Centrica Interim Results

Presentation Transcript – 26 July 2012

Sir Roger Carr - Chairman
Well good morning everybody. You know we had visions of presenting to maybe about three people this morning, so I think you have done really well to get here so thank you very much for making the effort.

Just a few words really from me. The last six months I think have witnessed the achievement of a number of strategic milestones in addition to what is clearly a good set of financial results. Under Sam's leadership our plan has been to build a more sustainable business model, vertically integrated, cost effective and customer friendly with meaningful geographic diversity. And over the last five years step by step much has been undertaken to achieve these objectives. But this year our billion pound investment in Norway, the generation of First Power from Lincs Offshore wind, the expansion of our North American interests, almost doubling in size in 36 months. All these things, plus the delivery from British Gas of lower costs and much higher consumer engagement, have all been landmark achievements in meeting the strategic objectives we set out to do.

Now as always, more remains to be done in continually replenishing the production assets, harvesting our upstream skills, building consumer trust at home, strengthening our North American footprint and driving efficiency throughout the business. But in the day to day what is inevitably day to day short term focus on short term performance, I just felt it was important to set some of those recent achievements in more of a strategic context. Nevertheless recognising that long-term success is a function of short term achievements, the financial performance in the first half has been good, particularly given the challenges of the general economic climate and the competitive market conditions.

It is important however to remember that notable improved profitability in British Gas reflected both the traditional first half weighting and compared with a particularly unusual period of warm weather and low consumption in the previous year. While showing material growth year on year therefore, the level of profit remains only that which is appropriate for maintaining a sustainable business model which in turn will enable the group to continue investing in long-term security of supply.

Looking forward the work undertaken by the management team in reducing costs and improving customer service will without doubt be vital to maintaining profitability and cementing continued customer loyalty in the face of upward pressure on commodity, environmental social and regulatory costs which are outside of our control, but inevitably impact retail prices.

In North America we have moved our Headquarters from Canada to Houston to reflect the new centre of gravity of the business and to build on the momentum of growth created under a refreshed management team. We have deployed capital thoughtfully and I think effectively both in extending our North American scale, customer reach and service activities and indeed at home expanding our North Sea presence.

I would emphasise to you that the financial discipline of sound economic returns and shareholder value are the bedrock of all our investment decision making and will remain so when evaluating all future projects, including new nuclear build.

In the meantime we will continue to develop Centrica with customers at the heart of the business by continued drive on organic growth, cost reduction, asset replenishment when necessary, customer additions when available and upstream expansion when appropriate to our business model.

I will now hand over to Nick who will take you through the numbers in more detail.

Nick Luff - Group Finance Director

Good morning everybody. As usual let me start with the commodity price backdrop to these results. Out-turn gas and oil prices were actually very similar to H1 2012 as they were in the comparative period in 2011. However they have been at these high levels for longer so more of the affect was felt both upstream and downstream without the delays in hedging seen last year. Spark spreads were of course very low, much lower than in H1 2011, impacting the running pattern of our CCGTs and feeding through into our power prices. In contrast our competitors in the last year before the end of free carbon benefited from the much higher spark spreads through their coal stations.

Commodity prices were not however the most significant external factor in the year over year performance. As Roger mentioned, that was the weather. You will remember the first half of last year was unusually warm. This year despite a warm Q1, overall the average temperature in the UK was slightly colder than normal and gas consumption per customer from British Gas increased by 5% as a result. That did mean that the British Gas residential segment produced a more normal level of profit in the first half and the Group as a whole was well ahead of H1 2011 as a result.

As you can see here revenue was up 4% reflecting those higher volumes and higher average retail prices and with upstream benefiting from higher realised prices and higher volumes due to the Norwegian acquisitions, adding to the recovery of BGR's result, the Group's operating profit rose some 15% to £1.4 billion. Interest and tax also rose due to the higher profits and the acquisitions, but earnings were still up 14% to £767 million and that translates to 14.8 pence per share. The dividend set at 30% of last year's full year dividend as usual will be 4.62 pence per share.

Here is the breakdown of operating profit and you can see the recovery in downstream UK and also the increased contribution from upstream. So starting with downstream UK, British Gas, here profits increased by 9% to £563 million. Within that residential energy was up significantly with the more normal weather driving higher volumes than last year. Higher average retail prices covered higher external costs both commodity and non commodity as we continued to control and reduce internal costs.

Residential services which now include new energy activity continues to perform well, despite tough economic conditions with cost control enabling a 14% increase in the first half. The services business remains on track for 10% growth in the full year. In contrast we were not able to mitigate fully the impact of the difficult trading positions in the B2B market with weak volumes and margins being squeezed there, leaving BGB's result down at £93 million.

