Centrica plc Strategy Update and Interim Results
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Transcript

Chris O'Shea, Centrica
Good morning. Thank you very much everybody for joining us here today. As well as the interim results, which you've already heard about, we're going to focus on our future strategy, what we plan to achieve in the coming years, and most importantly, what that will mean for our profits, for our cash flows, and for our shareholder returns. I hope you've all already watched our video on the first half results, and we'll be happy to take your questions on the results when we get to the Q&A session later. I think it's fairly safe to say that we're really quite happy with our first-half performance.

I'm delighted to be joined on stage today by Russell O'Brien, our CFO. This is his first results presentation. In the room, we've got our Chair, Scott Wheway, and the wider leadership team. For those of you that are here in person, we're all really looking forward to chatting to you over lunch. I'm lucky to have a fantastic leadership team with deep, deep knowledge and complementary skills, and experience right across the energy value chain. Please do ask them questions about what they're doing to deliver our strategy over lunch.

Over the next hour and a bit, I'll outline our integrated energy strategy and show you how our businesses fit together, how our longer-term plans are aligned to changes in energy markets, and how this comes together in our refreshed investment case. I'll then highlight the improvements we've made to strengthen our existing Retail and Optimisation businesses and why we're confident they can deliver sustainable operating profit of £800m a year, which equates to around 11p-12p of EPS, with growth potential on top.

I'll also touch upon the improvements we've made to our valuable existing Infrastructure positions and how we're planning to invest an average of £600m-£800m of capex each year into new assets at least until 2028. This will help maintain the balance in our portfolio, which we value so much and upon which our strategy is based. Russell will then pull all this together to explain our new capital allocation framework, including the importance of a strong balance sheet and our approach to investment and shareholder returns, all focused on underpinning value creation for shareholders through the energy transition as we help our customers transition to net zero.

Before we look forward, let me remind you of the journey we've been on for the past three years. Back in 2020, we set out how we'd deliver the turnaround of Centrica. We said we'd simplify and de-risk the portfolio through prioritising and focusing on those areas where we can win while strengthening the balance sheet. We've done

this by creating a simpler, more customer-focused business model through delayering the organisation and through selling Direct Energy and Spirit Energy Norway.

We said we'd have an energy services and solutions company with engaged and empowered colleagues. We said we'd reverse the mindset of cost-cutting to hit in-year numbers at the expense of the customer experience and longer-term growth opportunities. The fruits of this you can see are as follows: colleague engagement has almost doubled, NPS is up significantly, our cost per customer in British Gas Energy is coming down as we said it would, and operational performance in British Gas Services & Solutions is as good as it's been for a very, very long time.

We said we'd deliver stable and predictable profits and cash flows. Now, you'll have seen that the design of the Ofgem price cap can affect the timing of when profits are recognised, but despite this, over the last 3 years, we've consistently delivered material cash flows. This is one of the areas I think may be underappreciated when people look at Centrica. The highly cash-generative nature of our businesses. Over the past three and a half years, we've delivered £10bn in free cash flow. Two-thirds has come from normal operations, and the remainder has come from asset disposals.

I'm incredibly proud of all the hard work of our 20,000-plus amazing colleagues. We've come a long way, and whilst there's always room for improvement, the foundations of the business are now strong enough to allow us to create value and deliver sustainable growth. When we say we'll do something, we do it. We don't make commitments lightly, and we take the delivery of those commitments extremely seriously. That's part of the culture that we've built at Centrica.

You can see the benefit of all of this hard work coming through in the first-half performance: improved delivery for customers in our Retail businesses, another excellent performance in Optimisation, and strong reliability and volumes in our Infrastructure businesses. This allowed us to deliver earnings per share of 25.8p and free cash flow of £1.4bn, both well over double what we achieved last year. We ended the period with net cash of more than £3bn. Again, well over double the level we saw at the end of 2022.

Our performance and outlook give us the confidence to announce a 33% increase in the interim dividend and to extend our share buyback programme by £450m to £1bn. When completed, we expect to have bought back around 15% of our company's shares. Following this, our focus will be on delivering our investment plans, with any further distributions of surplus capital reviewed against the new capital allocation framework.

The operational turnaround is materially complete. We have a focused and complementary portfolio, a platform that is performing well, and an incredibly strong financial base. Very, very importantly, our talented colleagues have been re-engaged

and re-energised. We now have got all the ingredients we need for phase three of the turnaround. We want to underpin Centrica for decades to come, delivering sustainable earnings from our core businesses, investing for longer-term value and growth, and delivering attractive shareholder returns.

I'm sure you'll all be asking how we plan to do that, so let me tell you. The way that Centrica has been designed is no accident because we're incredibly well-placed to succeed through the energy transition. If the transition is slower than anticipated, our core businesses will still deliver healthy returns. If it's faster than anticipated, that's great because we're very, very well-prepared. We've designed our business model to be resilient in all scenarios, and the integrated nature of the portfolio means we'll benefit from the growing complexity of the new-look energy system.

We are absolutely committed to deliver net zero for Centrica and for our customers. Our new green investments won't be made just to satisfy some ESG target but because they make good business sense, and they give good financial returns. They'll be made to maintain the balance in our portfolio and to underpin the company.

We believe that taken together, this strategy represents a highly attractive investment proposition. The strong underlying earnings from the tremendous businesses we already have today, combined with our robust balance sheet, will allow us to invest for value, capture the inevitable upside from energy market volatility, and deliver strong returns to shareholders.

We've got a well-balanced portfolio with market-leading positions across the entire energy value chain. We're the largest supplier of energy to residential customers in the UK through British Gas Energy and the second largest in Ireland through Bord Gáis Energy, and we have a strong and growing B2B energy supply position. We're the largest provider of energy services in the UK and Ireland, with the largest energy services workforce. These capabilities and the scale will prove extremely valuable as the world decarbonises. In short, we have an enviable Retail position.

Our customers need energy, and this need is growing. Our Infrastructure businesses bring electricity and gas to the market every single day. Today, Spirit Energy produces just over 250m standard cubic feet of gas per day, and our stake in the UK's nuclear fleet generated last year more than 7TWh of electricity. While these assets will decline naturally over time, over the past year, we've been able to extend their lives so they can be important parts of our portfolio for years to come. Of course, we have the unique Rough gas storage facility. We also have a growing number of flexible and renewable power assets, but to maintain the balance in our portfolio crucial to our strategy, as existing gas production and nuclear positions decline, we need to invest to replace this infrastructure. We'll talk more about that later.

Then at the heart of these energy flows sits the Optimisation business, the glue that binds our group together. This has been a core part of our portfolio for many, many years, but it's really come into its own in the past 18 months. As you'll hear this morning, it will continue to be vitally important to our delivery of sustainable profits.

As I look at our portfolio, I expect each business to succeed in its own right, whether it's through the day-to-day customer experience in Retail right through to top quartile operational performance and uptime in Infrastructure. But the real value-add that makes us unique at Centrica comes at the portfolio level as we integrate the three legs of our stool.

This isn't just a strapline. If you'll let me pause for a moment to look at the advantaged portfolio position we've got because it's key to our investment proposition. When we make investments, we aim to make three returns from a single investment: an asset return, an optimisation return, and a retail return. For example, when we invest in new power generation, we'll aim to create additional value by optimising the energy flows in the market. Meanwhile, the invested capital will underpin the Retail business, allowing us a further margin by selling energy to customers. Three returns; one investment.

In addition to the portfolio balance, it helps us in so many other ways every day. Let me share three examples:

Firstly, every day, we buy energy for a quarter of the UK's households and many, many businesses. We do this better than anyone else by utilising our world-class optimisation capabilities.

Secondly, unexpected warm weather may impact our Retail business as customers turn down their boilers. Normally when this happens, you're forced to sell your gas into what's likely to be a falling market, but we can put that gas into Rough, which acts essentially like a stockroom. Only we have that. That gas in storage can be further optimised by our colleagues in Energy Marketing & Trading.

Thirdly, we generate a huge amount of zero-carbon electricity, principally through our nuclear assets, but we've recently started adding solar. Combined with additional green energy sourced by our Optimisation business, this allows us to respond to the demand from customers for zero-carbon tariffs.

There are plenty, plenty more examples, but as you can see, EM&T is involved in most of them. In investor speak, Centrica truly is greater than the sum of its parts.

Our unique portfolio is ideally placed to help us make superior returns from the energy transition. Everyone in the room today is well aware of these dynamics, but let's look at the key components. Electricity demand in the UK is set to grow materially over the coming years, and this will create significant opportunities, both in Retail and in Infrastructure. In Retail as we help our huge customer base manage

the transition, and in Infrastructure as we invest more to grow our access to green electrons. It’s estimated just now that around £240bn will need to be invested in the UK electricity system by 2035, not all by Centrica.

Most importantly for us, the electricity generation mix is becoming much, much more intermittent. This is because of the increasing penetration of renewables as opposed to the more stable baseload system we’ve seen in the past. For Centrica, this means that we can monetise our optimisation capabilities both on our own and on third-party assets to help balance the grid and to add value from any pricing disconnects we see. We already see this in Ireland and in Scandinavia, where we help to balance and optimise grids with substantial intermittent renewable assets.

For customers, the residential technology mix will transition away from natural gas boilers over time. As I’ve said, this will create significant opportunities for our Retail business in installations, in servicing and repair, and in energy supply. There are various views on the pace of this change, but we can all see it coming, and at Centrica, we are well-positioned to capitalise on the opportunities as and when they arrive without being dependent on their arrival.

These trends provide us with attractive investment opportunities across the energy value chain, and here we’ve clustered them into Customers, Renewables, and Flexibility, all aligned to our current capabilities and where we know we have the ability to win. We also have further longer-term opportunities building on existing positions and assets in hydrogen or carbon capture utilisation and storage, and potentially nuclear as well. Through our green-focused investment strategy, we’ll build investment levels to between £600m-£800m a year at least until 2028. These investments should deliver average post-tax unlevered returns of at least 7-10% at the asset level, but remember, we can make three returns on one investment, so we’ll exceed that 7-10% when you add in the Optimisation and the Retail portfolio benefit.

We already make attractive returns through optimising 16GW of third-party assets in the Renewable Energy part of our EM&T business, which provides route-to-market services, and, of course, we’re very confident that we’ll be able to do the same for our own assets. We’ll invest to maintain balance across the portfolio, which will mean most of the capital investment is targeted towards Infrastructure, given our current portfolio will decline over time, but at the same time, we’ll continue to invest heavily in customer service and in systems in our Retail and our Optimisation businesses. This investment is mostly expensed in the year it is incurred, and over the past few years, we’ve stopped the practice of identifying revenue investment separately and treating it as an exceptional cost.

