Centrica plc preliminary results announcement – 16 February 2022

Transcript

Chris O'Shea, Centrica
As always, I'm joined today by Kate Ringrose for our last results as Centrica's CFO. Before we start, I'd like to pay tribute to Kate's achievements during 20 years at Centrica and to personally thank Kate for the unstinting support that she's given me during my time, both as CEO and as CFO. Kate leaves with our very best wishes for the future.

As you can hopefully see, you're well covered today. We're joined by our Chairman, Scott Wheway, most of the leadership team, including Russell O'Brien, our new CFO. I know Russell's broad energy experience will be a huge asset to us, and I'm really looking forward to working with Russell in the coming years. I'm not sure what the collective noun is for a group of CFOs, but there is a free Hive, which will have to come in the mail because we don't have it with us, for the most creative suggestion at the Q&A session.

In total today our presentation will last around 30 minutes, and then we'll be delighted to take your questions. We're making strong progress in delivering our strategy, and today's results demonstrate the benefits of our balanced portfolio, with complementary activities across Retail, Optimisation, and Infrastructure. This has allowed us to successfully navigate what I'm sure you'll agree was a somewhat challenging time for the energy sector in the past 12 months or so. We've now got the balance sheet, the capability, and the assets to play an important role in the energy transition and in the journey to net zero.

In Retail, we continue to invest in improving customer service and in future-proofing these businesses to enable us to capture the huge opportunities from the essential decarbonisation of homes in the UK and in Ireland. We're also managing elevated and volatile commodity markets particularly well, capturing value from our optimisation positions and our capabilities. Our infrastructure assets delivered strong uptime, leading to higher volumes and higher profits. The outcome was the best-ever financial results in our 25-year history. Earnings per share increased to 34.9p. Free cash flow doubled to £2.5bn and we closed the year with £1.2bn of net cash.

Although the 2022 results were strong, we did see a poor result from British Gas Services and Solutions. After years of underinvestment and action more focused on in-year profits than long-term value, we've been investing in the infrastructure underpinning this business, investing in our people, investing in our systems, and investing in our customers by absorbing the impact of inflation. We're putting in place the right foundations for the net zero world, which is definitely coming. We've now reached the point where we need to grow out of this situation in services, but having stabilised the operations, I'm really confident that we're able to do that.

The strength of our balance sheet and the financial performance means that we're delivering cash returns to shareholders again, with our proposed final dividend of 2p making the full-year dividend 3p per share. We're now over 40% through the £250m share buyback programme announced in November. I'm very pleased to announce today that we plan to extend the program to buy back a further £300m of shares. At the current share price, before we opened this morning, this would result in us buying back roughly 10% of stock in total under this programme.

We're acutely aware of the impact this current environment is having on customers and on colleagues, and we're going to continue to do what we can to support them. For customers, we've invested well over £200m in customer service, support, and pricing across 2022, including more than £50m in voluntary support for domestic and business energy customers in the UK and Ireland. We believe this is the biggest ever energy support package in those countries and we've committed to donate 10% of both British Gas Energy and Bord Gáis's profits until the current crisis is over because protecting vulnerable customers is a priority for us.

That's why I was really disappointed by the allegations from a couple of weeks back about one of our third-party contractors and their approach to our prepayment customers. We immediately took action to address this, and we're completing a thorough investigation.

We've been working to make sure that customers have gas and power when they need it, with a multi-billion pound deal with Equinor to increase gas deliveries to the UK and the reopening of Rough as a gas storage facility.

Without our dedicated colleagues, however, we would be nothing, and that's why we're supporting all of our 20,000 colleagues during challenging times. Pay deals have taken prevailing inflationary pressures into account, including two significant one-off cost-of-living payments. We've worked hard to reset the relationship we've got with our colleagues, and I was really delighted to see another significant increase in colleague engagement to 73% – that's almost double what it was less than two years ago – because engaged colleagues means better customer service. Part of this is undoubtedly down to the fact that we're growing, that we're creating jobs, with 1,000 new apprentices across 2021 and 2022, and 700 additional UK-based customer service roles in British Gas Energy to improve answer rates and to improve customer service levels.

Last but not least, we take our responsibilities to our communities really seriously, providing £130m of support to vulnerable customers through the Warm Home Discount scheme, repaying in full the £27m received in furlough from the UK Government, and we're going to pay around £1bn of tax relating to 2022 profits.

