centrica

Centrica and Bayerngas Norge to create E&P joint venture

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Iain Conn, Group Chief Executive

Well thank you Chatch. Good morning everyone. I'm joined here by a group of people including Jeff Bell, Chief Financial Officer, Martyn Espley and Rebecca Triffitt from Investor Relations, and Chris Cox who is the Head of Exploration and Production, and Grant Dawson our General Counsel is also here.

As you've seen we've announced this morning an exploration and production joint venture with Stadtwerke München who control Bayerngas Norge. We are putting Centrica's European E&P business together with Bayerngas Norge and this creates a more sustainable stronger E&P business with greater future optionality, generates positive NPV, and the new entity will be self-financing with an attractive financial profile.

We've said since 2015 that we wished to create a stronger more focused E&P business, and with the sale of our Canadian E&P business this achieves that goal.

Just a word on Stadtwerke München before I go to some slides which you should have access to. Stadtwerke München is one of the top utilities in Germany; it's owned by the city of Munich. They are involved in energy and water supply generation and district heating, public transport and telecoms, and they have about 9,000 employees and EBITDA last year of 935 million euros. That just gives you a sense of the company, but obviously they've been involved in exploration and production through Bayerngas GmbH and Bayerngas Norge. And they are very aligned with us in terms of the future of E&P and what they're seeking from it, and that resulted in this joint venture.

So I'd now like to go through about ten slides and then we'll take your questions. The first slide is obviously our disclaimer which I'd just like you to remind yourselves of.

Then if I go to slide three, the transaction overview. We are combining Centrica's E&P business with Bayerngas Norge Group to create a newly incorporated independent JV. It will be an incorporated JV and, as you can see in the chart on the right, we will own 69% of the shares and the Group controlled by Stadtwerke München will own 31% of the shares. The holding companies and assets of Centrica's E&P business in Northwest Europe and Bayerngas will be contributed to the JV.

Centrica is contributing our business and making a series of deferred payments totalling £340m post-tax over the first five or six years for 69% of the JV. And the reason for that, which I'm sure we'll come back to in questions, is very simple, which is that we have a number of assets that are in or entering decommissioning. And clearly a partner purchasing those would want us to pay for them, simply given the fact that they are going to have no ability to generate cash flow. And that was part of the structure of putting the two businesses together.

There is no cash consideration in this transaction. At the time of the deal there will obviously be the usual true-ups to the balance sheet date, the effective date being 1st January 2017. Stadtwerke München and the minority shareholders will contribute Bayerngas Norge Group for 31% of the JV.

We will have an independent JV board which will comprise the CEO, and that CEO will be Chris Cox who's sitting next to me here, and Centrica will also have four other shareholder nominated directors and Stadtwerke München will have two.

We would expect the deal to complete in the fourth quarter of this year.

In terms of the strategic rationale, on the next slide we have two like-minded shareholders who want to own and be part of a stronger, more resilient E&P business, but also want that business to be strong enough to be able to participate in future consolidation in the industry and at the same time to limit the amount of recourse that that business has on a day to day basis from a cash perspective back to the shareholders. So we're very aligned. And obviously given that we are two companies that are involved in supply of services and utilities to customers we are very, very aligned around the role of E&P and come from similar backgrounds. And certainly over the last discussions it's quite clear that we are very like-minded which bodes well for the JV's future.

What we're putting together is a complementary mix of producing assets and development assets with strong positions in Northwest Europe, and I'll come back to that. We have an entity which will be self-financing with an attractive financial profile, enabling healthy reinvestment and distributions and sustainable production levels, which I'll also come back to. The transaction generates a modest amount of NPV initially, but obviously there is also the potential for future stages of consolidation, with £100m to £150m of NPV expected through synergies from cost savings and optimisation of the portfolio.

Then lastly we see that this venture will have the opportunity to further participate in consolidation or other joint ventures, and we don't rule out the possibility of an IPO in the medium term, although I should stress that we're not coming into this with the sole intention of getting out at all. This is just pointing out that this creates the optionality for the shareholders should either of them wish after an initial lock-up period to pursue an IPO that we see that as a viable pathway.

So that is the strategic rationale for the transaction. If I then move on to some of the impact of it before describing the physical parameters of the business.