When we look at customers, as well as the investments we’re making in energy management and demand response, we see a lot of opportunity to deploy capital and develop a scalable annuity stream of income. We’re starting here with smart meters. For years, we used third-party providers to finance our meters, but now

we're setting up our own smart meter asset provider business. This will underpin the set-up of a small asset tracking and financing capability, and as the model matures, we can consider further opportunities, such as financing or leasing, for example, heat pumps and boilers to households, expanding our business, and turning one-off sales into recurring revenue streams.

Second, investment in new renewable generation. This could be in our own projects, like the recently opened Codford solar farm, or by investing with partners, like our recent Gresham House investment. In addition to the asset investments, we'll generate additional returns through providing route-to-market services and supplying customers.

Thirdly, investment in flexibility. We've got the existing capability, and we've got an opportunity to scale this up. We're already invested in batteries and gas peakers, and we own a range of sites with valuable grid connections, such as the Brigg Energy Park, where today we're co-locating batteries, hydrogen production, and gas peakers. That allows the Optimisation teams to optimise those assets based on the prevailing market conditions.

Then on the right, you can see the longer-term options. We own 100% of Rough, and our controlled subsidiary, Spirit Energy, owns 100% of Morecambe. That means that we're in full control of developing plans for potential future hydrogen and carbon capture utilisation and storage investments. These are at a relatively early stage and may depend on government regulatory mechanisms, but these are incredibly valuable options for us to have in our portfolio. We've been clear in the past that we could be interested in investing in new nuclear depending on how the regulatory framework develops.

It's important to note that our strategy and investment plans are aligned to our net zero ambitions, and they also help energy security and decarbonisation priorities in our core markets. Our climate credentials are good. We're currently on CDP's prestigious A list leadership category for Climate Change, and Centrica was one of the first UK companies to publish a Climate Transition Plan detailing how we would achieve net zero by 2045 and how we would help our customers reach net zero by 2050.

Achieving net zero is absolutely non-negotiable for us, and it will provide opportunities for us to grow and create value for our shareholders. It's not just good for the planet, it's very good for our company too. As you'll hear from Russell later, it's a core component in our investment decision-making. In line with the targets published in our Climate Transition Plan last year, more than 50% of our capital is planned to go into green taxonomy eligible projects, such as solar and batteries. That's up from less than 5% only two years ago.

Before I provide some colour on the business unit plans, let me pause and recap why I'm so excited about the future of Centrica. Our balanced portfolio has leading

market positions, and as hopefully I've shown, each component complements, de-risks, and adds value to at least one other part of the Group. We'll deliver around £800m of sustainable operating profit from our existing retail and optimisation capabilities, and we'll continue to deliver material cash flows beyond the end of this decade from our existing Infrastructure positions. Over time, we'll complement this with valuable investments in new lower-carbon assets as we replace the existing asset base, helping us deliver net zero for Centrica and net zero for our customers.

In the past few years, we've rebuilt the balance sheet. Russell will explain later why the investment grade rating remains so crucial to us and why we want to keep net debt to EBITDA at less than 1x for now. We'll invest £600m-£800m per annum until at least 2028, and we aim to deliver average portfolio returns of 7-10%+ with additional group portfolio benefit, including from optimisation activities.

At a portfolio level, despite the expected ramp-up in investment over the coming years, we expect group return on capital employed to remain above 20% over the rest of this decade. As you expect, we'll maintain capital discipline, and we will return surplus capital to shareholders whenever appropriate. As I said earlier, we are extending today our existing share buyback programme up to £1bn. The progressive dividend policy will allow for an increase in the dividend today. We expect this to grow to 2x earnings cover over time.

Russell will take some time to unpick the capital allocation and investment framework in about 25 minutes, but now let's focus on our businesses, and at the heart of Centrica are our customers, so maybe I could start with Retail. We've got incredibly strong positions and capabilities in British Gas Services & Solutions, British Gas Energy, and Bord Gáis in Ireland. While I'm going to focus today on the UK businesses, I just want to reiterate how important Bord Gáis is to the Group, with its integrated business model essentially acting as a mini-Centrica. I'm really pleased with the work the teams have done to improve operational performance over the past two years. There will always be more to do to become more efficient and give customers better service. The journey actually never ends, but we're now able to focus on delivering sustainable profit and growth.

As mentioned earlier, electricity demand from customers in the UK is set to grow materially. This is going to lead to increasing demand for time and type-of-use tariffs and demand-side response offers. We've already got the platform, the technology, and the people. That includes 65 software engineers we've got in Antwerp focused on developing our demand-side response offering. We've got only one of three platforms licenced for demand-side response in the UK.

Under our PeakSave product, we're able to provide customers with offers such as our Summer Sundays, which allows half-price electricity each Sunday until the end of September. We've also got the SmartCharge EV offer which uses our Hive platform to allow customers to charge a car when the grid is quiet. The opportunity

from decarbonising UK households is huge, and we're brilliantly positioned to capture value from this.

We've got leading market positions in a highly fragmented market, with a much lower share in on-demand, and this is a market that is materially larger than our traditional contract service and repair market. We're also underrepresented in heating installations. This means that we've got a significant opportunity to grow our core services business by increasing the total addressable market and increasing our market share, and that's without any change coming from the energy transition.

British Gas Services & Solutions is a tremendous business. No one has anywhere near our 7,000 directly employed engineers, no one offers as wide a range of products, and no one else offers existing and new colleagues the quality of training that we can through our award-winning in-house academies. On top of this, the progress that we've made to improve our operations has placed this business on a much stronger footing. As you can see from the H1 results, we're back in profit. Our KPIs are the best they've been for years, and I believe that we're well-positioned to move back into a growth phase in this business.

We serve around 30% of households in the UK, but the 3m customers we provide cover to in this business is only around 10% of the UK's 28m households. We install less than 10% of boilers. We install around 4% of heat pumps. The growth opportunities are truly huge here. Our core protection product remains important for our future success. Improved operational metrics are enhancing the customer experience, and this remains a top priority for us. Ongoing planning and supply chain projects should improve efficiency and further improve customer retention. We're also taking a different approach to new customer acquisition, improving the digital channels and constantly refreshing propositions, testing the market, seeing what works, and going back to it. All of these improvements will take time to flow through to the financials, but we are absolutely on the right track.

The opportunity in on-demand services is huge. There are 20m homes in the UK who don't have a contract, half of which are owner-occupied properties. We're now in a much better place operationally. Our recent recruitment and productivity improvements mean we can focus on growing in this area, leveraging our brand, our scale, and our supply chain capabilities. Having the capacity to grow in on-demand de-risks the contract business. Now, this is a virtuous circle. Because we've created the capacity in our existing workforce, we can now test on-demand offerings, and we're doing it right now. As we grow in on-demand, we'll ultimately need to add to our workforce. With a bigger workforce, we'll have more capacity, and we can prioritise our contract customers, and this will allow us to grow that part of the business by giving better service. And so on and so forth. You keep growing. One bit grows the other.

To help you size this opportunity, each 1% increase in our market share in on-demand should add £25m to revenue. Most of that will initially fall to the bottom line,

but over time that will reduce as we have to add colleagues, and it will reduce to around £5m-£7m of gross margin, depending on the job mix. As I said, we're also underrepresented in the boiler installation market. Here, we want to improve our digital channels and the customer journeys to increase market share. Other things remaining equal, we estimate that each incremental 1% market share in boilers would add £40m to revenue and around £8m-£10m to gross margin.

As I mentioned, at the outset, we'd expect any margin increase to drop to the bottom line or any revenue increase, but over time, we'd have to recruit more people, and that would then mitigate the margin improvement, but it's very profitable. With the improvements we're making and the growth we're driving, I expect British Gas Services & Solutions to return towards historic profit levels of £100-200m over the coming years.

Now, let's take some time and move on to British Gas Energy. As you know, this is a market that has been somewhat challenging for suppliers. We are the only major retail supplier to have consistently made a profit over the past several years. Between 2019, when the standard variable tariff default tariff cap came into effect, and 2022, we made an average margin of 1.1% from the supply of energy to residential customers. This is around a third of what a supermarket would make. When you normalise that for the incremental costs incurred over this period that were recovered in the first half of 2023, the margin would have been slightly over 2%. If you compare that with the 1.9% margin the price cap is designed to give the average supplier, we beat this margin because we are better than the average supplier, especially in energy procurement.

It also reflects the work we've done on costs over the last few years. We have driven an average annual cost reduction of 8% per customer since 2019. We said that we would drive down cost per customer, and we've absolutely delivered, but we see the possibility of a further 10-15% reduction over time as our processes continue to improve and we migrate more customers onto our new IT platform.

The market dynamics are changing, and whilst customer switching has declined over the past 18 months, we would expect competition to intensify as the market emerges from the energy crisis. But given our strong foundation, we see this as an opportunity. It's not a threat. The regulatory environment has also changed, largely in response to the supplier failures we've seen over the last two years. Ofgem just now are consulting on changes to the price cap structure, which at current prices would allow an increased roughly 2.4% margin for the average supplier. With the new capital adequacy requirements in place, all suppliers should be encouraged to price at more sustainable margins. As the leading player in this market, this is incredibly positive for us.

We've now got a good foundation, but we need to continue building a better customer experience. There are three ways that we're doing this:

Firstly, we're migrating all of our customers from our legacy systems to a modern, more efficient software-as-a-service platform. That's having a positive impact. The NPS of a customer on the new platform is almost double that of a customer on the legacy platform, and so far, we've migrated around 3m residential customers.

Secondly, we're building a simplified, digital-first customer experience. Customers can interact with us through their preferred channel of choice, and they can self-serve for basic queries, which reduces contact volumes and improves customer resolution.

Lastly, we've set up a new customer service delivery model with multidisciplinary pods. That improves the way our expertise is deployed. It reduces hand-offs between teams, and it allows us to resolve more customer queries at the first point of contact.

Ultimately, driving better customer outcomes and lowering costs will underpin our ability to continue delivering sustainable results. Under the current and proposed regulations, we believe we should be able to achieve around £150m-£250m of operating profit each year, broadly in line with the margins allowed by the energy price cap. We of course see potential for this to be higher at times when our energy procurement expertise really comes to the fore, as we saw in the first half of this year. This is already a great business, and we see a clear path for making it even better in the future.

Now, we'll take some time and move on to Optimisation and another fantastic business in EM&T. You've heard a lot from us in the last nine months about the strengths of EM&T, including the LNG teach-in that we had in May and the Route-to-Market teach-in last December, but let me provide a brief reminder of our capabilities and set out what this means in terms of long-term sustainable profit.

As you've already heard me say a few times, EM&T is the glue that binds our group together. It supports both the Retail and the Infrastructure businesses. It's responsible for moving electricity and gas from the point of production to the point of consumption, sometimes via storage facilities. It's a massive logistics operation, and where we excel is in our ability to move power and gas across Europe and, in the case of LNG, globally.

