any supplier. That risk exists on the upside and the downside. If it's too warm and you've got too much, and the price falls, you've got a hit. If it's too cold and people use more, and you've not bought enough, and the price goes up, then you get a hit. It's always been the case. The weather risk is a bit enhanced at the moment in the higher-price environment, but those are the two things happening there.

In services, when you say structural, I think this is more temporal rather than structural. We've obviously seen issues in terms of our service levels, and we've invested quite a bit of money this year and effort in getting our service levels to the right place. I'm really pleased with what the team has done. But obviously, with inflation running as it is, people are looking, and they're making buying choices, whether it's trading down or whether it's actually cancelling their cover. The other thing to bear in mind is that you see a real correlation with weather. When it's warm and you're not using your boiler, you're less likely to buy boiler cover. It's not always something where people say I want to buy this stuff, I'm going to do it no matter what. The weather then gets cold, and you see a cold spike – and we see this in our daily sales numbers – people are more likely to buy that. I think this is more temporal rather than structural, but I think we have to be realistic and say that this is going to last for the duration of what people call the cost of living crisis.

Now, how do you mitigate that? What we would have done in the past is we would have gone into a slash and burn thing and cut costs and damage customer service and chase more customers away. What we do with everything, as you see with this with the share buyback, is we try and manage for the long term. We're going to make sure that we cut our cloth accordingly, but what we're not going to do is we're not going to make short-term decisions to prop up in-year profitability. This is a great business which has got a super long-term future. It's in a turnaround like Centrica was in, and it will take, I think, a couple of years for us to see the full potential of this business but we're going to continue to invest in customer service, we're going to continue to invest in giving our customers what they want, we're probably going to have to try different propositions.

I think that maybe in the past, we've been a bit overly focused maybe on what we call the insurance product at the detriment of what we might call on demand. So, you can buy a year's subscription, we'll fix your boiler, that's fine, but we'll probably have to get a bit more into the boiler breaks down, you give us a call, and we get someone out the same day to get that fixed. I think there needs to be some more commercial innovation in there, but I want to make sure we do the right things for the long run rather than prop up in-year profitability.

Pavan Mahbubani, JP Morgan
That's very clear. Thank you, Chris.

<u>Question 2</u>

Deepa Venkateswaran, Bernstein
I had one question, which is the follow on from the Rough storage reopening. How much of the upgrade to the 2022 earnings is coming from your usual upstream and nuclear versus the Rough storage repurposing, or should we actually expect most of the Rough storage repurposing earnings to come next year? I think that was my main question. The second one is obviously you've announced all of this customer support of £50m, but still, I'm not so sure that the tabloids and the others will take this buyback all that kindly. Can you just explain the thinking behind wanting to return that capital amid what might lead to a lot of scrutiny?

Chris O'Shea, Centrica
On Rough, we will get more of the benefit of that in 2023 than in 2022. What we're doing just now is filling the facility in order for us to have gas when people need it when it gets really cold. So, not much of this is Rough.

On the tabloids, that's something we could spend an age talking about. I've always taken the view that I have to run the company for all of the stakeholders. I work for the shareholders. We've got over half a million shareholders, we've got more than 10m customers, we've got 20,000 amazing colleagues, and obviously, we've got other stakeholders, but my focus is on our 10m customers, our 20,000 colleagues, and our half a million owners. The public are a key stakeholder, but that's in terms of the public being our customers. I'm always hopeful the press will write the right story rather than try and write something that gets them clicks on a Twitter page, but I'll leave them to their job. The journalists don't really – they shouldn't really factor highly in business decisions that you make.

Deepa Venkateswaran, Bernstein
Okay, thank you so much.

Question 3

Mark Freshney, Credit Suisse
I've got a couple of questions. My first question is for Kate. You've had a little bit of a benefit on your £3.5bn of gross debt in that that debt was financed at very expensive rates and given the rise in yields, that debt is a lot cheaper now to buy back than it would otherwise be. My question is, why have you not launched a tender offer to buy back some of the debts because arguably that may offer even better – forgive me for saying this – even better value than the equity? Secondly, just on the services business, there were some operational issues with Covid, some of the labour relation issues, which were weighing on profitability in previous years. I just wondered how those things are now being resolved. Thank you.

Chris O'Shea, Centrica
Mark, thanks very much. Let me take the second question and then touch on the first question before handing over to Kate. The operational metrics and services, I'm really, really happy with. I'll give you a couple of examples. Take a year ago, we were probably rescheduling 10-12% of appointments. Last week, it was 1.9% of appointments rescheduled. A lot of those appointments, the 1.9%, were actually within day. Saying, look, we're stuck at a job. Rather than be with you by one o'clock, we'll be with you by 3 o'clock. We count that as a reschedule. A year ago, it was saying, we're not going to come on Wednesday, we're going to come on Friday, and so we were annoying our customers. Another one is that we have very strict tolerances in terms of when do we get to priority calls, how quickly, when do we get to second-level priority, when do we get to third-level priority. All of our operational metrics are within tolerance. As you know, we're regulated by the FCA in this business. The work the team has done has been absolutely fantastic.