Firstly the joint venture financial framework. We have an objective to create a sustainable European E&P business, something that we have said since 2015. This business is capable of self-financing in a range of environments, including Centrica's low case of 35/35. We have always said that to sustain 35/35 clearly E&P businesses, including Centrica's heritage business, would have to make adjustments to capital in order to be self-financing, but we believe it's capable of doing so. And in a normal environment, or at least in the current environment, we see the business as being sustainable with medium-term annual production of 45 to 55 million barrels of oil equivalent per annum. And investing £400m to £600m a year of capex in the near term, representing an 80% post-tax operating cash flow reinvestment ratio through the cycle. And finally that the remaining post-tax operating cash would be distributed to the shareholders.

And so clearly, all other things being equal, and provided the JV is debt free, you can calculate from that that the venture through the cycle in the current environment should be capable of generating a dividend stream of £100m to £150m per annum. But obviously that depends on the environment and prevailing circumstances and the capital structure of the JV as it goes forward.

In terms of the impact on the Centrica Group from an operating perspective and an E&P perspective it increases the reserves to production ratio from a level where we were just a bit below seven to around eight. Now, it's not a massive increase in our 2P just given the relative scale of the businesses, but it's going in the right direction. And it importantly reduces the net decommissioning liabilities of Centrica by combining our mature E&P portfolio, and Bayerngas' portfolio has a lot of early lifecycle assets with a significant number of developments which we think we can add material value to.

It reduces Centrica's share of annual production into the range of 30 to 40 million barrels of oil equivalent, and our share of capital expenditure on a proportionate basis to £300m to £400m. Now, that 30 to 40 million barrels of oil equivalent is below our 40 to 50 million barrels of oil equivalent that we announced we were targeting back in 2015. I think it's just worth spending a moment on that.

We've done some financial modelling and believe that 30 to 40mmboe will achieve the same contribution to the Group's portfolio in terms of diversity of cash flows and balance sheet strength as our similar contribution to 40 to 50mmboe. And the other reason for pursuing 40 to 50mmboe is we believed really you need to be about that size to create a sustainable E&P company. Now, obviously this company is going to have 45 to 55mmboe sustainable production so it meets that second objective and we're satisfied it meets the Group's financial objectives around the portfolio mix.

Our share of synergies is obviously going to be £70m to £100m of NPV. We will be fully consolidating the JV post-completion and initially, although the E&P assets and staff and companies will all transfer to the JV, the direct operational team, we will be providing functional services to the joint venture initially: IT systems support, HR services, finance, HSES in order to enable the JV to get up and running. Over time we would imagine that the JV will want to establish its own, or have its own choices as to how it procures Group services down the road.

The transaction's expected to be earning accretive from 2018 in the current environment, and it will have a positive impact on Centrica's credit rating agency financial metrics.

So turning then to what is this JV and what is it capable of? On the next chart you see that of the independents in North West Europe, and we've excluded the super majors, basically this chart shows the reserves ranking of the companies, and you can see that we are creating one of the largest independent European E&P companies in this step. And as we've disclosed the joint venture will have reserves of 409 million barrels of oil equivalent and additional resources. I'll come on to that in a minute.

On the next slide we show production. Now, Centrica is already one of the larger independent European E&P companies by production. Bayerngas is much smaller because of its much earlier life and many of their reserves are still to come onto production, which is obviously what attracts us. The combined entity in 2017 will be the largest or one of the two largest independents in Northwest Europe.

We think this positioning relative to all the other players in the market gives us the ability to lead and participate in further consolidation, so creating an even stronger entity over time.

In terms of the portfolio on slide nine we have complementary positions in North West Europe with Bayerngas. First of all, 50 to 55 million barrels of oil equivalent production this year from 27 fields. You can see on the map on the right that there's significant overlap of our acreage and assets. We are quite strong together in the Southern North Sea and this brings us together with Cygnus which has just come on stream. If you remember Bayerngas is a shareholder in Cygnus, and it actually takes us to over 61% ownership in Cygnus.

But we're also active in the Norwegian and Danish sector of the Continental Shelf, and there are a number of developments that we have and they have in Norway, and there is quite a large development in Denmark which is partially developed at present, Hejre, which we see the ability to add significant value to. In the northern Norwegian Continental Shelf we also have acreage overlap. And then interestingly also in the Barents Sea we have a number of exploration blocks in the mature Barents which creates further optionality for the Group.

The combined JV will have 2P reserves and 2C resources of 625 million barrels of oil equivalent. The split of that in the footnote is 409 million barrels of 2P reserves and 216 million barrels of oil equivalent of 2C resources.