EM&T's primary purpose is to procure and deliver physical gas and electricity for our Retail energy supply business. This is an area of real competitive advantage for us today, and you can see that in our results. The team also provides a route-to-market for the physical output from our Infrastructure assets, which helps to deliver additional returns. At the same time, EM&T's world-class risk management expertise helps to optimise the integrated use of risk capital and cash across the Group.

As we've said before, over the years, we've developed the capabilities, proprietary platforms, and colleagues to be able to add incremental value in related areas. I

think that what we've created is incredibly hard to replicate. In addition to the role that EM&T plays for the Group, the other lines of business are logistics operations, all anchored around physical assets:

Firstly, Gas & Power Trading, where we've got more than 10TWh of European gas storage capacity, alongside substantial cable and pipeline capacity. These physical contracts allow us to capture value from any regional arbitrage opportunities, moving gas and power to where and when it is most needed. We now trade across more than 25 European countries, giving us distinctive insights into energy markets. We manage the system's complexity, and we can add value in all commodity price environments.

Secondly, the Renewable Energy Trading & Optimisation business, or the Route-to-Market business, optimises around 16GW of renewables and flexible assets. Our experience here gives me great confidence that we'll be able to deliver additional returns from the capital that we deploy into our own flexible and renewable assets.

Lastly, the LNG business built up over the past 15 years has great capabilities, and it's a valuable and flexible global portfolio of contracts and positions.

By having these three well-established lines of business across the energy system, we gain valuable information in real-time through physical assets across a wide geographic reach, and that in turn helps us inform the best decisions on supporting our Retail and Infrastructure businesses. All of these businesses are supported by scalable and well-controlled operations, as well as our distinctive talent in fundamental and quantitative analysis, our leading proprietary technology for analytics and algorithmic trading, and our robust risk management controls.

We have a business model that has a track record of delivering operating profit growth, with a compound annual growth rate of more than 20% between 2018 and 2021. This growth has come through a range of different market conditions. The portfolio today is very well positioned, and as 2022 demonstrated, we're also able to capture significant value in periods of extreme market price volatility. We see particularly strong growth potential in our renewable energy and in our LNG businesses. These are a core reason why our portfolio is so robust today, with both so well positioned given the energy transition.

The renewable energy business will benefit in two ways. First, from the growing proportion of intermittent assets supplying energy grids, and secondly, from the changing ownership model towards independent producers, who either can't or don't want to replicate our trading capabilities and they have a need to outsource their risk management requirements. We have 16GW of assets under management today, and our ambition is to double that over the next five years. We would expect this to translate to at least a doubling of gross margin compared to the 2021 base in that part of the business.

For LNG, the globalisation of gas will increase global demand, and with new attractive flexible contracts coming on stream in the coming years, including the recently announced Delfin contract, we're very well placed to capture additional value through optimisation.

These activities will help provide more stable and rateable profit. This is why we believe EM&T should be able to deliver operating profit in the range of £250m-£350m per year on average in normalised conditions. There's the potential to do materially better than that when market conditions are favourable. We saw that in 2022 and in the early part of this year, and we'll have more opportunity as we grow our activities.

So let me underline just how EM&T adds value to the Group and, crucially, how it can do so for the capital we deploy as part of our green-focused investment strategy:

Firstly, here's an example where we've invested in renewables with partners. In March, we announced a £65m investment into the Gresham House Fund. This investment provides an alternative route to support the building of renewable generation assets and batteries. It provides diversification to the portfolio, exposure to multiple technology classes, and access to third-party project pipelines, minimising construction risk. But importantly, we can take the energy output from these assets and thus capture additional value from our route-to-market capabilities, thereby realising higher returns compared to somebody who simply injects capital. We would expect to be the off-taker for more power than we actually own through that fund. We expect this investment to deliver returns consistent with the top end of the capital framework that Russell will outline later.

Another fantastic example of how the portfolio works together to deliver value is the relationship between the EM&T team and the team running the Rough gas storage facility. Here, the optimisation capability can add value above the intrinsic seasonal spread from a physical Infrastructure asset.

And number three, the value that EM&T adds to our Retail energy businesses was very clearly demonstrated in the first half of 2023.

EM&T manages our downstream commodity risk, and the focus has moved in recent years from risk mitigation to commodity purchase price optimisation. This will continue to help underpin the sector-leading margins that we see in British Gas Energy. The world-class optimisation capability, coupled with our market-leading positions and Infrastructure assets, puts us in a really enviable position to create value from the energy transition.

So you've now heard about the fantastic Retail and Optimisation businesses that are delivering value today and that are very well set up to create even more value in the future, but we've also got great large-scale Infrastructure positions in Rough, in Spirit Energy and in Nuclear.

I think that today there's a misconception that these assets have no long-term value. Indeed, in the case of Spirit Energy, some may think it may actually have a negative value given the eventual cost of decommissioning, but that's simply not the case. Over the past twelve months, all three of these Infrastructure businesses have performed strongly, and they've all seen significant developments that will extend their lives, materially increasing their value. They should continue to deliver strong cash flows for the rest of this decade and beyond.

This time last year, we were producing the cushion gas from Rough, and the asset was due to close in 2024. Today, it provides half the UK's gas storage, significantly boosting energy security. At Centrica, we've got the exclusive use of this asset at least until 2030. You can see the impact this has had on our results. Pre-tax profit of £76m in the first half of 2022; combined pre-tax profit of more than £500m in the 12 months since. We retain optionality to increase this further. We may require a regulatory support mechanism to ensure we can make an adequate return on what would be a material investment, though. We remain willing to engage constructively with the government on the long-term future of Rough.

Next, we'll look at nuclear. This time last year, we were about to decommission the Heysham 1 and the Hartlepool nuclear power stations in 2024. They're now expected to run at least until 2026, maybe even into 2027. These extensions were underpinned by a deep understanding of life-limiting issues and a strong and open relationship with the regulator, and that bodes well for the lifetimes of our other advanced gas-cooled reactor stations.

In Spirit, this time last year, it was expected that the Morecambe Bay gas field would stop producing around the middle of this decade. Today, the team expect production to continue until the end of the decade and in my position as Chair of Spirit, I suspect it might be even longer than that, and we've just been awarded a carbon storage licence, and that provides further future optionality.

In recent years, we've taken the time to get the focus on Infrastructure right, on maximising the value in existing assets and then improving the way that they're operated much in the same way we've done for the Retail and the Optimisation operations. This focus on running our existing assets much better has already created substantial shareholder value, and not all of that, in my view, has been fully appreciated yet.

Let me take a minute to touch on the net zero optionality we've got. This time last year, we were just really talking about hydrogen. We've now got three credible joint ventures in the UK and Ireland, and we're making some real progress there. Our existing assets provide an excellent platform, given their positioning across key net zero clusters. In the Irish Sea, the Morecambe Bay gas hub and the gas fields are very well placed for carbon capture, given their proximity to the West Coast Cluster and in May, the Morecambe Bay gas fields moved a step closer towards this net

zero vision by being granted a carbon storage licence. The location of the Whitegate CCGT power station in Ireland could also prove important over time, and we've got the potential to ship carbon from Whitegate in Cork to Morecambe. This again demonstrates the portfolio benefits of our unique position.

The Rough gas field is near the East Coast Cluster, and that's aiming to remove 50% of the UK's industrial CO2 emissions, half of the UK's industrial CO2 emissions come from the East Coast Cluster, and that's going to require material amounts of hydrogen. Rough is in a perfect position to be repurposed as a hydrogen storage facility. I've said before, but it's really difficult to see how the UK can meet any hydrogen ambition without material hydrogen storage. Ultimately, Rough could store up to 200bcf of hydrogen. That would make it not only the world's largest hydrogen storage facility but the world's largest single gas storage facility. It truly is an exceptional asset. Now, it's important to reiterate that for both Rough and Morecambe, in the absence of clear market signals, we would only invest if the appropriate regulated support mechanisms were in place because of our capital discipline.

As I said earlier, if we want to maintain the balance of the Group and underpin long-term profitability, we need to invest. It's not just in the legacy large-scale positions where we've been moving the dial. We're doing tangible things now in flexible and renewable power assets. This time last year, we had one gas peaker producing; we've now got an additional five being delivered today. We had one battery at Roosecote; we've now got detailed plans for another five, some of which today are under construction. We had no solar; we recently opened our first solar farm at Codford in Wiltshire, and we've got a big pipeline of further opportunities. The progress we've made in the past two years means we're now ready to ramp up our investment plans, having demonstrated their capabilities over the last 18 months.

In addition to the 600MW of projects we've got in planning and delivery today, we've got a further 2GW of early-phase prospects. Now this number will continue to evolve as we assess existing options and new opportunities, both organic and inorganic, as they come to light. Russell's going to talk to you shortly about the investment process we follow, but I'd like to provide a few examples of what we're already investing in and to highlight that this is across a range of assets, from merchant to contracted.

The 18MW Codford solar farm was opened in June, and it's our first major solar asset. It was sanctioned on a fully merchant basis and returns from solar are typically reasonably stable due to a relatively predictable generation profile and low ongoing operating costs. Construction of this took little more than a year, but this is another example of how business units benefit each other because EM&T arranged a 10-year power purchase agreement with Vodafone for half of the output from Codford. This PPA reduces the merchant risk that we carry, and we currently expect that project to deliver post-tax unlevered returns of around 9%.

You've then got our battery at Brigg. Battery investments are very, very attractive to us. They provide a natural hedge to system balancing costs in the Retail supply business, and it looks just now like it's the only way you can hedge those costs. Batteries are also significantly de-risked due to significant financial underpin from capacity markets, and they benefit from our strong optimisation capabilities. We would expect this asset to deliver a return of around 10% before portfolio benefits.

Next, let's look at our two 100MW flexible gas-fired generation assets in Ireland. These are a great example of what we see as a partially contracted investment. The project is a unique opportunity in the constrained Irish power market, with significant underpin from capacity payments. This project is future-proofed, with the ability to convert it to 100% hydrogen in the future. We are leveraging the advantaged access that we've got to grid connections, and it's a great example of us deploying capital in markets where we see the most attractive dynamics. Again, on this, we would expect to make a return of around 9%. Once again, before any portfolio benefits on top.

Finally, as we described earlier, the plans that we have to become a Meter Asset Provider in the UK provide what is essentially a regulated return with a predictable, contracted annuity-type revenue stream. This also de-risks the impact of customer churn because we would retain a revenue stream even if a customer left us. This is aligned to our net zero strategy, and we currently expect to deploy more than £100m of annual capex into this annuity stream, with expected returns over 8%.

I'll be back in about 20 minutes to close the session before we move to questions, but now I'm going to hand you over to Russell, who is another in the line of fine, prudent Scottish accountants to fill the CFO position in Centrica. Russell is going to update you on the refreshed capital allocation framework.