Now, we have prepared, for example, for a one-in-five winter, and it's a bit warmer at the moment, and so we are deliberately carrying excess capacity because I think what we've been doing in that business for years has been running too close to capacity and not really planning the work and balancing things as well. When you sell a premium product, you better give the customer a premium service. I'm really happy with where the operational metrics are, but I think we're seeing, like many people, customer behaviour and customers are prioritising their spend.

The other thing I'm happy about, we have actually gained market share in boiler installs. Now, it's not a huge market share that we've gained, it's maybe 50 to 100 bps. The overall market is down. I'm always trying to look and say, how are we doing in absolute terms, but how are we also doing against the market? Again, there's a long road in this business. Another couple of years, I think, for this business really to get firing on all cylinders, but we're setting it up for the next 20 years rather than, in the past, it might have been the next 20 weeks. I feel comfortable with the operational metrics, but I feel deeply uncomfortable until this business is back making the kind of profits that we saw in the past.

I'll hand over to Kate on the debt buyback, but I would say that, obviously, we look at all of these things. Some of the debt does look a wee bit expensive, but it looks a lot less expensive than it did a year ago. You think about it, when we've got investments to make, and we do have a clear line of sight on a number of investments, you don't want to go into the bond market and buy back your debt and then go into the bond market and maybe issue new debts, so we've got to think again. We're always thinking kind of two, five, 10 years ahead. But let me hand over to Kate and see if she's got anything to add to that.

Kate Ringrose, Centrica
I think Chris has covered the high-level principles of it. Rest assured, this is something that I continue to look at and will continue to look at, as you would expect, with good balance sheet discipline. With the rates that are up we are also earning more on our cash than we did before, so yes, there's an improvement versus where we were a year, but it's got to be balanced as well by the cash that's invested. There is still a meaningful range in terms of the coupon rates that we have available to us. But we continue to keep this under watch.

Mark Freshney, Credit Suisse
Very clear. Thank you very much.

<u>Question 4</u>

John Musk, Royal Bank of Canada
I just wanted to come back onto the buyback and just understand the thinking around that. Firstly, can you just indicate how long you would expect it to last for you to be able to complete the 5%? Then, when you get to the end of that, what conditions will you be looking at to decide if it should be extended or expanded? Then finally, why a buyback versus doing something with the regular dividend?

Chris O'Shea, Centrica
It depends, obviously, it depends on the market volumes, but probably the quickest we could do this is about three months. It could take four, but it depends really on what liquidity we see in the market. In terms of expansion, I think this is the first buyback in about nine years, so let's get this one done and then we will look. We as a board – and we met as a board this week – are always looking at what's the capital framework of the group. What capital do we have? What capital might we need? How do we make sure we've got the right buffer? I've always been really clear that, whether as a CFO or a CEO, that I like to sleep at night, and I like to make sure that we've got enough liquidity, enough facilities available, enough cash, enough capital so that we're never forced into making a decision so that all the decisions that we make we make through choice rather than through circumstance. Give us some time, but hopefully, this is a very clear demonstration of when we see that we have excess capital and we can afford it, we want to give it back to shareholders.

Then in terms of the regular dividend, obviously, you've got a regular dividend, which we want to be something that we can grow over time in line with underlying earnings, but when you've got chunks of capital, you think, you know what, that's probably spare from a structural point of view, then I think the best way to do that is to give it back to shareholders in the most efficient way. Our judgement is the most efficient way was to do it through a buyback rather than necessarily through a one-off special dividend, but no doubt we'll hear from our shareholders as we talk to them as to what their preferences are, but our judgment is this was the best way to do it.

Question 5

Bartek Kubicki, Société Générale
Just one thing on this weather risk you discussed at the very beginning. Just putting a thesis here, and please let me know if you agree or not because this winter may be peculiar in the way that people may have in mind that storage levels of gas will be very low at the end, and it will be more challenging to fill them up for next winter. Consequently, if there's any demand destruction or warm weather, it will be used by traders to fill up storage and storage sites. Consequently, there will be an additional demand which will put gas prices up. My question is whether you will agree that this year, the sort of demand destruction mild weather risk is a little bit different than in years before because prices may stay up, or you think this winter will be like in previous winters, mild weather means lower prices, you will potentially lose money on unwinding your hedges?