It's gas biased, but we are not driving the business to be gas only although we value it having a high proportion of gas, but this business will be seeking hydrocarbons of liquids and gas as it seeks to create value for the shareholders. And as you see also there's a material proportion of production that is operated by the partners, so giving a good balance between operated and non-operated activity.

On the next slide when you put the portfolio together what you can see is that Centrica's portfolio, which is very heavily weighted to established assets, with 15% of our portfolio being reserves and resources recently on stream and some very good development assets focused around Norway and a number of exploration licences, when we put this together with Bayerngas' portfolio which is heavily weighted towards future development with some material recently on-stream assets and very few established producing assets, it creates a much more balanced and sustainable portfolio of assets and hydrocarbon resources. And as you see, we're also involved in 64 exploration blocks, giving further optionality around in-fill exploration, infrastructure led exploration and also some of the more frontier-type exploration up in the Barents Sea.

And then finally in terms of capabilities we have operated and non-operated assets and experience in that. We are experienced in being a non-operated partner with major companies such as Statoil in Norway. We have onshore and offshore operations. The onshore being in the UK, owned by Centrica, and that being the Barrow terminal and the East Irish Sea coming onshore. We are also involved, as you know, and to a very limited degree in onshore unconventionals. We have a deep subsurface knowledge of these regions that we're in, and the combined capability, particularly in the Norwegian Continental Shelf we think is going to be very complementary, and also true in the Barents Sea.

We have 650 employees involved in this business. The main offices today are in Aberdeen, Stavanger, Oslo and Hoofdoorp in the Netherlands.

So in summary this joint venture brings together like-minded shareholders with a strong strategic alignment on the role of E&P; a complementary mix of producing and development assets with good positions, strong positions in North West Europe; a robust self-financing entity with attractive financial profile enabling reinvestments and distributions to shareholders; the creation of NPV through bringing the portfolios together, from cost savings and portfolio optimisation; and importantly the opportunity to strengthen the entity further through additional consolidation and joint ventures as the industry looks to do so, including the potential for an IPO in the medium term.

So, ladies and gentlemen I hope that's been a useful summary and now I would be happy to turn over to your questions and between us we will aim to answer them. Thank you.

Q& A session

Question 1

Jenny Ping, Citigroup

Firstly a question on strategy. You obviously hinted through the presentation that you're not coming into this with a view to exit. So can I just ask what is your long-term strategy on the

E&P business and is there an extent in which you still want to maintain a degree of hedging with the retail business and how you generally think about that?

And then secondly, on the financial metrics you talk about EPS accretive, I don't know if you or Jeff would be willing to give us some numbers there.

Then lastly on Hejre, as far I understand this is one field that has had very difficult technical difficulties in the past and has been over budget due to numerous delays. Can you talk about that project specifically as well? Thanks.

Iain Conn

What I'll do I'll just cover the strategic point and I'll ask Jeff to comment on accretion, and then I'll make a comment about Hejre before asking Chris Cox just to give his perspective on it.

So, strategically first of all we've always said that the primary role of E&P in our portfolio is to contribute cash flow diversity and through that and being invested in asset based businesses balance sheet strength for the Group as a whole. That has not changed.

To your point about the secondary factors, because there are a number of secondary factors, by being in gas production our ability to manage the cost of matching hedged positions with our own production reduces the cost of our overall cost of supply, and it makes us more efficient. However we did conclude in 2015 that the short-hand vertical integration arguments and security of supply arguments didn't really hold water, neither did the point about them being a natural hedge, because we tend to independently risk manage the E&P and customer-facing risk and so we hedge them independently. And obviously if gas prices collapsed we couldn't turn round to our customers and say, "Sorry, we're going to keep prices up" simply because we've got this hedge.

The security of supply argument doesn't really hold water because the markets are now very fungible, and only in the most extreme circumstances would this really apply.

And vertical integration, we don't really consume or sell much of our own production.

So, Jenny, that's the strategic rationale. I'll just pass to Jeff to comment on accretion and then I'll come back to Hejre.

Jeff Bell, Chief Financial Officer

The accretion, as we indicated on the slide, from an EPS perspective is small, not a material number and doesn't materially change the overall forward view of the Group, but it is slightly better than neutral in a sense.

From a cash flow perspective obviously consolidating the business on a consolidated basis we'll see a larger impact from an operating cash flow perspective.