Russell O'Brien, Centrica
Thank you, Chris, and what an introduction! Good morning, everybody. It's great to be with you today. One of the things Chris and the Board asked me to do upon joining the company was to look at the capital allocation philosophy. We have a positive future, but we must be measured and balanced. Our strategy will only succeed if it is underpinned by a solid financial framework.

In speaking to investors over the past couple of months, I know there is a desire for us to lay this out in a bit more detail. So, today, I'm going to talk you through the five key components of our financial framework that will underpin long-term value creation, namely: sustainable earnings, maintaining a strong balance sheet, progressive dividends, investing for value, and our philosophy on returning surplus capital.

So first let's go to sustainable earnings. In the past, we've been hesitant to give forecasts or guidance for the company or any of our individual business pillars. This was primarily because it wasn't really practical with the company navigating its turnaround, but it was also due to the inherent volatility of our business. The energy

system is complex, and our portfolio earnings will flex with the environment. The past year or so highlights this perfectly.

However, the work done to solidify the core of Centrica has given me the opportunity to unpack the underlying sustainable profitability of our businesses. Overall, I am confident that we can deliver around £800m a year in adjusted operating profit over the medium term, and that's equivalent to around 11p-12p per share of earnings, given the current tax rates and share count. That's just from our Retail and Optimisation businesses. Now, that number will flex with market conditions, so we've set out some ranges today.

But of course, we also have credible diversification across the portfolio. For example, in some years, volatile market conditions may be unfavourable for energy supply but provide a positive backdrop for our Optimisation business. On balance, I think the framework of sustainable profit is a fair yardstick to measure us by. Remember, this is before any earnings from our Infrastructure businesses.

Chris has walked us through what we're going to do to underpin profit in our larger business units, so let me bring that all together. Starting at the bottom of the slide: UK residential energy supply. Given the current and proposed regulations, we should be able to make £150m-£250m per year. This is supported by our work on customer experience and, importantly, the reductions in cost per customer that Catherine and her team are pursuing. It also includes some benefit from our superior energy procurement and risk management capabilities, which, as you've seen in today's results, allow us to capture industry-leading margins.

Then British Gas Services & Solutions. The recovery is now well underway, and we expect continued momentum in the coming years underpinned by new technology and refreshed customer offerings. We must walk before we run, and I do not want to overpromise on Services. However, the actions Jana and her team are pursuing should mean that we see continued financial recovery over the next three years, building to £100m-£200m from 2026.

Then to Optimisation, and Energy Marketing & Trading, our world-class energy movers. I am glad to get this one on the table today as the profit dynamics in this business have definitely been where I've had the most questions from investors over the past months. And it's understandable, given last year, this business made £1.4bn against a backdrop of unprecedented market dynamics. Strong performance has continued into the first half, and we've said before that if prices and volatilities return to 2022 levels, then we would expect to deliver a similar outcome. But in more normal market dynamics, this business should be able to deliver profits of between £250m-£350m per year and higher in favourable market conditions, as we've seen recently. Longer term, there is growth potential in this business too.

Then, finally, I've put UK Business Energy Supply and Bord Gáis together. We expect those businesses combined to deliver between £100m-£200m per year. UK

Business Energy Supply is of course embedded across our Retail and CBS businesses and is performing well. We expect that business to continue to be a solid contributor with room to grow. Our Irish business, Bord Gáis, although it made a small loss in the first half of this year, reflecting a difficult energy retail backdrop, the integrated nature of this business model and the improvements Dave and his team are driving mean that we plan to restore profit in line with historic levels.

So overall for the Group, that gets us to around £800m. I should reiterate, again, this is only from Retail and Optimisation. For the foreseeable future, we will also continue to benefit from our gas production in Spirit Energy and our 20% holding in the UK's nuclear fleet. These businesses will decline over time, but as you've heard today, we also had good news with the expectation for the Morecambe field to be producing until at least the 2030s and two of the nuclear fleet extended to 2026 versus shutdown in 2024. Then there's Rough. What an asset to have in the portfolio and critical for UK energy supply. We have sole use of this asset until at least 2030, so this profit stream will be with us for a while.

Infrastructure overall delivered operating profit of £1.3bn last year and £650m in the first half of 2023. Profit will drop over time if market prices and curves remain as they are, but we are helped in the short term by our rateable hedging strategy, which will underpin contributions over the next few years. We've included details about our current hedged positions in the H1 deck which you have today. Over time, our Infrastructure asset cashflows will be replaced by a contribution from the assets we're developing as part of our green-focused investment plan. The earnings from those new assets should be more stable, helping provide a more reliable, rateable earnings stream for the longer term.

So that's the money coming in. Let's move to the next element of our framework: the balance sheet. The transformation of Centrica and our recent financial performance has significantly strengthened our balance sheet. If you look back, at the end of 2020, we had net debt of £3bn and additional pension and decommissioning liabilities of over £4bn. Now, we have £3bn of net cash, and our other liabilities have halved to around £2bn.

A strong balance sheet and investment-grade credit rating is not just a nice-to-have. It is essential for the efficient running of Centrica. Let me remind you why. As a responsible energy supplier, we manage the risk of providing energy to our customers by hedging our exposures through financial derivatives and other contracts. And as a supplier to nearly a quarter of the UK's households, those positions are significant. This is not optional. We all saw what happened in the past two years to those suppliers who did not have the balance sheet strength or the inclination to manage their risks sensibly.

Similarly, we hedge our upstream electricity and gas production rateably, and we can only do this risk management with a strong credit rating. The balance sheet also allows us to secure financing. Now, given our current positive cash position, this may

not be immediately pressing, but we must maintain flexibility to finance our company and investments in ways that add the most value and diversify our risks.

We described the opportunities for our LNG business earlier. They will in part be underpinned by long-term contracts, which require the backing of an investment-grade credit rating. We also need to maintain material liquidity at all times. The energy system can be volatile, as we saw last year, and when markets move, we're required to post collateral on some of our hedging positions. In August last year, the Group saw a £2bn margin cash outflow at one stage. But it's worth remembering that by having that liquidity, we were able to capture significant value from market disconnects, as you saw in the EM&T results last year. The balance sheet both protects and adds value. We will continue to take a prudent and robust approach to managing the balance sheet at all times.

So, having reviewed our current position and future aspirations, I've also considered the appropriate medium-term leverage for the Group. I currently see us needing to operate at debt levels of up to 1x net debt to EBITDA. I believe that this level provides enough of a buffer to manage volatility in the energy system while we can continue to invest in the future and, importantly, maintain and grow our shareholder distributions. I wouldn't want to take this as a hard target, though. I wouldn't want you to see it as a solid cap. You could see us go above this boundary for a short time if the right opportunity was there, but only if I was comfortable we had a credible path to get debt back into the zone thereafter.

Our position with the rating agencies is good. Given our current business mix and risk profile, they do require us to hold material buffers. In S&P language, that's 50% FFO to net debt for our current BBB rating. Over time, I'd hope our debt flexibility could increase as our portfolio evolves. We have more certainty in the core underlying profitability of our existing business than we've ever had in the past, and we'll invest in green assets that will build a new stable Infrastructure cash flow stream. Both of these should be credit positive through time.

Let me now cover shareholder returns. Shareholder returns are core to our investment case, and we were delighted to restart the dividend last year at 3p per share for the full year. The Board has reconfirmed our intention to grow the dividend progressively over time as the business develops. Given the continued positive progress in the business this year, we are today declaring a 33% increase in the interim dividend. As another guideline in this overall capital framework, we expect to move to dividend cover of around 2x over the coming years.

I should highlight the ordering of the capital allocation framework is deliberate. We do see the payment of this sustainable and progressive dividend as coming before further investments. When we have surplus capital, we will consider further share buybacks. This is an element where we will not be giving specific long-term guidance as it really depends on our performance and market outlooks, and investment opportunities in any period. We have already bought back over £400m of shares as

part of our £550m programme. As you've heard already, we expect to extend the buyback by a further £450m taking the total to around £1bn, to be completed over the next twelve months. Our focus then will be on delivering on our investment plans and dividends, with any further additional distribution being subject to the prudent capital allocation we've outlined and our future outlooks.

Moving onto the next element in the framework: our investments. Now Chris has set out the logic for our green-focused investment strategy. Given this is a step-up from the previous levels of spend, we have refreshed our internal investment processes. I thought it would be useful to walk through this today.

Our Investment Committee process sets five tests for any opportunity that enters the funnel. What's the impact on the Group and the balance of the portfolio? Is it aligned with our strategy? Or said another way, can we bring a competitive advantage? Will it help us achieve our net zero ambitions? Does it have the right financial profile and deliver appropriate returns? Here, we also consider the potential for any investment to generate additional returns across the portfolio.

Then importantly, the broader risk profile. Let me unpack that element in a bit more detail. The environment we operate in is evolving, and we must take care to understand the broad risk profile now but also how that may change. As you might expect, we take into account macroeconomic risk, specific industry and asset class risk, project development risk, but we also need to take into account regulatory risk, market risk, counterparty risk, and more. We then consider if we have the ability to manage these risks and mitigate them and then ensure the expected project returns capture the risk properly.

All our investments follow a stringent management process. We critically review opportunities as they move through the funnel. In fact, in the past months, there have been a number of opportunities presented to Chris and I which just didn't match the criteria, and we rejected them. We push hard to ensure that we can see real portfolio upside, and some asset development options just didn't bring it. Subject to meeting all the criteria, the opportunity is sanctioned first by the Centrica Investment Committee and, if of scale, the Board.

We will consider the evolving shape of the portfolio. In practice, that could mean, for example, ensuring that we have a good mix between investments with a short return cycle and those with a longer duration. Merchant and contracted returns. We don't want to have all of our eggs in one basket, nor do we want significant unproductive development capital at any point in time. Importantly, we also learn from this cycle for future investments through our robust post-investment review process.

So, let's look in a bit more detail at how this links to the options we are currently considering. This is the framework Chris showed a little bit earlier, unpacked a bit. As you would expect, given different risk profiles, the returns we're targeting differ across the investment options.

For investment in customer energy assets, we would expect to make a post-tax unlevered return of at least 8%, and importantly, given the nature of these investments, there is negligible pre-productive capital deployed.

For renewables, the contractual framework is key. A solar asset fully contracted under a fixed-price PPA with a highly creditworthy corporate off-taker would be a lower hurdle rate than a fully merchant renewable investment.

Investments in flexible assets are expected to make a return of at least 7-10%, again depending on the risk profile. As an example, if a project comes with a guaranteed capacity payment, we might be willing to accept a lower return. If fully merchant, then we would be looking for returns at the higher end of the range at least.

Finally, for potential larger-scale infrastructure projects such as Rough or Morecambe, or new nuclear, we would only invest in these, as Chris said, if government regulatory support was in place. We would need to work through the risk and return dynamics for those as they develop.