Right at the start of the journey, we set out three overlapping phases to our turnaround, and I'm delighted with the progress that we're making. We completed stage one in the first half of 2022, with the sales of Direct Energy and Spirit Norway together raising $5bn. We're now in a net cash position. We've removed more than £1bn of decommissioning liabilities, and our pension liability has been materially reduced.

We're now well into phase two. We've fixed the basics, and the focus can move to continuous improvement and delivering growth. I'm never going to be happy with operational performance because there will always be room for improvement, but we are so much better than we were.

We're now increasingly turning and engaging to phase three. The opportunities presented by net zero for our business are absolutely huge. We've talked before about our capabilities in Energy Marketing and Trading and how increasing system penetration of renewables and the resultant intermittency in electricity play to our strengths. We have the know-how to facilitate both our own and third-party net zero investments, and we're progressing a number of flexible distributed generation and storage projects, in addition to progressing the material options we have to repurpose existing assets into net zero infrastructure, supporting the energy transition.

Now, I'll be back in about 15 minutes to provide a bit more detail on our progress, but for now, I'm going to hand you over to Kate, who's going to walk us through the financials.

Kate Ringrose, Centrica
Thanks, Chris, and good morning, everyone. Let me move straight on to the results.

Financial performance was strong in 2022, demonstrating the virtues of our balanced portfolio. Revenue and gross margin increased, reflecting strong operational performance against the backdrop of higher commodity prices. Operating costs increased by around 400m, largely reflecting a £235m increase in the bad debt charge, specific in-year financial support for customers and colleagues, and the furlough repayments.

Adjusted operating profit was up significantly to £3.3bn, of which half a billion related to the disposed Norwegian Spirit Energy assets. Net finance costs reduced as we earned more interest on our gross cash position, and the group tax charge increased to over £1bn, reflecting the increase in operating profits and increases in upstream tax rates. This resulted in adjusted earnings per share of 34.9p or 34.2p when the disposed Spirit Energy assets are excluded.

Moving now to operating profit, where I'll start with Retail. We saw a poor result from our British Gas Services and Solutions business and reported a small loss. While customer retention was marginally higher than in 2021, sales remain challenged against the weak economic backdrop, and some customers have been trading down to lower-priced servicing and installation products. This, coupled with investments in both service and pricing, impacted the bottom line. We are continuing to invest in the efficient delivery of better service for customers, as well as the longer-term opportunities from the decarbonisation of heating in the UK. We expect to start seeing the benefits of these investments in 2023.

Moving to British Gas Energy, where operating profit reduced to £72m. This reflects the choices we made to repay furlough money and support vulnerable customers against the backdrop of high commodity prices. The high and volatile wholesale prices, weather patterns, changing customer consumption, and regulatory interventions during cost-of-living pressures were complex factors through 2022. However, we managed the risk around these well, with the impacts broadly balanced from a financial perspective.

Finally, for Retail, Bord Gáis Energy demonstrated the value of a vertically integrated business model in Ireland, with the loss in the energy supply business due to the investment in customer pricing and support offset by good trading performance and strong availability from the Whitegate CCGT, which was offline for most of 2021.

Next, on to Optimisation. Energy supply was the driver of the significant year-on-year improvement in Centrica Business Solutions' operating profit to £44m. This reflected a recovery in demand given Covid was still a factor in 2021 and upside from selling back surplus gas and power into the markets in periods of warmer weather. However, we did also drive a reduced loss from the services part of the business, reflecting improved commercial focus and lower operating costs.

Moving on to Energy Marketing and Trading, which is well positioned when commodity prices are high and/or volatile. We deployed more working capital against this backdrop and were well rewarded with operating profit of £1.4bn. We delivered material profits from each of our gas and power trading, route to market, and LNG shipping and trading activities. We have a good track record of delivering returns in much more benign commodity environments in gas and power trading, but significant price dislocations between markets and volatility and seasonal spreads meant we delivered material incremental value in 2022 from our contracted pipeline, interconnector, and gas storage positions across Europe.

As we talked about in our teach-in in December, our route-to-market activities deliver a sustainable base level of profit that also benefited in '22 from the higher price environment. In LNG, even though we typically sell cargoes forward at least a couple of years, large differentials between US and European gas prices provided opportunity to capture additional value. We have now sold forward all cargoes for 2023 and 2024 at a profit.

It is also helpful that the historically painful legacy gas contract for Sole Pit is nearing its end of life. In 2022, it contributed a profit of £19m and at current forward commodity prices, we now expect it to lose around £100m in total before it ends in 2025. This is an improvement of £50m from our expectation at the interims last July.