Iain Conn

Thanks Jeff. And then on Hejre, this field actually far from being a big negative was of interest to us because it's already been materially developed. Now, it has had problems and so clearly we were spending quite a bit of time making sure we understood the nature of those problems, but we're very satisfied with the level at which Hejre has been represented in the JV and the optionality for upside value that it creates.

Chris, would you like to comment on that?

Chris Cox, Head of Exploration and Production

Sure. Jenny, obviously it's something that stands out in the Bayerngas portfolio and therefore we spent a lot of time in due diligence looking at Hejre.

Whether you like Hejre or not kind of depends on whether you've been spending money on it up till now. So, Dong probably look at this from a very different perspective from us. Frankly we haven't put a huge amount of money on Hejre in the transaction and we see quite a lot of upside in it. It's a field that has a jacket in place already. It has got three producing wells already drilled. It has an export pipeline in place. It probably needs a couple more wells and it needs a topside of some description on it.

The problems with the project to date have been pretty much all around the topsides where the contractor did not deliver frankly. That contractor has now been cancelled and will have nothing to do with that contract going forward. Any obligations in relation to that sit with Dong.

So, we're quite excited about Hejre as a development coming into it already partially developed. And of course the intent is for INEOS to take over as operator there, and I think combined with our abilities we ought to be able to find an interesting way to develop that. And we'll be looking at different development options in the coming months.

Iain Conn

Thanks Chris. And I think Jenny last comment would be that this joint venture brings two companies together and the optionality with a number of other big companies, like INEOS for example who are going to be involved post their transaction with us in Hejre, just as it brings Bayerngas and Centrica together in Cygnus. So we're going to end up having material capability to influence some quite important projects going forward.

Jenny, thanks for your questions.

<u>Question 2</u>

Ajay Patel, Goldman Sachs

Three questions if I can please. Firstly, you alluded to a lock-up period; can you give us an indication of how long that lock-up period is?

Secondly, on the credit metrics and the comment on decommissioning liabilities and how this would be an effective structure for that, how much does that actually reduce your net exposure on any decommissioning liabilities? Is that the sole reason the credit metrics are better as a result of this deal rather than not?

And then finally, I understand that you're marketing 50 to 55 million barrels of oil equivalent from this effective deal but you'll own 30 to 40, but why is 30 to 40 the right number? Why not 20 to 30? I understand balance of cash flow, but we were of a situation where 40 to 50 was fine, I'm just wondering why is 30 to 40 the right number.

Iain Conn

Let me cover the lock-up and then also the 30 to 40 comment, and then I'll ask Jeff to just come back on the point about the decommissioning impact.

The lock-up period is medium term and it depends on the shareholders, but I can confirm two to five years, depending on the circumstances.

As far as the 30 to 40 is concerned, when we announced the 40 to 50 in 2015 we were trying to judge from a range of different inputs, as we said at the time, from a portfolio modelling perspective, from a capital affordability and cash flow balancing perspective, what's the right sweet spot for us to get benefit from the diversity of the portfolio whilst at the same time reducing Centrica's exposure and reinvestment ratio going into E&P. And we settled on the 40 to 50.

Now, the other reason for the 40 to 50, as I said earlier, was the notion that really below that sort of scale it's quite difficult to be a material player and able to shape consolidation and to participate in a range of developments and support a decent exploration budget, and so we believe for a sustainable business it also needed to be about 40 to 50.

Now, in analysing this a bit further over the last year and a half we've concluded that actually 35 or so would fulfil the same effect or a similar effect for us as a Group from the first reason around the balance sheet strength and diversity of cash flows. But we also still conclude that the second reason holds i.e. you need to have an E&P company of sufficient materiality to have enough optionality and choice so that you can create a high quality E&P portfolio. This transaction achieves both of those things. It achieves the 35 million barrels or 30 to 40 for us net, but it also achieves the appropriate scale to be able to shape a sustainable future.

So, that's the, just to repeat, that's the simple rationale.

And Jeff, the decommissioning liability and impact?

Jeff Bell

Ajay, there are effectively of course two things here. From an NPV or economic value perspective obviously outside of the £340m payment the joint venture partner is picking up 31% of our decommissioning liability. From an actual credit metric perspective of course though we consolidate all of the joint venture, which means we do consolidate all the decommissioning liabilities. However, because Bayerngas comes with very little decommissioning liability, in fact that really doesn't change the liability much at all, whereas from a retained cash flow perspective we of course are consolidating their operating cash flows and of course we're consolidating the synergies that we get within the joint venture as well. And it's really the combination of those two having a more positive effect than the additional decommissioning liability from Bayerngas within the metrics themselves that gives us a small positive on the credit metrics.