I want to delve into four things that are worth reinforcing here. First, we are aiming to invest in assets which complement the Group's overall capabilities, positions, and exposures. Therefore, enabling us to generate additional portfolio returns of up to 2% beyond the individual core asset return. Then, on the actual returns, these are based on current interest rates, and it's important to remember that we invest for the long term and will look to earn an appropriate return over the lives of our ownerships, so we remain responsive to ongoing rate and market developments. Third, our philosophy on financing. Here, for simplicity, we assume our investments are funded 100% from our own balance sheet. In general, we believe that can speed up development and avoid partner misalignment and the risk of value leakage. But of course, there are many projects and structures where project financing will be appropriate, and we are open to that if it maximises value overall.

Then to partnerships. We're also very open to partner with other sources of capital to help accelerate the development of those assets. We can bring considerable value to a partnership by providing a route to market for the electrons. Having Centrica as a partner can de-risk a project's development, and we aim to be a preferred partner. The Gresham House investment outlined earlier is a perfect example here. We don't contribute all the capital but can take more than our share of the electrons. Helping the venture, but also allowing us to keep the optimisation upside. Needless to say, if we were to consider hydrogen storage at Rough or carbon capture storage at Morecambe, we would certainly look at bringing in partners and other sources of capital in addition to needing the required government support.

Bringing all this together, how do we expect capex to evolve over the coming years? We expect capex to build over the next couple of years to around £600m-£800m to 2028. This is in addition to the Retail and Optimisation investment in customer

service and systems that is typically expensed, as Chris has mentioned earlier. Capex is likely to be at the lower end of the range in the shorter term. We are naturally prudent, and we're still building our capability and pipeline. But 2023 and 2024 are still likely to see a significant step-up compared to previous years of around £250m. For clarity, given likely project timelines, we are not assuming any material spend on Rough redevelopment or Morecambe within this range. This range also includes maintenance and other capital for our existing business of between £100m-£200m. This is expected to decline to the bottom of that range in the medium term.

The actual phase of our spend will undoubtedly be lumpy, as it will depend on our development funnel and what projects make it through. We would consider M&A in addition to organic spend, but as Chris has said before, and I agree with him, this comes with an additional hurdle, and we would only expect inorganic spend when we have a really robust value case all-round. I think of M&A here as an opportunity to accelerate our organic plans and create value above other options. This level of spend will fit comfortably into our financial framework and still leave a balance sheet buffer. If the world changes around us, of course, we will revisit the range, but certainly, for the period to 2028, I think this is a sensible level.

So, before I hand back to Chris, in summary, our earnings and cash potential is strong, with around £800m of underlying sustainable operating profit just from our Retail and Optimisation businesses, with further material medium-term cash flows from our Infrastructure positions. I hope I've made clear that a strong balance sheet underpins everything we do, supporting our current business and allowing us to add more value in the long term as we guide the company through the energy transition.

Core earnings and a strong balance sheet support a progressive dividend trending towards 2x coverage over time, and today, we announce a 33% increase in our interim dividend. Plus, we have the capacity to ramp up investment, delivering attractive and accretive returns across a range of net zero-aligned technologies. We've pencilled in £600m-£800m per annum, but let me repeat, that will only be spent if the investments pass our investment criteria and hurdles. If they don't, we'll spend less, and any additional financial capacity will either be kept on the balance sheet or returned to shareholders when appropriate.

This is more information on capital allocation and our philosophy than we have shared in the past. I do hope this helps answer most of the questions you have been asking me over the past months and gives you comfort that we will be good stewards of your capital as we drive for value through the energy transition.

Back to you, Chris.

Chris O'Shea, Centrica
Thank you very much, Russell. Hopefully, you'll all agree now that Centrica represents a compelling investment proposition and is incredibly well-placed to

create value through the energy transition. There are five things that I'd like you to take away from this.

Number one, we are a uniquely integrated energy company. We've got a balanced portfolio, and each component complements, de-risks, and adds value to at least one other.

Number two, we will deliver on average £800m of sustainable operating profit from existing Retail and Optimisation businesses. That's around 11p-12p of earnings, and we've got growth potential on top of that. We'll grow our annuity revenue streams and asset leasing with additional strong cash flow from existing Infrastructure assets into the next decade.

Number three, we've now got a green-focused investment strategy, creating value for shareholders and delivering net zero for Centrica and for our customers by investing around £600m-£800m a year at least until 2028, making attractive returns and additional portfolio benefits on top.

Number four, we'll maintain balance sheet strength and strong liquidity and capital discipline. We'll return surplus capital to shareholders whenever it's appropriate to do.

Number five, we'll deliver compelling shareholder returns with a progressive dividend policy.

I'm really proud of the work that we've done at Centrica to set ourselves up for the future, and I've got full confidence in our team to deliver this success. I hope what you've heard here today helps demonstrate our confidence in the company's future, and it helps to build your confidence in our future as well.

Now, we're going to stop. You probably agree we've been talking for just long enough, and we're going to move on to Q&A. Russell and I will be delighted to take your questions. Remember, we've got some of the leadership team here, so if you ask us really difficult questions, we might put them on the spot before lunchtime.

Question 1

Martin Young, Investec
Can we talk a little bit more about the British Gas residential business? You've probably got somewhere north of 6m customers when you look at it on a dual-fuel basis. If I think of about a £2,000 average bill, hearing everything you've said around your ability to beat on procurement and your aspiration to beat on cost, Ofgem's methodology should take us to about a 2.4% EBIT margin on a £2,000 bill. That suggests to me that we should be landing around about £300m EBIT from the residential business. You've alluded to some of the funky things you might be able to do with time-of-use tariffs and the like. Surely that should be a positive. How on earth

do you end up at 150-250m? Unless you're going to come up short on the EBIT margin, which I don't think you're saying, or you compete very aggressively in the fixed cost market, or you lose customers. And I'm sure you're not going to tell me that you're planning on losing customers. I suggest that you're somewhat lowballing it if that's not too impolite.

Chris O'Shea, Centrica
There's always a risk when the first question comes from somebody that used to work for Ofgem. Look, it's funny, Martin. The reason I'm smiling is because I've had exactly the same question for Russell quite a few times over the past few weeks. Firstly, we are absolutely not planning to lose customers. Obviously, we say that this is in a normalised period. There are questions on, for example, what your bad debt charges are. I keep coming along and saying, "I've done the sums that you've just done, and 150-250 is too low," and Russell keeps saying, "Yeah, but remember, it's not just the 2.4% that's coming in. There's also some offsetting consultation." I think, for example, and Russell can take us through them, like ROCs and the like, whereby there's some reduced cost allowances in there. It's not simply it goes to 2.4%. I wouldn't say that we're lowballing, but what we want to make sure is that we don't come out and present something that says we need every single thing to go right in order to hit what we're telling you. What we want to say is we think that this is something that is reasonably achievable, and that means that there are points, such as in the first half of this year, where you can outperform and sometimes significantly outperform, but it's really important that people realise in a normalised time, we would expect 150-250 of operating profit here.

<u>Question 2</u>

Mark Freshney, Credit Suisse
I have two questions, if I may. Firstly, as a follow-up for that, it's clear that the domestic supply industry, the market structure is not fit for purpose. We saw that earlier this week with the call for evidence. I was just wondering, given you've worked in this industry for five years now, what your vision for what the market structure should look like?

Secondly, a question for Mr O'Brien, just on the EM&T business. This is the one that clearly you believe in, but as trading/optimisation, we have the least visibility on it, it isvery difficult to model. You mentioned that under normal energy market conditions, you laid out a trajectory for profit, could you confirm those normal conditions would be pre-energy crisis in terms of volatility differentials, carbon, gas, and absolute prices, or is it assuming a new paradigm of higher volatility to meet those higher numbers? Or is it the case that the base within that business is just higher?

Chris O'Shea, Centrica
Mark, thanks very much. I'll take the domestic supply question, and then Russell will take EM&T. I would say, remember, in EM&T, as we laid out, it really is a massive logistics operation. There is trading, but it's not really screen-based trading, it's

asset-backed trading with storage facilities and pipeline and cable capacity, so we can move gas and power across Europe.

On the domestic supply business, there's a whole lot going on at the moment. Ofgem I think announced earlier this week their capital adequacy requirements, which is a great start. We think it's too low. £115 per customer we think is probably too low, but it's great to have something in place. There's then something linked to ringfencing customer deposits. We also think that doesn't go far enough, but it's a good start. We've been calling for proper prudential regulation in this industry for a good couple of years. Ofgem are putting some of that in place, but we think that there's more to go. Where I think the market should be, and that's different to where I think it may end up because I think the regulator doesn't always want to go as far as they could. I think if we were in financial services, we'd see very, very different regulation. But where should we end up? We should end up that companies in our market are adequately capitalised so that if they go under, shareholders take the pain and not consumers.

I think we've got to be careful as we come out of the energy crisis that we don't go back to what we saw before. I think that some of the steps the regulator has taken have been really quite good limiting the number of new entrants, but the conditions could exist again in the future where new entrants could come in. If they're required to post only zero capital or up to £115 by 2025, you could see disruption in this market again. We think that would be a crying shame. How the market should look is very, very well-capitalised companies, an acceptance by the regulator that you achieve your desire in terms of fair price, and either by having extreme competition or by having price regulation. The whole design of the price cap was based on a fundamentally flawed concept that you could have extreme competition and price regulation. It just makes no sense at all. Economically, either go for extreme competition and let the market set the price or go for price regulation. We've been quite clear we're supportive of price regulation. We'd also be supportive of extreme competition, but having both, something's going to break.

Hopefully, the market will move towards something whereby there's an acceptance that good customer service is a thing that should underpin the regulation, the retail market, and you have profits that will allow innovation. Good customer service should mean – if you think about where Ofgem were over the past few years, their biggest single measure was customer switching. If you didn't have customer switching, the market wasn't very good. Customer switching suggests your customer is unhappy. If you're a regular that is supposed to make sure your customer is happy, that's a very strange metric to have, so I think just a realisation of how the market should be.

You'll see something more, as I say, time and type-of-use tariffs, you'll see more demand-side response in there, you'll see a fantastic take up of this Summer Sundays that we've got, half-price electricity. What we're doing is we're learning as we go on what the customers want. That's what's got to drive this market. Do

customers like the half-price electricity between 11 and 4 on a Sunday? Well, maybe they want it between 10 and 5, maybe they want it on a Saturday night. What we're trying to do is to test and learn so that we can give customers what they want, but you've also got to make sure that you have reasonable profit that will drive innovation. But where we've got to go a lot further is on having fit-and-proper-person tests and having adequate capital.

During the energy crisis, somebody from one of the very large new entrants into the market suggested that their calculation was that the capital you need to hold for a customer was £750. We haven't done that calculation. We've got an asset, a very heavy asset base. I'm not saying that's the number, but it shows you the difference between what Ofgem have come out with and what one of the market participants said before. We hope that £115 is a start. We saw this with the market stabilisation charge. When Ofgem brought it in, they then quite quickly made a change. Hopefully, what we'll see is a realisation that £115 is a wholly inadequate sum to hold in that market, but the most important thing is to make a start, so they should be applauded for some of the things that they're doing.