Moving on to our Infrastructure businesses, and after excluding the disposed Spirit Energy asset, pre-tax operating profit was £1.3bn. The retained Spirit assets delivered operating profit of £245m with gas production up 3%, reflecting strong operational performance at Cygnus and Greater Markham and higher achieved prices, despite the impact of forward hedging. This was partially offset by higher depreciation rates as a result of impairment write-backs last year.

Centrica Storage operating profit increased to £339m, largely due to strong returns during periods of gas price volatility in the fourth quarter, with Rough now operational again as a gas storage facility.

Nuclear reliability was much improved, which resulted in a 5% higher volume year on year, despite the end of generation at Hunterston B and Hinkley Point B. Operating profit was £724m, reflecting higher achieved prices.

Finally, in 2022, we initiated a global profit share award for all colleagues, so they could participate in our success and to encourage colleagues to drive future performance. The total cost of this in 2022 was £23m.

Moving to cashflow. EBITDA was up by over £2bn, which is the main driver of increased tax. Including amounts paid so far in 2023, we have paid almost £1bn in tax related to 2022.

We deployed around £600m of working capital in the year, which is largely a function of high commodity prices and market volatility. I will briefly outline the big-ticket items. In British Gas Energy, we saw an inflow of £1.1bn. Given higher prices, we would normally expect an outflow, as we typically pay for commodity in advance of receiving payments from customers. However, the introduction of both the Energy Price Guarantee and Energy Bill Support Scheme in the second half of 2022 actually resulted in us being paid quicker than under standard consumer payment patterns.

Offsetting this was a £1.2bn build of working capital in Energy Marketing and Trading, driven by our investment in gas inventory for our storage and LNG positions and unrealised profit on derivative positions. We also invested £0.4bn of working capital in Rough as we injected 16 bcf of gas into store. While we would expect these positions to reverse over time, movements in working capital can be material, and commodity prices are moving as significantly as they have over the last 18 months. Hence, the importance of a strong balance sheet and cash flow flexibility.

Underlying capex increased as we invested in flexible generation assets, and we would expect capex to ramp up again in 2023. Exceptional cash flows relate to the substantive close out of our 2020 restructuring program. Overall, free cash flow from continuing operations was £2.5bn, up from £1.2bn in 2021.

Switching to the right-hand side of the slide, the most significant movement is the £1.2bn outflow in margin cash. In an elevated and volatile commodity price environment, initial margin requirements are greater, and the likelihood of large variations on variation margin are also increased. This margin cash is the cash held on exchange or with counterparties to support both trading and hedging positions.

We returned over £100m to Centrica shareholders in 2022 from both the restart of the dividends and the share buyback program. We also paid a £273m dividend to our Spirit Energy partners – their share of the proceeds from the Norway disposal. The net impact of all of these movements was the closing net cash position of £1.2bn compared with £680m at the end of 2021.

Our balance sheet is far more robust now than it was a couple of years ago. We showed a version of the chart on the right last July, and we've updated it for the end 2022 position. In September 2022, we finalised the triennial pension agreement with a March 2021 technical deficit valuation of £944m and unchanged deficit contribution. On a roll-forward basis, that deficit now stands at around £850m, compared with £2.4bn less than three years ago. We've also delivered material reductions in decommissioning liabilities.

This improved position underpins our strong investment-grade credit ratings, important for our energy procurement, asset hedging, and EM&T activities. As I highlighted at half-year, a core capability in managing our business risk is how we balance the trilemma of market credit and cash liquidity risk. Our strong balance sheet and robust liquidity ensures we can manage this effectively and capitalise on any opportunities which arise.

During periods of extreme commodity price movements over the last couple of weeks in August, we saw margin cash outflows of over £2bn across initial and variation margin. However, our liquidity levels at their lowest point were still around £5bn, and a large portion of the outflow quickly unwound as commodity markets settled.

We did opt to temporarily increase the size of our committed facilities by £1.1bn, expiring in mid-2023, as market illiquidity was impacting commodity prices, and other participants were relying on government support. This is reflected in our current liquidity levels of £7.6bn. With uncertainty regarding future levels of commodity prices and volatility, we will maintain a prudent balance sheet that provides us with the cash agility, resilience, and the ability to respond to opportunities as they arise.