Ajay Patel

Fantastic, thank you.

Iain Conn

Thanks Jeff, thanks Ajay. Next question Chatch.

<u>Question 3</u>

Mark Freshney, Credit Suisse

Morning. Three questions if I may. Firstly you've spoken about the rationale for 30 to 40, but my question is how we got there, because going through this transaction you entered with a

40 to 50 target and you're coming out with 30 to 40, so my point is what is the justification for that dilution?

Secondly, on the trading businesses, so you've got a large commodity trading business, you've got contracts with Cheniere and various swaps with Asia, the value of that trading business partly revolves around having the hard assets, so how are you going to capture all of the value through those?

And thirdly, a question for Jeff. Just on the technical accounting, this transaction provides a lot of mark to market data if you like on the value of your oil and gas production business. Is there going to be any potential impairment or loss on disposal reported either at the half year or the full year?

Iain Conn

Thanks Mark. Well I'll ask Jeff to comment on that but obviously the JV operates at varying prices and the strategic point is that we can do this JV without having to net crystallise value, but Jeff can comment on value and impairments.

On the rationale to the 30 to 40 I really think I've covered that in some detail, it's not a dilution per se, I mean it is a lower participation in a larger business but with the net effect that we believe fulfils our strategic objectives. And having reviewed that really carefully we're very satisfied that although it's not 40 to 50 anymore net, as I've said, it fulfils Centrica's objectives while also making sure that we participate and lead as a lead shareholder in a business capable of reshaping and consolidating the industry.

In terms of the trading business, as the RNS says we will be buying and marketing all the production from the JV, and so our Energy Marketing & Trading business will retain some optionality around this, although the reality is that as has always been the case our Energy Marketing & Trading business, and the clue is in the word marketing, is significantly involved in serving and servicing the other businesses of the Group, and will do so for this joint venture as well. And needless to say Stadtwerke München has been very focused on making sure that the transfer pricing and the ability for EM&T to serve the JVs in the interests of both shareholders, but by having access to these flows at a fair market price EM&T will still potentially be able to capture some additional value from it that our other shareholder is not capable of doing.

So Jeff, on impairments and valuations.

Jeff Bell

Yes, I mean obviously Mark we'll have a chance in a couple of weeks to talk about where we are at the half year, but I think I'd probably make the observation that at the end of December 2016 when of course we did our impairment testing, and as you rightly point out, we effectively are mark-to-marking the E&P assets at near term liquid curves in our longer term view of prices. I think my observation would be that prices haven't materially changed in the last six months versus where we were at the end of December. I'd clearly love a chance to talk more about that at the interims, but you might hold it that way.

<u>Question 4</u>

Deepa Venkateswaran, Bernstein

Thank you. I've got three questions. So firstly, I just want a little clarification that the post-tax contribution of £340m that you refer to, that is indeed the net outflow from the Group, because presumably the tax deduction will happen at the JV level. So I just want to get that that's the net amount that goes out from the Group?

Secondly, can you clarify how does this transaction really impact your Group sources and uses of cash, both immediately as well as in the next two to three years, given that your dividend policy is quite linked to that. So I just wanted to understand what's the net impact on Group sources and uses of cash.

And last question, clearly you've acquired less mature assets, or the JV has some less mature assets from Bayern. So is the combined capex level of £400m to £600m still sufficient to harvest those assets? Thank you.

Iain Conn

Thanks Deepa. Let me answer the third question and ask Jeff to cover the first two. So on the third one, yes we believe that £400m to £600m at the appropriate level of finding and development costs we should be able to stabilise and sustain a business of 45 million to 55 million barrels of oil equivalent.

So you can get from that that it infers in a very rough way F&D costs of sort of £10 to £12 per BOE which is absolutely within our grasp going forward. Clearly depending on what happens to inflation in the industry if you get prices going up you'll see F&D costs going up but we've modelled this joint venture at a number of different price environments, and it's relatively price inelastic in terms of our ability to sustain the business under a range of environments. And certainly the base case assumption in this current environment is within our grasp having driven quite a lot of capital efficiency and operating efficiency into both businesses.

Jeff, the first two?