Russell O'Brien, Centrica
And then on EM&T and our guidance of £250-£350m of sustainable operating profit under normal market conditions. It's important to just realise what's inside EM&T. There are three businesses there. There's our LNG business, our route-to-market business, and our power and gas business. Not all of these businesses are just dependent on prices and volatilities. There's a core asset position, and in the route-to-market, there's a base of income because of the contracts that we can package together. It's not, as Chris said, just trading on screens; there are logistics involved, and there's an underlying base of earnings.

On the market conditions, yes, we do expect that market conditions will revert somewhat towards where they were before the crisis. But as we also outlined today, we expect looking forward that particularly in the electricity market for there to be more volatility, more intermittency, and those dynamics play to our strengths, so we think that that trend will also continue.

<u>Question 3</u>

Anna Webb, UBS
I've got two for you. The first is on nuclear. The strategy clearly has a focus on smaller flexibility, renewable security of supply assets, but you still see the potential open for new nuclear. Can I ask why you still see new nuclear as an opportunity, and do you see Centrica adding value in a new nuclear build or just as a capital provider? You talk about needing an appropriate regulatory framework for this, could you give a bit more detail about what would be required to make investment?

Secondly, on the 11p-12p EPS guidance you've provided, which I think is very helpful, can I ask if you're thinking of this as a floor? Factoring in normalised

upstream and also the new investment, what's your estimate of where EPS could be in five years from now? Could it point to 15-16p with this new investment?

Chris O'Shea, Centrica
I wouldn't say that 11p-12p is a floor. I think what we've said is we expect we can make about £800m from the existing businesses. That doesn't include existing Infrastructure or new Infrastructure investments, and you can never look at that as a floor because you just can't see what the market would do.

On nuclear, why is there value in nuclear in general for the UK? Because we need a baseload of electricity. I mean, we were burning coal three days ago, so very small amounts, but we've still got coal being burned. When there's no wind – I check every morning when I wake up what the electricity mix is. It's quite a sad admission. Sometimes I put it on social media, and I get completely crucified, but I always have a look. Sometimes you wake up, and it can be 85% coming from wind, and sometimes it's 15%. The fact that it can be 85% coming from wind means that we've already got – there are not as many people up using electricity at that point, but we've already got a lot of wind. To quadruple wind generation in the UK, if the wind doesn't blow, it makes no difference at all.

We've got to say, how do we get this baseload through? I think hydrogen-fired power stations is going to have to be part of the mix, but I also think nuclear has got to be part of the mix as well. Zero-carbon electricity. How do we add value? We know nothing about building nuclear power stations, so we don't go in and tell our partner put this here or there. Dave Kirwan, who runs the Irish business, knows most about building power stations in our business, so Dave will add some help there to the Board personally, but for us corporately, we're not really big on building nuclear power stations. What we can do is to add a lot of value to how we take those electrons out and how we get them to customers. We've got 7.5m customers. Increasingly, they want green energy tariffs. At the moment, how do companies do that? Either, like us, you own green assets, or you buy certificates. We think that over time, really, what you've got to say is, look, we either produce this electricity or we buy this electricity. The idea of being able to go and buy certificates, which are getting more expensive, and saying this is green is probably one that I think will be consigned to the past in the future.

For us, there could be an interest here. What would we have to see? We'd have to first understand – what about the construction risk, the cost overrun, the schedule overrun, which has happened. It's quite public at Hinkley C. I think it's less likely that you'll have such a big risk at Sizewell C because the second one you build should be easier than the first one. We'd also have to look at the returns. You just look at risk and return. If we take a lot of risk, we want a higher return. If we take almost no risk, then we're willing to accept a lower return. Then the question for us as a board is, how does that fit within our strategy, and how does that fit when you look at the pipeline of other opportunities? I can't tell you if it's X, Y, and Z, we'd invest in that because there might be other things coming down the pipeline that we're not even

thinking about at the moment. We're always dynamically – we know our strategy, we know the type of things we want to invest in, and for me, nuclear looks quite attractive just now if the terms are right. But in two years, when you come to put money in, there might be something else on the horizon. Hydrogen might really take off. The great thing about our company is we're in all of these places, we've got choices, but we just need zero-carbon electricity.

Question 4

Ajay Patel, Goldman Sachs
A few questions. Firstly, on the balance sheet, I heard through the presentation, fantastic cash flow, and you look at the capex programme, and you work through, and you think, if 1x net debt to EBITDA is your target at, let's say, 2028, it looks very clear that you're not going to deploy the full amount of your cash generation that you may generate over that period. I'm trying to understand what's the trigger points. How much of an under-geared balance sheet would you run over that period? Maybe you won't fully utilise up to 1x, but would you seriously consider, at a point where maybe you're net cash, that there are sources or directions at which you could deploy capital – be it capital returns or investment?

The second question is just on the journey of services and the targets or numbers you highlighted. Can you maybe unpack that a little bit more in terms of how much are initiatives that are driven on the revenue side, i.e., increasing market share, and how much is cost-driven and efficiency-driven and doing different practices?

Lastly, one more specific for Russell, could you maybe go through the dynamics of this year for H2, i.e., division by division? To what extent is it very heavily H1-weighted? What's open to uncertainty? Just so we can gauge the range of outcomes for potential earnings this year.

Chris O'Shea, Centrica
Just let me take the question on services, and then I'll gladly let Russell take the other two. If you think about the recovery in profit and services is not predicated on big cost reductions. We've got programmes, however, to improve our supply chain and our planning and dispatch. It's predicated upon being more efficient and creating more capacity, and then using that capacity to get more customers. I think, traditionally, what we've done is we've been focused on this pool of 8m customers who are buying contract services and not really on these 20m customers who pay for repairs as and when they happen.

We've actually been testing in the first half. As Jana's been leading the team to build more capacity, the dream that I've got – Jana's heard me say this 100 times and is probably sick of it – the dream is that you give customers until a certain point to call you if they're a contract customer to say they need a repair that day. At that point, then you've got the operational person saying, I've got X-thousand jobs, and you've got the commercial person selling those jobs in the market on the day. I think there's

a very strong proposition there. It's all about how do you get the maximum efficiency. It's about managing this business really well. How do you minimise travel time with your engineers? If you've got an engineer that comes out of one home, if there's another home five minutes away, rather than have them drive 30 minutes and have somebody else drive in the direction, how do you make sure that – and you can dynamically manage that. That's why we're investing heavily in a new planning and dispatch system.

Undoubtedly, we do have to grow customers. We cannot get this business back to £100m-£200m of profit by cutting costs. This is a growth story. However, we really had to get to grips with the operational issues in this business to really get control of it. It feels as well controlled as it's been in all my time in the Group, and now we can start laying on the growth on that. Firstly, you'll see the growth coming through from existing capacity, then secondly, we'll have to add on more capacity. That idea is you test and learn. We sell this capacity. What's the demand for on-demand? What do they like? What's the price point? Make sure that it's attractive. The beauty of this is it's all unconsolidated. Really, the competition is a man or woman in a white van, and the great thing about British Gas is I think we've got better-trained people, I think we give great service, but you know where we are. If you've got somebody in a white van to repair, can you call them up if it goes wrong? You know where we are, we're not going anywhere, so I think we've got a huge amount, but we want to make sure that we don't do what's really tempting, which is we go out and tell customers what they want.

We test, we find out what customers – if you get the Hive app, for example, if anybody's got Hive, you'll see in it for the last couple of months there's been something to click on if you want a service. It's a brilliant example of just testing. We've done quite well on that. We're seeing, do customers like to buy through Hive? Do they want to buy a one-off boiler service? How do we help understand more? I think that's more of the digital work that we're doing. You've got to test and learn. Okay, that didn't work, let's stop that. It used to be we'd spend months coming up with a proposition and then a long time to launch it, and then it either worked or it didn't. Some of the propositions I've got no idea. I hear about them when we have our monthly performance reviews, and that's exactly as it should be. I'm excited about the prospects for that business. As you can see, we've got a 10% market share. We used to talk about 50%. That's 50% of the value for contract services, but in reality, we touch 10% of homes in the UK; 90% we don't touch. Massive growth opportunity.

Russell O'Brien, Centrica
Moving on to the balance sheet and your questions about the 1x net debt to EBITDA target and I just looked back at my script, and I quite clearly said don't take this as a target. I think that this really should be seen as a boundary over time, and with the flexibility a company like us needs to have as a sort of upper boundary. You've got to remember that this great company does have to deal with a lot of volatility every day. We have to have significant liquidity at all times, so the balance sheet needs to

always have the buffers for that. We talked about margining, which is a positive at the moment, can go in other directions. We've still got £800m of technical pension deficits. We've got £1.1bn of decommissioning liabilities. We want to invest. We want to continue with the progressive dividend. Within that mix, we've got a lot of flexibility. We're not trying to reach that target or see it as a cap; it's just part of an overall boundary.

Then on to the second half of the year. Just to reinforce, there's no change to the guidance we gave at the AGM trading statement that we expect the profitability to be heavily weighted to the first half of this year. Let me just run through the business units as you requested. For British Gas Energy, of course, the obvious one is that we've got the material one-off items, particularly the cost recovery in the first half of this year. It's also important to note if you look back through the last three years in H2, British Gas Energy has lost money. There's just the natural seasonality of that business in the second half of the year, where with the cost base and the dynamics, your profit will be naturally lower. In Services, that business is continuing to grow, but I don't want to give any particular guidance there. The trajectory is positive. EM&T, we did come into 2023, as I say, with a bit of a tailwind from last year and some of the dynamics. That will naturally taper off as we go through this year. With less volatility in the markets in general, you have less opportunity for optimisation around the natural flows of the business. Infrastructure, Spirit, and nuclear prices are lower in the curve, so that drags down earnings, even though we're partially hedged on part of that.

In the cash flow, there's one particular item to highlight. The Energy Generation Levy, we accrued £180m in the first half for that. We haven't paid it yet. That will continue into the second half. There are higher taxes in the second half of the year. Margin was a cash-in of £300m at the end of the first half. Of course, that's a number that can go in either direction and has been out over the past months. We must remember that in our bank accounts, we have £600m of money, which is our customers' money, and that over time can change as well. There are quite a few things making me reinforce that there are many uncertainties as we look into the second half of the year.

Question 5

Dominic Nash, Barclays
Just a couple of questions from me. I think you touched it just on the earlier question with Ajay, but you talked about the need for actually having cash on your balance sheet, so not net cash or net debt. What do you think the actual cash that you need to have held back are going forward? Then what are you going to do with your debt book? Are you going to be buying that back? What's the impact of the current high interest rates on earnings?