Moving to the upstream, profits here increased by over 25% to £682 million. Both gas and power contributed to the increase as gas production volumes were up by 6% driven by the assets acquired by Statoil and our increased interest in Statfjord, both of which were owned for two months of the first half. These additional volumes offset lower production at Morecambe where we did have some gas blending challenges as well as seeing the continued natural decline of that field. As you can see liquids production was broadly unchanged with the acquisition of assets from Total which does include a fair amount of oil production not yet fully completed.

Hedging had held back realised prices upstream last year so we did see higher realised prices in 2012 despite market prices for gas and oil out-turning at similar levels.

The power result was perhaps surprisingly strong in part reflecting the profit we recorded when we sold down 50% of our interest in the Round 3 Irish sea zone for offshore wind development bringing in DONG as a partner. However the underlying trading result from the CCGTs was still poor. Although our realised spark spread only fell a little, that was due to peak running and hedging. And low market spark spreads meant that we were running the stations much less.

In contrast the UK output remained high, with slightly higher realised prices also helping the overall nuclear results.

At £36 million storage was only slightly down on H1 2011. We did have low SBU prices for the first four months of the year, but the business is now benefiting from the higher SBU prices for the 2012/13 storage year. The full year profit is set to show improvement as a result.

In North America Direct Energy's profits were slightly down in the first half albeit that was in part a phasing issue and they remain on track to deliver a healthy increase in the full year. Despite the expected decline in Ontario and unfavourable weather, residential energy still posted results of over £100 million benefiting from the three acquisitions made in 2011. We will see further benefit from these acquisitions in the second half although there will be some integration costs associated with the Energetix and NYSEG acquisitions we announced two weeks ago.

Business energy supply was slightly up with underlying growth more than offsetting the effect of the milder weather on volumes. Services in North America was also slightly up with the result held back by the impact of industrial action - that has now been resolved.

And with North American gas prices reaching new lows in the first half, conditions were challenging for our upstream business and you will see we did record a small loss there.

Turning to cashflow. You can see that cash generation remains strong with EBITDA up to nearly £1.8 billion. Capex was also high of course, with close to £1 billion spent on acquisitions, pushing net debt up to £4.5 billion. At that level we should have an RCF to debt ratio for the full year in the mid 20s with that ratio set to improve in 2013 as this year's acquisitions contribute a full year of cash flow. And all that is consistent with our A grade rating.

Capex, that was in line with expectations in the first half. Upstream, spend on organic projects is weighted towards the second half with significant spend planned on Rhyl, York and now with the extra tax allowance announced yesterday on Cygnus.

In power, spend on Lincs Wind farm stepped up as we near the date of first power and we will see high spend on that project for the next twelve months, offset by the early sale of the transmission assets out of the Lincs joint venture.

Acquisitions there include the assets acquired from Statoil and the additional interest in Statfjord. That line also includes some payments for the assets acquired from Total albeit there is more to pay on that deal in the second half.

The amounts flowing through the cash flow for all three of those deals is less than the announced headline prices reflecting the cash generated between the effective dates and the closing dates. That cash is retained by the vendors but knocked off the acquisition prices.

In summary then, a good first half benefiting from more normal weather in the UK and from acquisitions upstream. Looking forward, we have seen a drop off in commodity prices, particularly oil. But hedging means that the upstream result for this year is largely protected from that. Trading conditions are tough for BGB and for upstream in North America, but we continue to see growth elsewhere both organic and through acquisition, with cost control also contributing to the results.

So overall we remain comfortable with expectations for the full year with the usual variables of commodity prices, the weather and the competitive environment.

With that, I will hand you over to Sam.

Sam Laidlaw - Chief Executive

Thank you very much Nick and good morning everybody. As you have heard the business performed well in the first half, delivering further earnings growth despite the weak economic environment. We are successfully delivering our Group-wide cost reduction programme and with a clear objective of sharpening the business and maintaining our competitive edge for the benefit of both customers and shareholders alike.

And we have made important strategic progress; driving long-term growth in British Gas with high levels of service, leadership in energy efficiency and innovation, together with a simplified energy offering; delivering a substantial increase in the size and geographic diversity of our upstream gas and oil business and crystallising value in offshore wind through our partnership model; and building scale in North America, adding customers in key markets and driving efficiencies, making good progress towards our target of doubling the profitability of the business.

And across the Group we are continuing to generate strong cash flows, deploying capital where we see attractive returns and delivering year on year real dividend growth - with a total increase in the dividend of more than 55% over the last five years.

In British Gas we have distinctive leadership positions in a number of core areas. And these have enabled us to maintain a stable customer base in competitive market conditions. The investment we have made in our systems and call centre technology is delivering real results. Contributing to improvements in NPS and enabling more efficient handling of customer calls and targeted sales efforts. We have now enrolled over 4 ½ million customers through our affinity programmes and we have upgraded our online offering, recording a 10% increase in the number of transactions with over three million customers now registered online.