Jeff Bell

Yes, so Deepa, the £340m is the cash outflow from the Group, so you were interpreting that correctly. I think on the second question, in terms of the sources and uses of cash a bit linked to my response to Ajay on this on the credit metrics. Clearly we will end up consolidating 100% of the joint venture, and therefore effectively their production and cash flow profile as well, while at the same time the capital expenditure at least in the short to medium term is still within the £400m to £600m range we've been signalling for the Centrica Group.

So kind of the net of the operating cash flow improvement backed by the existing Bayerngas cash flows and synergies will be a slight net positive to the Group and we also had a slightly less share of capital expenditure.

Iain Conn

Deepa, thanks and everyone so far has had three questions, we may struggle to get through everyone's questions if everyone has three, but we'll keep going and see how we do. Next question Chatch.

<u>Question 5</u>

Lakis Athanasiou, Agency Partners

Good morning. I'm going to have three questions, everyone else has, I don't see why I shouldn't.

Iain Conn

You're quite right, you deserve three. Go ahead.

Lakis Athanasiou

Okay. And these are simple I think. The first is what's the timeframe of the delivery of the NPV benefit? I presume there's operating expenditure and what kind of level will they reach in steady state per annum pre-tax?

Secondly, on the reserves split, presumably all the reserves are at the beginning of this year, so 1st January 2017, and we can get out of that what the split is on the 2P reserves, but the 2Cs, the 2016 of 2Cs, can you split that between yourselves and Bayerngas please?

And the third question, I still don't understand what the £340m post-tax actually means. Could you explain it in the context of the physical amounts of money that are going from Centrica to the joint venture, irrespective of how the consolidation is done? What is actually going to be paid to the joint venture?

Iain Conn

So first of all the timeframe of the NPV, so we're not disclosing that precisely, but some elements of the NPV will clearly depend on the ability to optimise capital flows, and those will be slightly longer dated, but most of the value we think will be pretty front end loaded, it's about the optimisation of the portfolio immediately, it's about cost efficiency and optimisation, it's about tax optimisation of the portfolios and so it should be pretty front end loaded.

On the reserves split, look we're not giving the split today of the 2P or the 2C between the two companies, but we will do it at the end of the next reporting period, I mean you can clearly go and find the split, certainly of the 2P. With 2C the problem is people do tend to use slightly different bases and what we have disclosed though, just to confirm your question, is the WoodMac consistent basis, and it is as of the end of last year.

In terms of the £340m, Lakis, so from memory this is a nominal amount, I believe it's nominal, and it directly corresponds to and is derived from the estimated cash obligations for fields that are actually in decommissioning or literally about to start decommissioning in '17 or '18 pretty much. So the problem we've got there is quite rightly any partner's going to say well what's the point of me buying 31% of that because it's near in, I can't participate in the learning curve of decommissioning, it's got no cash generation capability, it's just a straight liability. And so we've agreed that for those fields in the very front end we will pay for sole risk effectively, the cash payments for those, and it's an identified group of fields over the next five years.

For all the rest of the decommissioning, and you know our nominal decommissioning liability's £3bn, that's right isn't it Jeff?

Jeff Bell

That includes Canada.

Iain Conn

Oh that includes Canada, I'm sorry, so a bit lower than that, but it's a sizeable number and obviously with the exception of the £340m our partner is participating 31% in the full decommissioning liability of the rest, including its upsides and risks.

Lakis Athanasiou

But can I think of the £340m then as the amount of money Centrica will be paying into the joint venture, less tax credits associated with those payments?

Iain Conn

It's a post-tax number Lakis, so it includes our estimate of the tax treatment, but obviously it's before we receive cash from the joint venture from the dividend. And so it's probable that if you do the maths on the inferred dividend level, if you take the 80% reinvestment ratio and a dividend of £100m to £150m or thereabouts gross our share of that should easily pay for these payments, although they'll be a bit lumpy, so that Centrica will be able to receive free cash flow from the JV net of these payments.

Question 6

Iain Turner, Exane BNP

Hi, morning everybody. Can I just ask, in the RNS you say that the Bayern side was loss-making last year and that you expect the deal to be accretive in '18. Can you just walk us through what changes between last year and next year in terms of the performance?

And then just secondly, can you just clarify how many staff from each side are transferring into the JV?

Iain Conn

Okay, I'm going to ask Jeff to talk to accretion. On the staff it's about 10% from the Bayerngas side, so about 65 people and the balance are from Centrica. I'm just checking with Chris, that is about right isn't it?

Chris Cox

Yes.

Iain Conn

So Jeff, on the accretion point.