Secondly, I just want to just quickly run through my maths and make sure that I haven't missed something. Your starting net cash is £3bn, maybe £2bn after all the

one-offs; your operating sustainable earnings is roughly equal to your operating capex or your growth capex after tax; you've probably got, I don't know, £1bn or so coming in from Infrastructure and others by 2028, and that's probably lowballing it; and if you say that we could get to £1bn of net debt by 2028, in the round, I know it's not a target, but in the round, that sort of number, does that basically mean that you've actually got the ability really to pay £4bn back to investors over the five-year period?

Chris O'Shea, Centrica
I'll probably have to let Russell go with that on the cash. I think the answer is probably not, but hopefully, because what we're in business to do is to give customers an amazing experience and give shareholders an amazing experience, and hopefully, we're getting closer to doing both of those things. If we do, one follows the other. Obviously, you've got to bear in mind, although if you take it and we're saying we're going to invest roughly what we're going to make in profit, remember, we've got, what, £200-£250m or something in dividend each year depending on the number of shares. There's probably a couple of hundred million into the pension scheme. I think that tail comes down a little bit, but you've got other things. You've got, obviously, the interest costs. There are a number of things there. But again, I'm loving all of this because these are the questions I keep asking Russell because, as you would expect, can we spend more money?

But we've also got to bear in mind, I think, and having done Russell's job before, there can be points at which you go into some energy volatility, and you see massive movements in your margin calls. If I think back to when Scott was appointed Chairman and he asked me to be CEO, we had to sell assets in order to get the balance sheet in the right place. We tried to sell more assets than we wanted to. There are a number of assets in our portfolio today that we love that we tried to sell because we had no choice. I would say I've always tried when I was a CFO to try to have a company in a position where you had choice, and we didn't, and obviously, I was the CFO, so I failed miserably in doing that at Centrica, but we didn't really have choice. I'm glad that we sold the assets we sold, I'm glad we got the place that we did, but it's always far better, and one of Russell's key things is to make sure that when something happens, we don't all run around – I was going to say like our hair is on fire, but like our trousers are on fire or something. That we've got choice, we've got time to think, and so that will always probably in our business mean that the balance sheet is – if you were being unkind, you'd say it's slightly flabbier than people would like, but there are points, we found this last August, there are points where you say, thank god for that because you're not in a panic when all of a sudden you're posting hundreds of millions of pounds a day in margin calls and then figuring out what to do. But anyway, tell them, why can't I spend more money?

Russell O'Brien, Centrica
We're in a volatile business, and we need to be prudent as we serve our customers. I just looked back at my script again. I did not say it's a target for the net debt to EBITDA. It's a boundary over time, including all those flexibilities, so I really wouldn't

put it in my model as a target for 2028 and backsolve how much cash is available because, of course, in any period, you want to have some buffers and the market is changing around you. Take that in the round of everything else we've described today about the investments and everything else we're trying to do. Just on the treasury aspects you asked about as well, our Group Treasurer is sitting at the back of the room. He's a very prudent individual, and that's what we want him to be. We keep the cash, which is significant at £6.7bn, in very secure money market funds. That's not something we're doing anything apart from being very conservative with. Then on the debt book, of course, it's a legacy debt book of a Centrica that looked a little bit different in the past. As we've looked at liability management, I mean, it's very hard to make liability management work. We'll keep looking at it. We don't have any active plans. We'll tidy up the debt book if we can, but for the moment, that's all I can say.

Question 6

Harrison Williams, Morgan Stanley
The main question, I'm afraid, sort of comes back to the shareholder distributions. If we think about the £600 or £800m investments you have or plan to deploy, what are the key barriers to potentially deploying that you foresee? I know that your recent investment into I think batteries in the UK can't get a grid connection until 2028. If we can't deploy that capital, I presume that's one of the things that could be considered to redistribute. So that's question one.

Then secondly, just to comment on the latest churn trends you've seen in the UK retail market. Thanks

Chris O'Shea, Centrica
I'm happy to take both of them on. On the deployment, the biggest barrier we've got, firstly, is finding projects that we think we can add value to and that can give us the returns that we want. So that's a non-negotiable barrier. I think there are plenty out there, but we've got to be mindful of that. You've then got in the UK planning permission and grid connections, and they can be problematic. Some of the stuff that we've done is to buy things that already have grid connections and planning permission, but as we go further on, obviously, when you do that, you give up a little bit of value, and so we want to have more organic developments. And it's an issue. People criticise National Grid for it. It's actually not National Grid. Mostly, it's the Distributed Network Operators. There's a question, I think, for the regulator, which is, how do you make sure that they are going to make the connections more quick? We have had some where they've said you can have a connection in 2030, which is deeply frustrating. We even had one that said, what if we pay the cost of the upgrade and we take the regulated return on that? They said no, it's still 2030.

There's something, and I don't think this has been done deliberately, but one of the things we've been pushing for is to rethink the recent decision by the regulator to allow Distributed Network Operators to participate in the flexibility markets because I

think as soon as you do that, and they have done that, you create a perverse incentive. You're a Distributed Network Operator, your job is to deploy your capital and get your regulated rate of return under the RIIO-2 settlement. As soon as you can play in intermittency, you have a perverse incentive to have an intermittent grid and not to connect all the things that want to be connected. Now, I'm not suggesting for a minute that that's what's going on, but what I'm saying is that the regulator has put that incentive in front of these companies. I think that has to stop. You either invest and get a regulated rate of return, or like us, you deploy merchant capital, and you participate in flexibility markets. But if we continue to allow these network companies to participate in flexibility markets, I think we'll more and more see delays, and that's not in consumers' interest. What we want to do is to get it on, get the flexibility, get the prices down, that's what's in consumers' interest. But there are undoubtedly barriers there. But we're quite tenacious, we're quite resilient, we're quite determined, and we're more than willing to point out to others when they're not getting things right. In the same way that we're willing to have it pointed out to us when we don't get it right. But there are definitely risks there. By having a number of smaller projects, we defray those risks, I think.

Question 7

Deepa Venkateswaran, Bernstein
I have two questions. The first one is on BGR and EM&T, so the very strong results this half, and you've mentioned that you've changed the approach from risk mitigation to optimisation. What does this mean? Are you taking a directional view on commodities? What's the risk that you're adding, and can this backfire? That's the first question.

The second one is on the returns that you're targeting. Obviously, you are stacking several revenue sources, so these are not maybe guaranteed returns, but this is your best estimation. Can you just maybe walk us through how conservative you are? Then is there a rule of thumb that you can say we're deploying this £800m or, let's say, £600 is new growth? Is there an EBIT to capex ratio of 8% or something with the time lags that you mentioned?

Chris O'Shea, Centrica
I'll ask Russell to take the second one, but on the first one, what we try to do at Centrica is to make sure that people focus on the things that they're really good at. We, as a company, focus on the things that we're really good at and the things that we're not, we stop doing, but that also applies internally. How it used to work was: EM&T are the team tasked with buying energy, gas, and power for the downstream businesses, but there was an element of choice in the downstream businesses as to how long or short you went on a book. I was never comfortable with that when I joined as CFO because that's not their expertise. If you run a retail business, your expertise should be in giving a fantastic customer experience and making sure that you're able to predict demand.

So what we did was we changed that when I became CEO. Now, Catherine, who runs the residential business, and Greg runs the B2B space, they meet regularly, I think on almost a weekly basis, and talk about the demand forecast. Catherine is responsible for demand, and Greg's responsible for demand. Cassim, who runs Energy Marketing & Trading, is responsible for optimising the cost of energy. Now, that might mean you run the book slightly long or slightly short, depending on your fundamental analysis. It doesn't mean that you've got this big huge trading play for your traders, but the job is the traders are tasked with basically beating the marketplace for the acquisition of gas and power. They do that consistently, they did that very well in the first half of this year, but it's just all about making sure that people focus on the things that they're good at. It's not running much more risk; it's just a recognition of different businesses, but they work very closely. This energy margin meeting I think happens on a weekly basis. Russell goes to that, Cassim, Catherine, and others.

Russell O'Brien, Centrica
Then on project returns, you're asking for best estimations. Behind that, how conservative are we? We are pretty conservative. I think, overall, that's good. We're not trying to show you today results that are not credible and deliverable. We put quite a lot of work in. I took you through the different risks behind them and how the energy market could change, just so that we make sure that when we put money to work, it's a solid return. We're given rates of return by asset category. That's the only guidance we really can give at the moment. There are no metrics or data capex that I can give you today, but hopefully, what you've got there is enough of a sensible toolkit to be able to give some sort of view of how we might progress in the coming years.

Question 8

Harry Wyburd, Exane
Two from me, please. The first one is for Russell. It's a follow-up to Dominic's one on the cash. My observation would be that some of these assets you're targeting, IRRs 7/8/9%, you can earn 5% on gilts now, so I'm interested in at what point do you expect your net interest expense to become a positive figure. What are you assuming in your 11-12p for the income on cash?

Then secondly, for Chris, I'm just interested in how you came to size your investment in flexible generation. If you deduct the meters and the maintenance capex, you're looking at £300-£500m a year, if I've done the maths right. Interested to know why it wasn't £100m or £1bn. You've got the total addressable market for the UK, I guess. I think it was on slide 12. Did you do this on a market share basis? Is that opportunity going to grow? Would you go internationally? I'm just interested in where you see that going in the long run and how you arrived at that figure for what you're going to spend on it.

Chris O'Shea, Centrica

Let me take that and then ask Russell to tell you what the interest income is going to be in a few years. There's no science to this in terms of how you size it. We said £240bn to be spent on the energy transition in generation and in storage. A lot of that is going to be in offshore wind. UK offshore wind – very congested, very busy. I don't think we bring anything to it. We are looking at wind in Ireland because I think we bring something there, and with a joint venture partner, but not so much in the UK. Then you look and say, what is it we're good at? Could we build large-scale gas-fired power stations? We could, we kind of know how to do that, we've got a very big one in Ireland, but we actually think the right thing to do is to build these smaller peaking plants. We think the right thing to do is to build these batteries. We're looking at some other interesting battery technology.

It's not just the current technology; we're looking at other ways of storing energy, but it's all around, what do we bring to it? Solar, for example, is a great example of building a solar farm and selling half of that to a corporate customer. You've got the residential book, which will underpin the investment, you've got the corporate customer as well. It could be lower; it could be higher. What we looked at was to say, what's affordable, and what do we think we can deploy? It will be challenging to deploy this for the reasons that we spoke about – grid connections, planning permission, and the like – but we like to stretch ourselves. If we came out and said it's going to be £100m, then that's not actually going to replace the asset base that we've got declining over time. If I say it's a billion, I just don't think that's credible. I'd love it to be that we were coming out saying we were going to spend £1bn a year because that would mean that we were making more money, we had a more stable income, and as a Board, we were comfortable that was a place to deploy our capital.