And we are continuing to help our customers reduce their energy consumption with around 250,000 customers taking up our free insulation offer so far this year. We have now installed over 600,000 smart meters for residential and small business customers and see considerable benefit from our decision to go early in line with the strategy for the ‘Smart Connected Home’. And we continue to lead in our support for the vulnerable, once again significantly exceeding the levels required by Government with British Gas having the widest eligibility of all suppliers for the warm home discount. We are also simplifying our energy offering by launching a new bill design and a simplified tariff structure, all consistent with the objectives of Ofgem’s retail market review programme.

And in British Gas Business, while economic and competitive conditions remain challenging, we are taking to the opportunity to invest for the future. We have signed our first multi-year energy performance contracts working in partnership with our customers to deliver energy efficiency savings, a good example of growth in business services.

In British Gas Services we continue to see strong retention of our core products underlying the value customers place in our services, particularly in the tough economic environment.

Upstream in Centrica Energy our recent North Sea acquisitions have delivered a step change in the business taking us much of the way towards our 75 million barrel production target and transforming the scale of our Norwegian activities. Now that we have successfully achieved this we will focus on bringing reserves into production with over a billion barrels of 2P and 2C reserves in our portfolio. As you can see on the chart, Morecambe now contributes a much smaller proportion of the production, currently around 20% and falling to 15% next year compared to over 40% in 2010.

On our development projects, we expect to deliver around 140 million barrels of reserves equivalent into production in the next three years. We achieved First Gas at Ensign in May, with Seven Seas Atla and Rhyl expected to follow over the coming months. Our York project remains on track for first production early next year and at Valemon, part of the package of Norwegian assets we acquired from Statoil, construction is progressing well as you can see in this photo.

Significantly as a result of yesterday’s welcomed announcement from the UK Government, we are also now moving forward with the development of Cygnus, the largest field to be developed in the Southern North Sea in recent years.

In exploration and appraisal we have had positive results at both the Maria prospect, and the Cooper well, although still drilling, is looking very encouraging. We are also making considerable progress in offshore wind bringing Lincs online, working towards final investment decision on Race Bank and crystallising value by selling down a stake in our Round 3 permit in the Irish Sea.

In North America we are benefiting from enhanced scale and synergies with our successful downstream acquisition strategy delivering both growth and efficiencies underpinned by higher levels of service. We have also been able to add some 90,000 customers organically in the US North East during the first half of the year. We are having success with the launch of a number of innovative customer propositions. Our ‘Power to Go’ prepay product continues to attract new customers, enabling more people to take control of their energy requirements. And in the US North East we have introduced ‘Free Power Saturdays’ encouraging customers to take advantage of off-peak periods of demand. These products are welcomed by the regulators who are increasingly recognising the benefits that competitive markets can bring.

By contrast the market in Ontario is moving back towards re-regulation. And as a result we continue to face customer losses there. However much of the pain is now behind us with Ontario accounting for only £20 million of the DE residential profit in the first half. And we have taken firm action on costs halving our cost base in the region to protect our margins as far as possible.

Turning next to DE business, where we are delivering further organic growth. Electricity volumes were up 8% in the period. Much of the growth is coming in the small commercial business segment where we are making good progress with bespoke solutions and high levels of customer service. We have also seen strong renewal rates in the commercial and industrial market as we focus on reducing costs and continually improving our price competitiveness.

In North American services we are driving growth through our established On Demand business model. But we are also developing propositions to cross sell services to the energy customer base and over time to introduce service protection plans. In each case, building on our experience from the UK services market.

Upstream in North America the business continues to face a low gas and electricity price environment, although the price for liquids has remained relatively high. In power generation we have seen some recovery in spreads in Texas, but the market remains extremely volatile. We therefore optimised the running patterns of our CCGTs to capture the power price volatility.

Our £500 million Group-wide cost reduction programme is well on track with a little over half the savings expected to be realised this year. Our aim is to sharpen the business, maintaining a competitive edge while continuing to deliver high levels of service. In British Gas we are successfully delivering a reduction in the operating cost base, having taken challenging but wide ranging actions for which I particularly like to thank all our people for their willingness to embrace the significant changes.

Key initiatives include the cessation of our field sales activity, a pay freeze for all our employees, pensions reform and a restructuring of our services field management teams. And more recently we have announced the closure of our Southampton call centre together with some offshoring of roles within British Gas Business.

In Centrica Energy we are closing our loss making Kings Lynn power station with the future of Peterborough and Roosecote under review.

In North America we are achieving scale benefits both from organic growth and recent acquisitions and our cost structure will also benefit from the move of our Head Office to Houston.

So in summary we are taking significant action across the Group to reduce costs and sharpen the business. Whilst, very importantly maintaining the highest standards of health and safety and customer service to position us well for the future.

Turning next to our investment programme. As Nick set out we have a balanced business model with strong cash flows and attractive opportunities for ongoing capital deployment. In gas and oil we are investing some £900 million per annum delivering reserves into production and sustaining our reserve life. In offshore wind we are bringing Lincs on stream and are working towards final investment decision on Race Bank.