Chris O'Shea, Centrica
It's a great question. As with everything, there's a bit of a multi-layered answer. It depends how full storage facilities are when the warm weather comes. If you think about trying to push gas into a bottle. When the bottle is empty, you can push the gas in easier; when the bottle gets more full of gas, the pressure increases, it becomes harder to push gas in. Storage levels in Europe are I think, 90%+ full. Right now, where you've got a warm front, when you look, last night the price for today was about 90p and the price for December is 270p, the price for January is 314p, February 321p, March 314p. You do see this softness in the front end of the curve when you've got warm weather. Now, if we get quite a cold snap and take stuff out of storage, and then we get a warm snap – and I'm talking pan-Europe rather than UK – you'll be able to put that gas into storage, so you should see some amelioration of that price impact. You need to look at the storage levels before you understand where the gas can go. Then Europe are quite full. We're obviously putting into Rough at the moment in the UK, but the UK has got nine days of storage; the Netherlands has got well over 100 days, France has got over 100 days, they're all full, but if they take that out quite quickly, then you could see some propping up there. Other than that, you'd expect to see the same kind of weather risk. It's actually a bit heightened this winter because, obviously, with the prices being higher to start with, then your risk is higher as well on the upside and on the downside.

Question 6

Mark Freshney, Credit Suisse
Thank you for taking my follow-up. A question for Kate just on technical reporting. As I imagine it, the remainder of the Spirit business, the cash flows are relatively locked up until they cover 1.5x pre-tax decommissioning. My question is, will you present an earnings number excluding the profits from Spirit, which in any event, is very short live? Of the upper end of the range in the guidance update that you gave today, how much of that 25p pertains to Spirit?

Chris O'Shea, Centrica
Mark, can I take a little bit of that first? The line broke up a little bit, so apologies if I get the question wrong. There's two things. One is, some of Spirit's assets are relatively near live. If you take Morecambe, for example, we expect cessation of production in Morecambe to be about 2027. Obviously, this depends on price, technical, life extension. For example, if you take Cygnus, we expect that to go into the 2030s. Although Spirit has got, I think, probably six years reserves to production life, that doesn't mean it's got six years to go. You can see line of sight for another maybe 15 years or so. Now if prices get incredibly low, and you know that you bring forward your shutting date because it's very clinical – are you making money or not?

On the question of would we present earnings separately, what we said is the structure of the group is one that we like. Now, that's not to say that it's never going to change, but we spent quite a bit of time getting this group in the right shape, where we've got our retail businesses, our optimisation businesses, our infrastructure businesses. Spirit is a core part of that. Kate keeps me very honest on this. I would like to have our reporting as simple as possible. You can't see her, I can see Kate, I'm going to get a row for saying this, but you can backsolve Spirit by looking at the minority interest in the group. You've got the information. You know the share that SWM have got. We declared the, I believe it's called non-controlling interest. I'm an ex-finance person, as you know, so I used to call it minority interest. You can kind of backsolve through that. But no, I wouldn't want to kind of represent this saying, here's the group, here's the group ex-Spirit, because that's not how we think of the group. I'll be with the team in Aberdeen tomorrow to go through some of the stuff that they're doing. It is a core part of the group, and it's managing well.

I'm going to hand you over to Kate, who can take any of the technical questions but also will tell you quite clearly, we're not going to give you a breakdown of how much of this is Spirit and how much of this is other places. Save her having to be rude, I'll be the rude one, but Kate, hopefully, I got that right.

Kate Ringrose, Centrica
Yeah, no, spot on, Chris. One of the many advantages for working for an ex-CFO. With regards to cash, just a bit of clarity, Mark, in terms of how we're dealing with that cash. It's basically it's a restriction to dividend out of Spirit such that we make sure that that entity can cover decommissioning in the long term, but with regards to

the consolidation of cash, how it's used to contribute to margining, etc., that's absolutely part and parcel of the flow of cash on the balance sheet. I think just a little bit of clarity there.

Closing remarks

Chris O'Shea, Centrica
Thanks again everybody for joining. As I say, second short notice call in two weeks, but hopefully, as you see, we've given you a bit of advance notice to come along and learn a bit more about the Energy Marketing & Trading business in early December. We'll get the invites out to that very shortly. We're really keen to continue a dialogue to help you see the quality that we see. I want you to see the quality that I see in the underlying businesses.

Just to recap, strong performance, strong cash position, strong balance sheet, strong liquidity, and as I say, we like to do what we say we're going to do. Returning money to shareholders through shrinking the capital by 5% we think is the right thing, but we're also looking to take care of our other stakeholders by putting another £25m into a support fund for those of our customers who need it most.

I hope to speak to most of you, if not all of you, in a few weeks when we can learn a bit more about Energy Marketing & Trading, but thanks. I hope you have a good day. I know you've got a busy day today. You've got other results, so I am really grateful that you found the time to dial in. Thanks, everybody.

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