Finally, let me move on to cover the outlook for 2023. As always, there are a number of external factors outside our control, in particular, weather, commodity prices, the economic backdrop, and any changes to regulation or government policy. This results in a range of outcomes for many of our business units. However, we've put a lot of focus over the past few years on creating a balanced portfolio and improving the foundations of the group, leaving us well placed to profitably manage a range of external environments. We have also developed good growth options, and we expect capital expenditure to increase in 2023 compared with 2022.

In Retail, we will continue to invest in further improvement in our operations, in services in particular. Our focus is also on improving commercials performance, and we'll be looking to drive some financial recovery in 2023. In Optimisation, although we do not plan for 2022 conditions to repeat in 2023, we have sold forward LNG cargoes at a profit, and where volatility is a factor, our strong capabilities and contractual positions should enable us to capture value in physical storage, pipeline, LNG, and generation offtake. We expect to continue to invest working capital in this area.

For Infrastructure, although wholesale commodity prices have been falling since towards the end of 2022, they remain elevated compared with historic levels. As hedges roll off, we expect to see higher captured prices in our gas production and nuclear activities. Albeit earnings will be significantly impacted year on year by the implementation of additional upstream levies. As we've done before, we've provided our hedging positions in the table on the right, which you can use to construct your Spirit Energy, Centrica Storage, and Nuclear forecasts.

Thanks. Now, I'll hand back to Chris.

Chris O'Shea, Centrica
Thanks, Kate.

Ok, so what does the future hold? Maybe I can remind you of how I see Centrica today. We are a uniquely integrated energy company, able to unlock synergies across Retail, Optimisation and Infrastructure. We've got a diverse and balanced portfolio. The strength of each of our focused business units reinforce and de-risk others, making the whole greater than the sum of the parts.

As we have recently seen, our markets are rather dynamic. Our simplified organisation allows us to respond quicker than competitors. We have a very short chain of command. We're market-led. We won't invest material sums into primary research and development. We will, however, continue to invest in our proprietary optimisation technology and we will deploy new technologies faster than our competitors can do it. And of course, we will only invest where the risk is compensated by the returns available.

We have growth opportunities across the entire energy value chain. We can choose where to invest, and we can change the mix dependent upon our circumstances. We have choice, we have flexibility, we have the ability, we have the capital, and we have the discipline.

In British Gas Energy, we're improving our operational performance. We've materially accelerated customer migration, with more than 2m now on our new IT platform. We've bolstered customer service capacity through recruitment, and we're seeing higher customer net promoter scores. As you can see here, net promoter score is materially higher on our new system. It's a better customer experience.

Our underlying cost per customer remained flat despite the impacts of dual-running IT costs and inflation. Remember, we no longer exclude transformation costs from our results. We're growing customers organically for the first time in many, many years.

All of this has come whilst managing the operational requirements of bringing on over 700,000 new customers under the supplier of last resort mechanism and implementing new customer support schemes. We've made over 35m individual payments under one government bill support scheme. Catherine and the team have done an incredible job.

But we've also got our eyes on the future. Our Peak Save trial launched in early 2023 is enabled by the new platform and by its flexibility. We're excited by the response of our customers, and our offering is the best on the market. It pays energy consumers more than any other company. We'll increasingly bring demand-side response offers to our smart meter customers over time. This is the future of the electricity market.

As we go through the energy transition, our regulation, however, must evolve, along with the evolution in our underlying markets. Over the past 18 months, more than half of the UK's energy suppliers have ceased to trade, which impacted more than 4m customers and it's costing energy consumers billions of pounds. In response, Ofgem has made a number of positive regulatory changes. The introduction of the market stabilisation mechanism and the ban on acquisition tariffs, both of which have recently been extended to March next year, will ensure that responsible companies like us are not commercially disadvantaged by hedging appropriately.

However, we all recognise that the changes made have been reactive in nature, rather than fundamentally fixing systemic issues in the energy market. The undercapitalisation of market participants, including some of the largest suppliers in the UK market today, has not yet been addressed. That's why we're going to continue to push for financial services-style prudential regulation with four main themes. Number one, fit and proper person tests. Number two, capital adequacy rules. Number three, well-monitored risk management activities. Number four, full protection for customer deposits. At Centrica, we already have all four of these, so we know that it's doable.

At the end of the year, we held £643m of our customers' money in a separate bank account. We voluntarily ring-fenced their money. It's theirs, not ours. We believe a fundamental root-and-branch review of regulation is required urgently to ensure the system is ready for the energy transition, that it works for consumers, and it allows well-run suppliers to make an appropriate return, compensating them for the risks they take in this market.