And in North America we are continuing to seek value added acquisitions further enhancing the scale of the business in competitive markets.

We also welcome the progress the UK Government is making on electricity market reform and in particular the recognition of the role of gas as part of the longer term energy mix for the country. We have a portfolio of options across a range of technologies. In offshore wind new nuclear biomass new build CCGTs and indeed gas storage. In each case we will only deploy capital in these longer term projects where we see attractive stable returns and a good fit for the business model. In this respect the clarity provided yesterday by the Government around the medium term ROC banding for low carbon technologies is helpful in informing our future investment choices.

So in conclusion, we have made good progress in the year to date delivering growth and sharpening the business to maintain our competitive position. We have achieved significant strategic milestones, broadening the geographic diversity of the business, delivering a step change in our upstream gas and oil portfolio and further enhancing the scale in North America. And this is all in the context of our distinctive integrated business model with a leading customer focus downstream business, strong cash generation across the Group and an attractive portfolio of investment options, delivering both growth and value for shareholders.

So with that let's open it up for questions.

Questions and Answers

Q1. Jonny Constable, Nomura

Hi, Jonny Constable from Nomura, two questions. Firstly could you give us your latest thinking on your investment options in terms of order of preference, can we take slide 27 at face value?

And secondly on your power procurement, I understand that you have a long-term contract with Drax that is due to roll off shortly, will you look into entering into any new power purchase agreements and would you rather buy price or spread?

Answer: Sam Laidlaw

Well let me just take the first one and maybe let Nick speak to the Drax contract. In terms of our priorities on investment options, we have always been very clear that this is actually about returns. In order to sustain the integrated model, clearly there is a level of continuous investment that we need to do in upstream gas production, purely because that is depleting. And what we have said is that actually the long-term target is around 75 million barrels and we are as I said in the presentation, close to that. So we are getting close to being broadly balanced for the UK. So therefore the options are do we invest in low carbon generation in the UK? Do we invest in gas fired generation in the UK if there is a capacity payment mechanism in place? Do we continue to invest in blocks of customers in North America? Or do we continue to strengthen the integrated model in North America? It will depend on the returns. The ROC banding is helpful providing some clarity for some of the intermediate decisions. So we now know what wind and biomass are going to be, if they are sanctioned between now and EMR. And we will be making decisions as to whether the ROC banding is sufficient for our investment hurdle rates over the next few months for wind in particular with Race Bank as our next wind project. But we don't have a priority in the sense of saying we must do this particular technology or that particular technology. It will be entirely functional of the full cycle returns and the anticipated volatility of those income streams, because what we are trying to build here is a portfolio of investment options that has both rapid payback opportunities such as near term gas development opportunities together with some longer but inevitably exposed to the commodity price together with some longer opportunities that may have less exposure to the commodity price because they have an element of support mechanism in place, and the returns will determine the priorities.

Answer: Nick Luff

On the Drax contract Jonny, we actually have two contracts with Drax, one that comes to an end at the end of this year and another one that stretches out into 2015. I would point out that since we did the first one of those we have bought into the British Energy stake and therefore have a big offtake from that, but what matters to us clearly is the overall cost of electricity that is our input cost for our customer base. So we will look at what the most cost effective way of sourcing that electricity is and whether that is buying a spread and then buying some coal and hedging the carbon or doing something different, we will make that commercial judgement.

Q2. Iain Turner, Exane

It's Iain Turner from Exane. You went through a list of lots of investment options. One of the things you didn't talk about was further upstream acquisitions. You've obviously hit your target now in terms of the kind of size of upstream business you would have but is acquisition of further stakes in the North Sea something you would consider?

Answer: Sam Laidlaw

I think what we are saying Iain is that we are now getting close to being well balanced. Inevitably with the broader portfolio we have got now, you would expect us to continue to optimise that portfolio. There may be bits that we sell out and bits that we bring partners into in addition to bits that we may wish to top up. But we are not signalling a massive further step change, because we think we have a reasonably balanced model and we want to get returns out of the investment that we have already made and I think that is very important. You know, we continue to seek ways in which we might integrate our North American business better if we can do that for value, but the challenge with low commodity prices is that we are not seeing attractive short term returns. So I think you know you never say never if there is a hugely attractive opportunity, but based on the other priorities we have got, we think we are pretty well balanced.

Q3. Rob Chantry - Berenberg

Just two questions on UK downstream. Firstly in British Gas you have a slight decline in customer numbers, I just wondered if you could elaborate on competitive pricing pressures - why you are losing customers and who you are losing them to, and if that would impact your pricing decisions later in the year.

And secondly on services, I just wondered if you saw any big opportunity or light on the horizon. You have got product holdings pretty much flat since the end of December, looking obviously for 10% EBIT growth this year, which is just kind of a bit of revenue, a bit on cost. Is there any potential big opportunity on the horizon that you are working on or is it more just grinding away? Thanks.