Jeff Bell

On the accretion, Iain, it's primarily driven by synergies including tax optimisation starting in 2018 that allows us to have a slight positive from an accretion perspective. As you rightly say it wasn't a big loss in the context of the size of the joint venture and the synergies themselves create some positive accretion.

Question 7

Mark Freshney, Credit Suisse

Two extra questions if I may. Firstly on Rough, my understanding is that Rough is separate to this deal, it's on a whole separate basis anyway, but is there any scope, or what's your plan with the scope with the Rough property going forward?

Secondly, within the Centrica portfolio of upstream assets, or your side of the assets, my understanding is Morecambe Bay was historically even last year one of the most profitable assets you had, I think it was the best part of ten mmboe per year and only taxed at 40%. I understand that there's an outage on that asset this year, so could you update on the current operating performance of that please? Thank you.

Iain Conn

Thanks Mark. I'll ask Chris to comment on Morecambe but it has been in an extended shutdown for us to optimise it in the current circumstances because the flows in and out of that plant have been changing. But on Rough, the Rough field is absolutely separate, we are currently under obligations still to offer Rough as a storage asset, but we have now indicated that we no longer can do that from a safety perspective, and believe therefore that the field can no longer be used for injection and withdrawal purposes, so we are going to be applying to the government for permission to turn it into a producing field, and we're applying to the CMA to be relieved of the obligations under the undertakings.

Once we've done that clearly the Rough field, while separate from this joint venture and not envisaged to be part of it, becomes an E&P producing asset, assuming we get all the relevant permissions, we'll look at all possibilities for the future of the Rough field, and if this joint venture including our partner were interested in it then we would have a conversation, but it's way too early to draw any conclusions there, we've got to go through the appropriate permissions first. But clearly us having a single field producing assets outside of this joint venture with everything else in it would mean that the joint venture would at the very least have to provide technical services to Rough and we have already built that in to the joint venture agreement.

Chris, on Morecambe?

Chris Cox

Yes, so you're absolutely right, Morecambe has been very profitable for us in the past, and we are in an extended outage right now and the purpose for that was to make some changes to make the plant more efficient. As Iain indicated the flows into Barrow have changed a huge amount over the years from one dry gas field to several with higher liquid content and CO2 and other impurities in it, and as a result the plant has not been running very efficiently, and we're in the process of making some changes to make it more efficient going forward. We're in the middle of that work right now, we anticipate being back up some time in August and back on stream and our plan is that runs more efficiently going forward.

Iain Conn

Yes, I think it's important also Mark to realise that we brought the plant down for the reasons Chris has just outlined but it also had a scheduled shut-down for a couple of months from June to August and so what we've effectively done is just run one into the other to give us more time to get the plant positioned correctly for a restart. We expect that it should restart very well on the back of all of this but yes, it has been out.

Mark Freshney

Okay, so normalised production would be what, eight or nine mmboe per year from all of those Morecambe Bay assets and this year will be some way below that?

Iain Conn

It'll clearly be impacted by the outage. What we'll do is update you on this at the time of the Interims in a couple of weeks' time.

Mark Freshney

Okay, thank you very much.

<u>Question 8</u>

Andrew Moulder, Creditsights

Hi, thank you. It's just a couple of clarifications really. On the £340m payments that you've talked about I just wanted to be clear here, even if you hadn't done the joint venture I guess these are payments that Centrica would still have had to have made for the decommissioning of those fields?

So that's my first clarification. The second one, on the credit metrics you talked about, is it right that the only reason they're improving is because of incremental cash flow, or is there any other effect? And I guess when you talk to the rating agencies about this what do they feel that this transaction has done for the risk of your business? I mean I'm guessing it's probably decreased the risk of the business slightly, but I wonder if you could just comment on that.

And finally, Iain, I think you just made a comment right at the beginning about assuming the joint venture was debt free, and I just wanted to confirm, is the joint venture actually debt free at this stage or will there be any debt going in from either Centrica or from Bayerngas? Thank you.

Iain Conn

So on the debt point, I mean it will be debt free and thanks for asking me to clarify that, yes there's no plan to put debt into it. And on the £340m, you're absolutely right, these would have been obligations that Centrica was already going to have to expend and in fact we were already embarked upon expending them and had the rigs booked for these decommissioning of the wells and so on. And so as a result not surprisingly Bayerngas just said well we're not really sure why we'd want to participate in that and so that's why it's the way it is.

On the credit metrics Jeff?