No great science, but we do have to invest quite substantially to replace – although Morecambe will go into the 2030s, in my view, it is going to stop at some point. Four of the five nuclear power stations will probably stop this decade, the advanced gas-cooled reactors, so we'll be left with Sizewell B. How do you replace that asset? I look at that more as a replacement investment, but we're just going to replace it with – we're not going to go and drill for oil or gas. We're very clear on that. Other companies have said we're going to be green, and actually, price goes up, we're going to drill for oil and gas. We're not changing, so we're really quite focused, but we'd like to get after and deliver this.

I'm excited about the meter access providers. I think that will, if we get that right, open up our ability to stop doing one-off boiler installs. Start saying to people we'll give you boiler as a service. Pay us a subscription, we'll service it, we'll install it, we'll finance it because at that point, hopefully, we'll be tracking hundreds of thousands if not millions of meters, so we can track assets and the like. We're trying to build things that are really going to be sustainable. If we could turn our boiler installs into a recurring revenue stream, if we could keep a revenue stream when a customer leaves us, should they choose to leave us, I think that's going to be very powerful. Then we can finance heat pumps as well, which are more expensive. There's a lot of

thought into what we invest in, but the number could be plus or minus a few hundred million.

Russell O'Brien, Centrica
On the interest rates dynamics, the average rate of interest on our debt in the first half of this year was 7.74%. That's a combination of the fixed-rate bonds that we've got, but half of them are floating, so even though the cash rates are going up, some of the cost on our debt book is also going up, so you wouldn't really catch up with that.

Returns, and your question about the gilts at 5% versus some of the returns on the chart I showed you today. We're looking at assets, which are very long-term stable assets. These are assets that we want to earn an appropriate rate of return over that long period of time. It's not directly comparable to a gilt investment, for example. Also, remember, what we're talking about is that we're looking to build assets that complement our portfolio. We're looking to have additional returns on those assets as they come through our optimisation capability and eventually to our customer, so that is also an additional benefit of those. We're conscious the interest rate environment is changing. Hurdles and expectations in the market are changing. Supply costs are going up. We're eyes wide open to that, and we won't be putting any money to work until we've fully captured that, whether it's a supply chain or investments that we're putting to work. Hopefully, that helps.

Harry Wyburd, Exane
Thank you. Sorry, could I collar you a little bit on the assumption in the 11p-12p guidance?

Russell O'Brien, Centrica
11p-12p is just taking the £800m basically, taking off tax and divided by the share account. There's no interest in that. That's just that business's contribution to Centrica.

<u>Question 9</u>

Owen Tutt, Federated Hermes
One question on the investment in the 200MW flexible gas assets. I think it was €300m in capex and an estimated 9% IRR. Are there any early estimates on what those numbers would be when factoring in the conversion to hydrogen in the future? Second question is on the estimated operating profit from the EM&T business. How much of that is coming from gas and LNG trading?

Chris O'Shea, Centrica
On the investment in the peakers in Ireland, I think it's about €300m. I don't think that's sterling. The key thing in converting these to hydrogen is having hydrogen available. When the technology works – I mean, these are engines that started off basically being built for ships, and they were run on diesel, then you could run them

on natural gas. We're very confident we can run them on hydrogen. We had a hydrogen CHP unit, essentially the same technology, in the offices in Windsor a few weeks ago just to demonstrate to people that it can actually work. I don't think the conversion costs will be a massive material cost. €300m is going to have a lot of civils, a lot of connections in there, so it's not going to be a big amount of that. It won't materially change the returns.

In terms of the question on the operating profit, we wouldn't go one further down to split where that comes from, but we're looking, for example, in EM&T at the moment, how will hydrogen be traded. It could be ammonia. We're going to have a look at ammonia. Maybe you want to start looking at how do you – because ammonia is the best way to transport hydrogen rather than transporting it as a liquid fuel. The profit that comes from gas trading or from LNG trading in EM&T will reduce over time as the world's dependence on gas reduces over time, but what we can't do is to drive that. We can help it along, and we can help to develop new markets, but we can't simply decide not to do that anymore. We see gas as an essential transition fuel. Obviously, we've just signed a contract to buy LNG into the 2040s. That gives you an idea as to how long we think people are going to be using natural gas. It's because it's net zero; it's not gross zero. We think gas will be there. However, we're not going to be producing it, but we have to give our customers what they want. That's a key part of the business. But it will naturally progress over time. Very, very innovative team in EM&T. They're always looking at different products.

Question 10

Pavan Mahbubani, J.P. Morgan
I have two, please. My question was in terms of M&A, do you see that as being more related to any particular lines of business, or is it more overall in the portfolio? My second question was on headlines a couple of weeks ago that the UK may drop plans to replace home gas boilers with hydrogen. I just wanted to get your overall thoughts on whether you think that it's realistic to replace all the current boilers with heat pumps or where you think heating would go if that did turn out to be true.

Chris O'Shea, Centrica
Okay, so that second question, there's a bit of political jeopardy in that. On the first one, M&A, for us, we're very clear about what we want to do, and we're very clear how we want to do it, but you could say, for example, when we buy a consented site to install a peaker plant, that's M&A because what we're not doing is we're not buying the land and developing it all ourselves. It's not focused on any one particular area, but the hurdle for M&A is higher than the hurdle for organic investment because it's riskier. Could we look at M&A in Retail? Absolutely. That would have far bigger risks than if you looked at M&A in Infrastructure because, in Infrastructure, you buy an asset, you can do your due diligence, it's quite straightforward. If you're buying thousands or millions of customers and hundreds of thousands of staff or something then that's really, really difficult. We'd always look at it and say, does it

get us closer to where we want to be, and are we confident that we could execute that without taking our eye off the ball? But it's not focused in one area.

On the headlines on hydrogen boilers, take a step back. We were a hydrogen economy from before the 1970s. Town gas is what we used. That was hydrogen. It was not nice hydrogen like the hydrogen you can produce today. It was 55% hydrogen with a whole bunch of other stuff in it that you really didn't want, but you burnt coal, and you captured the gas. Is hydrogen safe in homes? Well, it was either unsafe before 1970, or it is safe today. I don't think we would say it was unsafe. We just found natural gas. That was easier, that was cleaner, and it was cheaper. Now we've run out of natural gas, and we've got the carbon cost of it, so could hydrogen go back into homes? We think hydrogen is essential to decarbonise the UK. Our name is a wee bit unhelpful – we trade under British Gas – because people think that we're pro-hydrogen because we have to be. We don't own any gas infrastructure other than the Rough storage field. Rough can store CO2, it can store methane, or it can store hydrogen, so it doesn't really matter, to be honest.

But when you look and say 85% of UK homes are heated by natural gas boilers, are they all suitable for heat pumps? Absolutely not. Can you make them suitable? You probably could by insulating them properly, but the carbon cost of insulating a very draughty home might be in excess of the carbon that you would save. You've really got to think practically. You then look and say a heat pump is more expensive than a boiler. Is the cost coming down? Heat pumps, 50/60-year-old technology. I don't see anything that's bringing the cost down. Somebody brings out a new iPhone, the cost comes down over time. Technology curve. Lots of people have made the mistake of thinking heat pumps are new technology. That's just because it's new to us in the UK. France does 600,000 heat pumps a year. I don't think the cost is coming down. I don't think they're suitable for everybody. There are trials at the moment to have hydrogen in homes. One of those trials has been cancelled. I'd rather see the result of the trial before I comment on whether hydrogen is safe.

Now, hydrogen, very briefly. It will explode more readily, or it will ignite more readily than natural gas, but it disperses more easily than natural gas. If you assume that you're as likely to have a leak, what the tests have got to say is because it will explode more quickly, is that more dangerous than the fact it's lighter, so it goes up, and the molecule is one-third of the size of a natural gas molecule, and therefore, it can find ways to get out more easily? You're less likely to have any hydrogen pooling in a home, you're less likely to have any accumulations in a home, but if you have it, it's more likely to explode. The point I've made to politicians, regulators, and the like is if you're unfortunate enough to ever have to go to the site of a gas explosion, I promise you, it doesn't matter whether it's natural gas or whether it's hydrogen, it's a very traumatic place to go. The thing we've got to focus on is, can we do it safely? It looks like we can do it safely, but we've got to go through the tests. Then we've got to say, do customers want it? It's all got to be down to customers want. Maybe we've got to lay out what the various costs would be. There's a carbon cost for having to build two or three new national grids if you're going to electrify everything.

My personal view is that hydrogen will be in the mix – that it should be in the mix for heating our homes. It may also be in the mix for road transport, and not just heavy road transport. You might see hydrogen internal combustion engines. That's what a hydrogen peaker is. There's a lot more to go for this. The great thing about our portfolio is if it comes, it's great for us, but it doesn't need to come in order for us to have really strong growth prospects. In Jana's business, the best thing for us would be everybody has to get a heat pump because we're the biggest installer, we're going to be installing a lot, but what we're trying to do is to say, what's the best thing for the customer? It might well be a mix of heat pumps and hydrogen boilers. Time will tell. There's a lot of emotion. Sometimes there's a lot more heat than light in the debate. We continue to try and put the point across for our customers, and we see how we get on, but hydrogen, irrespective of whether it's in homes, it absolutely is essential to decarbonise the UK. The East Coast Cluster, which is 50% of the UK's carbon emissions, can only be decarbonised with material hydrogen production.

Question 11

Martin Young, Investec
In the answer to Pavan's question around M&A, you suggested that it's possible that you could look at M&A in Retail. Obviously, Shell is endeavouring to exit the UK market. I wondered if you could just share any views you might have on the attractions or otherwise of the Shell retail customer base in this country.

Chris O'Shea, Centrica
You're trying to get me in trouble. If there's anything that's for sale, and the price is good, and we think we can make it work, and it's aligned with our strategy, absolutely brilliant. If it's not aligned with the strategy, we're not interested, and if the price is not right, we're not interested. I'm as interested as you are to see who ultimately buys that and what price they pay, but we've got a great business. We're focused.

Closing remarks

Chris O'Shea, Centrica
Thank you very much for coming. Really appreciate it. If you think about what we've laid out today, I think it's a compelling investment proposition. We have bowed to pressure and given guidance on what we think our returns will be. I'm quite allergic to that, so hopefully, you'll see that's quite a big step, but it's a sign of our confidence. The increase in the buyback, the increase in the dividend, you should take as a sign of our board's confidence in our long-term prospects, and a recognition of the fact that we work for shareholders and shareholder returns have got to feature very highly as we look forward into our investment phase. There are not many companies that announce a big investment phase that also say that the return on capital employed will remain north of 20% throughout that investment phase. Again, I think that's something that is really not that well understood. Thank

you very much for coming. Thanks for sitting in the room, and hopefully, as many of you as possible can join us for lunch after. Thank you.

END OF TRANSCRIPT