Answer: Sam Laidlaw

I think in terms of British Gas business, some of the loss of customer accounts unfortunately is a function of businesses, particularly SMEs actually ceasing trading. So that is a component of it. We are seeing it as also being a more competitive market. I don’t think it is appropriate to comment on who we think are the most aggressive out there at the moment. But I think people are definitely shopping around more and we reference that in the statement. One of the things that we are working on, and Phil may wish to speak to this, but we have a big systems investment going on in BGB which we think will enable us to segment our customers much better and offer a higher standard of service as well.

Further answer: Phil Bentley

I think we are seeing pressures to deliver more than just a commodity and that is why we are branching out into services and the relationships we have to embark on energy efficiencies the way we do in domestic homes, in the same way in businesses, is going to be the way forward. We have invested a lot in service in systems in BGR as you know and that is probably why we are leading the way now in so many areas. In BGB we haven’t invested as much and that is why we need to address that to get service up at a similar level that we are seeing in BGR.

Answer: Sam Laidlaw

I think I may have misunderstood your question. Was your question about BGB or about BGR?

Further question

Well a bit of both really. BGR as well, quite a big focus. I know you have seen the likes of Eon coming in for instance, is there any indication on what you might do with prices later in the year? I know you don’t commit to that, but...

Answer: Sam Laidlaw
You know, as you are aware we have the cheapest electricity offer out there, but despite some very competitive offers by some of our competitors on gas, the fact that we have actually, due to our service in some of the differentiating attributes that Phil has just described, we have actually managed to keep our customer base flat for the year to date. So I think that is a good story.

Further answer: Phil Bentley
Just one point there was a small reconciliation at the end of the year which was about 40,000 customers. Every time there is an industry true up, we didn't bother restating which is why that year end to half year looked worse than it is. The only real losses we saw were at the very end of the first half in BGR which was around the big switch where as you know Co-op came in and a number of others. The new entrants have an advantage at the moment over us because they don't pay social obligations and they don't pay environmental obligations. But once you get over 100,000 and 250,000 customers they get those obligations placed upon them. So it kind of keeps them competitive below that level, but once they get above that level they have the same cost base as the rest of us. So I don't see that as a major threat.

Answer: Sam Laidlaw
And your second question was around services growth. The answer is we are continually, I think you saw good bottom line growth in the first six months, but in this economy undoubtedly a large element of it is grinding it out in terms of cost base. We are getting some top line growth as well, particularly on service and repair which is a high value proposition which is good to see. So I think despite the economy we are still managing to achieve top line growth, but a lot of it has to come from continued improvements in productivity and cost reduction.

Further answer: Phil Bentley
It is installations where we are struggling for volume because people won't spent that for the big ticket items.

Q4. Martin Brough, Deutsche Bank
Hi, it's Martin Brough from Deutsche Bank. Can I ask a little bit about your experience so far with the smart meter rollouts and the 'Go Early'? Because, I think, you originally talked about maybe spending up to £350 million by the end of 2012. Obviously the whole timetable has probably been pushed out a little bit. How do you see recovering the money you have spent so far? And in terms of managing the relationship with customers through the process of getting smart meters into their homes, is it easy to make them informed customers about their choices and the costs and benefits for what is in theory a sort of competitive activity, where you do want to be recovering the costs over time from those customers I guess?

Answer: Sam Laidlaw
And I guess the answer, the short answer is we are recovering the costs, but Phil do you want to speak to the progress we are making which I think is good progress?

Further answer: Phil Bentley
Yes, I mean the meters we are putting in at the moment, a lot of these are replacement meters because it is a clapped out one and we are making the decision rather than putting a dumb meter in that you have got to rip off by 2019, we might as well put a smart one in. So, we have now got clarity from the Government in terms of what is called a smart compliant fully recoverable meter and those are meters that we will start rolling out.

We find churn in customers that have taken a smart meter from us lower than the average base. And that would imply to us that they like the fact that you have got an accurate bill, you only pay for what you use and you don't have to worry about having meter readers knocking on your door. So I think it is the future.

And the other point of the story and why we went early is that we believe it is still a good opportunity to generate leads for green deals and ECO when you are in the home with the customer and that is a huge initiative that is coming round the track from Government and that is one that for us having a national footprint of engineers we feel competitively advantaged to make the most of. So we are seeing the cross sell, its not direct selling, but lead generation during the visit and the installation of smart meter better than we expected.

Further answer: Sam Laidlaw
There is definitely more demand pull than consumer resistance here. I think people recognise that particularly as Phil says, if they are having their meter replaced anyway, they would much rather have one that will give them additional functionality.