Jeff Bell

Yes, I mean the big piece probably on the credit metrics that makes a difference, and as I said to one of the answers to one of the earlier questions, it's a small positive, it's primarily not only the Bayerngas cash flows which we're consolidating, but it's actually the synergy, so the actual positive impact of £100m to £150m of NPV synergies that come in on a year by year basis, and as Iain said we think we'll realise those in the near term or the short term.

I think the credit rating agencies would look at this, you know, the broad answer is we have an E&P business that we think is now a more sustainable, stronger, joint venture with a more balanced set of near term cash flows and long term development options and therefore net net is a positive to the shape and a positive to the E&P business as a sustainable ongoing business.

<u>Question 9</u>

Lakis Athanasiou, Agency Partners

Hi, since there seems to be a lull. On Morecambe you seem to be accepting one of the previous questioner's statements that you're close to ten million barrels of oil equivalent production there. I mean certainly in 2016 my numbers there are significantly less than that, in fact less than half that, and it's very difficult to see if you can get anywhere near ten in the future, or am I completely wrong?

Iain Conn

Lakis, I think you're correct that it's not ten, it is below that level, but I think what we would be looking at is somewhere between five and eight, so you're right that it's below that level and as Chris said - and he's had to step out - obviously we're hoping that the Morecambe field when it comes back will be able to operate more efficiently and with much better reliability, that is the hope. So we might actually see some net benefit in the near term obviously as the fields have also been rested for a while, but we would expect a lower level than that ten, i.e. in the five to eight range.

<u>Question 10</u>

Deepa Venkateswaran, Bernstein

Hi, thank you for taking an additional question. I just wondered whether you would be able to comment on what are the other options you looked at for your E&P business and why you finally landed on this JV option? Thank you.

Iain Conn

Thanks, Deepa. So firstly, although a number of people were convinced that we were looking at selling, as I've said many times, in this environment it would not be the right thing to do, and furthermore we see the strategic benefit that E&P provides to the portfolio as a whole as I've described earlier. So what we were focused on was how to strengthen the E&P business. Now, we have decided to sell Canada and the rationale for that is very straightforward, that we were not seeing the ability to extend E&P into the Lower 48 or to expand it in Canada; we believe that we do not have the strategic intent or capability to add yet another set of basins to the portfolio. And secondly, as a result of the amount of shale gas being produced in the United States, Canadian gas has effectively displaced up the pipe, if you like, and is therefore unlikely to see significant upside even if natural gas prices were to increase. And it will be significantly dampened relative to the Lower 48 and even the rest of the world. And so that was the reason we decided with our partner, the Qataris, to exit Canada.

That aside, we've then been very focused on only one thing, which is to strengthen what remains, to make sure that it is sustainable, and to create strategic optionality for us, and that meant a combination, which clearly means we don't have to net crystallise price, it means that you can evaluate a combination at a range of prices, and this one, the shareholdings between us and Bayerngas are relatively price-inelastic, which allows us to combine with confidence on behalf of our shareholders without running the risk of crystallising price in a negative way at this point. So we're very much in line with what we've been saying and we hope that this venture will be the beginning of further optionality for our shareholders from the E&P business.

Concluding Comments: Iain Conn

Chatch, I think we've come to the end of the time, and I'd just like to wrap up by first of all thanking everybody for joining us today to listen to this. I hope it's been helpful in explaining what we've announced today. I want to leave you with just one thought which is this joint venture on its own creates value, is accretive, and creates a more sustainable business which is capable of standing on its own two feet. Therefore it's in the interest of our shareholders and we're very pleased with the nature of the strategic alignment with Stadtwerke München.

However, I want to emphasise one important point, which is we see this as only the beginning of the ability to participate in the further consolidation of the E&P business, there's no guarantee of that of course, but we think that this entity is now large enough and sustainable enough to enable further consolidation steps and we would obviously hope to create further shareholder value and NPV through those. And it also creates optionality for both shareholders in terms of their long term ownership and participation in E&P.

So we see this as a strategic move in line with our strategy from 2015 and a very large component of phase one of repositioning Centrica. We've obviously made a number of announcements recently, including the sale of the two large CCGTs, the sale of Canada, the cessation of storage operations at Rough, and with this and the acquisitions we've been making in the customer facing businesses we're doing what we said we would do in 2015, which is to reposition the Group while benefiting from the asset businesses that remain and, in particular, the E&P business.

Thank you all very much for joining us today and obviously we can follow up with any further questions through Investor Relations. Thank you.