Q5. Gus Hochschild, Mirabaud Securities
Gus Hochschild, Mirabaud Securities. Two questions if I may, firstly with regard to Docking Shoal and the failure to permit not being granted for that project, is it therefore dead in the water and hence now you are focusing on the development of the Irish licenses or is there some form of process that could review that consent?

Answer: Sam Laidlaw
We have the option available to us to appeal the process. But we are really moving on and focusing on the Race Bank project which is the most immediate one. We have got a large, as you rightly identify, large tract of 4.2 GW potentially in partnership with Dong in the Irish Sea where we will also, we are going through the planning process there. We were obviously disappointed by how long it took in terms of the outcome on Docking Shoal. We will consider our legal options, but actually it is not critical to the development of our wind portfolio because we have got such a lot of other opportunities to invest in if we want to. And then the question is, will they be under the ROC banding regime or more likely given the timescales involved, they will be dependent on the EMR and CFD regime.

Further Question
May I also ask with regards to this shallow water tax break, could you perhaps explain to us the rationale, I know it is the Government's thinking and not your thinking, of why coming up with this perhaps rather arbitrary 90 ft ruling and yet it is not ungenerous with the £500 million barrier?

Answer: Sam Laidlaw
Well I think what has undoubtedly happened over the last twelve months since we had the increase in supplementary corporation tax eighteen months ago, is there is a much closer dialogue between the industry and the treasury and DECC about how we can extract the remaining reserves from the North Sea and you saw the West of Shetlands being given allowances. You saw some heavy oil projects being given allowances because they were technically challenging. And in shallow water because of actually the very high construction costs because you can't get heavy lift barges in, that is also a significant technical challenge on the cost of those projects. And therefore given the economics of those projects it was felt that they should be suitable as well. I think it is also recognition I think of the fact that gas has an important role to play in the energy mix going forwards and that actually security of

supply of gas is important in getting the remaining reserves out of the North Sea and is an important component to our supply picture going forwards.

Q6. Fraser McLaren, Merrill Lynch
Hi, good morning it's Fraser McLaren from Merrill's. May I ask about when you locked in the value of your emissions permits for this year with a view to thinking about the magnitude of the hit next year which you refer to in the statement? Thanks.

Answer: Nick Luff
That's a good question Fraser, we did lock in the value of free carbon allowances some time ago, so it is £80 million plus of value in this year's numbers that you will have to take out next year. So the CCGT current spark spreads will be loss making next year.

Further answer: Sam Laidlaw
Which I think is by no means unique to us. I think if you look across the industry and you see that in some of the closures that have been occurring with CCGTs, you know the disappearance of free carbon allowances for the power generation sector particularly those with higher carbon intensity power generation is going to clearly have an impact on profitability next year.

Q7. Ashley Thomas, SocGen
Hi it's Ashley Thomas from SocGen. Just a follow-up on field allowances. So we have had the positive from shallow water, could you perhaps give us an update on discussions with the treasury regarding brown field allowances and whether you remain optimistic that the industry could achieve both?

Answer: Sam Laidlaw
Those discussions are still continuing and there is nothing to suggest that the two are mutually exclusive, so they are still continuing, but I think it will be wrong to pre-judge the outcome. But they are still ongoing.

Further answer: Nick Luff
Shallow gas is much more important to us than brown field.

Further question
Sorry second question. It is just on Morecambe and the quality of gas issues. Are you confident that that is now resolved presently or is it something that you are confident can be resolved in the second half?

Answer: Sam Laidlaw
No, we have now installed a pipeline, we've re-commissioned effectively a pipeline that connects the North and South terminal and that basically enables us to achieve the blending that we need to do to meet the national grid specs. So we should see significantly improved reliability in the second half.

Q8. Andrew Mead, Goldman Sachs
It's Andrew Mead at Goldman's. I have two questions on North America. I will ask them one at a time to make it easier. In terms of doubling the profit, I think you originally said that was partly acquisitions and partly organic. Given you have made quite a few acquisitions including the New York one recently, are we there now in terms of acquisition growth to hit that target?

Answer: Sam Laidlaw
In terms of the acquisitions, we are well on track for achieving that target which I think when we set it out we said was going to be about half and half organic and acquisitions, and I think that has been born out. The headwind that we have clearly had which we didn't anticipate at the time when we set out the target was the Ontario market and to some extent we have also had the headwind of lower natural gas prices in North America, obviously also impacting the upstream business. But despite that I think we have overcome that through the organic growth that we have achieved, the cost reduction initiatives which will continue, and the acquisitions that we have made. We will continue to look for bolt-on acquisitions of customers because actually if we can buy them at low multiples, put them on our platform, retain the customers and extract significant synergies, that has proven to be a very good model.

Further question
Will that mean therefore that if those came through they would be taking the outlook beyond the two times?

Answer: Sam Laidlaw
Yes I would expect that when we achieve the two times target, we will reset the target and move the game on.

Further question
My second part of the question on North America was, you have made the acquisitions, particularly on the retail side, you are saying and I understand it is difficult to make upstream acquisitions, you got through last year's heat wave in Texas without too much damage, clearly it is quite hot in the North East at the moment. As that customer base has grown, is that applying more pressure to get that hedge in place or is there enough liquidity in the market in your view to cover those risks even with the bigger customer base you now have?

Answer: Sam Laidlaw
Well there is enough liquidity in the market, but actually, if you have a big spike up in prices, and we saw that last year in Texas where it was particularly hot, you know and prices went to several thousand dollars a MW, then you know in those circumstances if you have got to go out and cover that in the market, even if there is the liquidity it is going to be very expensive. So you need to find other mechanisms for covering that risk off, which were able to do. We still think we are able to do, but there are clearly advantages in those circumstances of having power generation. You have got to make sure the power generation is running, otherwise you are in a worse situation than some of our competitors. So there is an advantage in a structural hedge in power generation. There is also a collateral benefit in that you require less credit clearly if you are buying some of the energy off yourself. And that is beneficial, but it has to be done for value.

Q9. Lakis Athanasiou, Independent analyst
Lakis Athanasiou, Independent analyst. Can I just focus on UK upstream. First question is do you anticipate much in the way of organic additions to 2P reserves this year? I am thinking particularly Norway, likes of Butch, Maria, Fogelberg? I see also coming to the UK side, you have got Annabel East there as producing. I am not sure but I don't think it was on your 2P reserves in 2011, I could be wrong on that. So what do you expect and where do you think those additions could come through for 2P reserves in 2012?

And secondly, just following on from what Iain asked earlier about your strategy in upstream, clearly the Statoil acquisition was big, it was value destructive of the value of 2P level with the justification being it enhances your ability and gives you access to 2C reserves, massive justification for it, versus the Total, Statfjord acquisitions. Are you saying you are not going to go further for the Statoil stuff in the future and that you have satisfied your appetite there and it is really going to be more the Statfjord type, Total type acquisitions?

Third question, coming down to Trinidad, would I be right in assuming that the development costs in Trinidad once you go ahead would not be tax shielded once you are spending the Capex as they would be in the UK and Norway?

Answer: Sam Laidlaw
Why don't I let Mark take the reserves one and I will take the one on acquisitions.

Answer: Mark Hanafin
So clearly I can't tell you what the reserves will be at the end of the year, but the ingredients of it, starting point at the beginning of the year for 400 million barrels of 2P, we have added about 165 from the three deals that you mentioned. We have then got estimate 57, 58 million barrels to come off in production. And then there are lots of ups and downs as we relook at the various fields, the usual adjustments. But in terms of some of the bigger ones, you have seen mentioned about the Maria North appraisal wells coming very well. That probably means the 16 million that we have from Maria goes up by another 9 or 10. We are still working on that, but that is kind of the indication. We have got strong results we think at Cooper, but anything that comes through on exploration is likely to be in the resources area rather than the 2P area. So those are the big elements.

And on Trinidad, yes you are correct it would be a production sharing agreement type arrangement rather than tax allowances.

Further answer: Sam Laidlaw
But I would just add that the structures we are looking at on Trinidad actually involve quite extensive partnership where we would only be putting up a small amount of the capital.

I think your second question Lakis was around Norway. Implicit in that I think was an assumption actually that the Norwegian acquisition you felt wasn't delivering much value at the 2P level. I would take issue with that in that I think actually if you look at the Kvitebjorn Production, it is certainly running ahead of the investment case at the moment. So as with all exploration production acquisitions, you have to see over time how it does, but so far it is performing well. I think if we do continue to trim and top up the portfolio as we talked about earlier, then I think it is likely to be around more production assets and near term development assets rather than very long-term assets because we have actually improved the organic quality of our exploration portfolio and we have got things like Butch and Maria and possibly Cooper and things in the portfolio to develop, so we don't need to go and buy those.

Q10. Jamie Tunnicliffe, Redburn
Jamie Tunnicliffe from Redburn. I think you have got two CCGTs in the UK which will remain under STOR contracts which I think finish in Q1 next year. If things remained as they are, are they pretty likely to be closed as well?

Answer: Sam Laidlaw
Yes, so we have got two currently that are not in the STOR market which is Roosecote and Brigg – sorry and Peterborough, I beg your pardon. And we have got two that are in the STOR market and we will see how obviously whether they continue to remain in the STOR market at the end of the year and what the outlook is. If they are not successful in bidding in the STOR market then they would be under review for closure as well.

Q11. Edmund Reid, JP Morgan
Ed Reid, JP Morgan - two questions, first is on gas storage: given the government's increasing appetite I guess for gas do you think that they would increase incentives for new gas storage? And the second question on CCGTs, seems a strange question to ask when you are closing them but going forwards what would you need to build new CCGTs?

Answer: Sam Laidlaw
I will take the one on gas storage and if Mark can take the one on new CCGTs. In terms, as part of the holistic gas strategy, clearly gas storage has an important role to play. Ofgem have conducted a consultation process about what would it take to get gas storage going. We have made a submission to that with some suggestions. That now is going to DECC for review and we will see what comes out of that. I mean our view is that if capacity payments are going to come into incent new gas fired power stations then there is no point in having a capacity payment for a gas fired power station that doesn't have the gas. So it needs to be a holistic view looking at gas storage as well. And I think there is some market mechanisms that can be put in place to actually help incent storage.

Further answer: Mark Hanafin
I should have been listening more carefully Ed, the second part of your question was, what is it going to take to build?

Further question
To build new CCGTs?

Answer: Mark Hanafin
Well it is tough at the moment. You know 2013/14 we are looking at £2 a MWh spark spreads maybe improving to 3 or 4 at the end of 2014. That is a trend we are going to see through 2015/16. Maybe £6-7 in 2016. You know you need 8 to 10 really for a new plant to give you 10% return, that is why the capacity in a mechanism is important. We are going to need to see revenue for gas generation coming from not just energy but also from capacity because of intermittency. So on current conditions and market I don't think we could build anything or anyone else could, but let's see how the market develops.

Answer: Sam Laidlaw
I think most people in most of the industry are, with one exception, in favour of capacity payments as being a necessary measure to get new CCGTs built.

Further question
Do you have any preference for the mechanism in terms of an auctioning system and so on?

Answer: Sam Laidlaw
We think it should be an auctionary system.

Q12. Peter Bisztyga - Barcap
If we go back to the older CCGTs obviously capacity mechanisms seem to be coming in and Ofgem was speaking last week about how they would like to see it coming sooner rather than later, does that have any impact on your decision to close these stations because obviously they are potentially capable of providing capacity at some point in the not too distant future if it is going to be rewarded?

Answer: Mark Hanafin
If you have got a spread as we have of efficiency right from the very top of the merit order through to the bottom, you have got to take a view even in a world where you have capacity payments, are those very small plants going to be rewarded and you have to look at their flexibility and capability to operate in the meantime. If a capacity mechanism came in tomorrow and it was auctioned, I assume that the clearing price would be pretty close to zero because the country doesn't need capacity today. So for a number of years that won't make a big difference. So we have got a judgement to make around where do those plants sit. And the ones that are under threat of closure have really been pushed well along the merit order by the new plants that are coming on. So the whole merit order has shifted and you know we felt that at Kings Lynn the overall NPV of that favoured closure.

Sam Laidlaw
We have two supplementaries now so we will go with Lakis

Q13. Lakis Athanasiou
Lakis Athanasiou again. Just following up on the CCGT question. I may be wrong, but I just get the impression that Government may actually split the capacity mechanism into short term for existing and long-term for new. Now, and just restricted to new. Now if that happens you are going to get significant value destruction in existing plants. It will hit your existing CCGTs including the new ones, it will hit new nuclear. Do you share those concerns?

Answer: Sam Laidlaw
We haven't heard that being positive, I haven't heard that being positive so I think if you did start to split it clearly then you do have winners and losers, between those who have recently invested a lot in power generation and those who haven't. But that…

Further question
There was a phrase in the EMR which said, if new build comes in from now we will treat it as new in the capacity mechanism which just sparked off alarm bells in my mind.

Answer: Mark Hanafin
And you have hit the point that if you introduce a capacity mechanism and you give it to new plants then it completely distorts the market, so we would need to take a look at that and make sure we got the right answer.

Sir Roger Carr
Good, clearly a trained lawyer there. Right supplementary there.

Q.14. Martin Brough – Deutsche Bank
Hi, Martin from Deutsche again. Just a quick question in terms of gas procurement. Obviously you have a lot of your own production and development options. In terms of getting new therm gas delivered to the UK on a long-term basis, do you think you would need to sign oil-linked contracts to get that whether it is LNG or pipe gas? And

could you get some short-term deals and a bit of volume at NBP prices. But if you really wanted to compete with the Asians in buying long-term committed gas to be delivered to the UK, would you be willing to sign some sort of oil-linked contracts if that was required to get the gas committed?

Answer: Sam Laidlaw
The short answer is Martin, we wouldn't. If, because we believe that actually you know the UK obviously we have to buy gas at a price that is competitive with the UK market in order to resell it in a competitive market. So and I think the principle suppliers that we talk to understand that imperative from our point of view. Our discussions with various gas buyers continue and they continue on the basis of a UK NBP related price mechanism rather than an oil price mechanism. So, so far we are able to continue to do that. Now to your point, that might restrict the ultimate length of the contract, but I think that is a better thing to do than to lock in very expensive gas for the future.

Sir Roger Carr
Very good. No more questions. Record time. So another record logged up for the UK. Everybody have a very good summer and we will see you after the holiday period, thank you.

End of Presentation