Turning to services, I said earlier that we stabilised the operations. You can see this here in improved operational metrics, with lower absence rates, lower job reschedule rates, and higher customer net promoter score. The £80m investment that we made in customer service and in pricing in 2022 contributed to the poor financial results, but we now give far better service, and we're in a place to address years of decline in customer numbers. Jana and the team have a clear commercial plan for 2023 as we drive this business forward.

Clearly, the current cost of living issues are impacting customer demand, but we're fixing this business, which is a great business for the long term because it's hard to overstate just how well positioned we are to benefit from the decarbonisation of 30m households in the UK and Ireland, and also, how excited I am and the rest of the team are by this opportunity.

We've got the largest energy services field force in the UK, with our award-winning training academies allowing us both to train our own apprentices, but also to upskill our engineers. We've now set up a net zero business within British Gas Services, giving this growth area the level of focus it both deserves and it needs. We're already installing and maintaining net zero technologies. In 2022, we installed more heat pumps than any other energy provider in the UK. It wasn't enough, it was a small amount, but we're leading the market just now and we want to continue to lead the market.

As you can see from our results, we have world-class optimisation positions and capabilities. We lifted the lid on these a bit at the half-year and again in our Energy Marketing and Trading teach-in last December. We understand energy markets very well and we're able to manage system complexity to add value in all commodity price environments, but particularly when prices are high and/or volatile.

We've always had physical trading and risk management capabilities, principally to support the retail gas and power supply businesses, but we've developed our capabilities, our proprietary digital platforms, and our team, to become the world-class operator we are today.

What we've created over a number of years is very, very hard to replicate. There are huge barriers to entry. In gas and power trading, we're active in 24 countries. We have a world-class team managing a network of physical positions across Europe, moving gas and power to the highest value market. We've got interconnected capacity, we've got pipeline capacity, we've got 11 terawatt hours of contracted gas storage capacity across Europe. We've got one of Europe's largest third-party renewable energy portfolios and one of the most advanced cross-European virtual power plants. I think it's the most advanced, but the lawyers wouldn't allow me to say it.

Today, we manage around 5,000 individual assets with a combined capacity of 16 gigawatts, of which approximately 75% are renewable technologies. To put this capacity into context, 16 gigawatts is enough to power almost 10m homes in the UK. With an increased proportion of renewables coming online, this creates a great opportunity for us, both due to the growing size of the overall market and the volatility in prices created by the increased intermittency of renewable generation when the wind doesn't blow and the sun doesn't shine.

By having the assets and the ability to move gas and power across Europe, we're able to capture value from this very broad portfolio. Our world-class team have got a deep understanding of the global LNG market and of its logistics, so we're well placed to benefit from the increased importance of LNG in global gas markets, in particular driven at the moment by security of supply concerns in Europe. This is another set of physical options backed by great expertise.

In 2022, we traded 284 physical cargoes, including those from our contract with Cheniere. We sell these cargoes forward to manage risk, and we have now sold forward, as Kate mentioned, all cargoes from the Cheniere contract until 2024. We've done this at a profit, and we would expect to generate further upside from the embedded optionality we've got in this portfolio. Being able to move molecules and electrons physically is key to our optimisation activity. This is so much more than a bunch of people trading financially on a set of screens. Cassim and the team are the energy movers. They keep the lights on without anyone seeing what they do. They work in the background.

LNG is an important business for us. As we previously indicated, we're going to hold a teach-in on this part of our portfolio, probably in April, to give you a better understanding both of the people that we've got, the positions that we've got, and the capability that we've got.

We're managing a lot of third-party assets and our optimisation capabilities give us the confidence to deploy our own capital into flexible generation and storage assets. In the past 12 months, we've approved four new gas peaking plants – two in Ireland; two in the UK. All of which will be capable of being converted from running on methane to zero-carbon hydrogen.

We've also approved three new batteries – two in the UK and one in Belgium. All seven of these sites come with existing grid connections, which avoids the need for additional network capex and speeds up the time from approval to operations. As you can see, the capex is relatively small, and the build cycles are relatively short. We're always looking to retain optionality and to maintain flexibility.

Maybe I can move on now to our existing Infrastructure position. All of our assets generated good levels of cash flow. However, they all have a limited lifespan. We have an amazing opportunity to reinvest cash flows into new, profitable, and stable net zero assets, which will continue to provide the balance our portfolio benefits from today.

The retained Spirit Energy business delivered strong production during 2022. There will be no further exploration spend, but we may pursue some infill drilling opportunities if returns are attractive. Otherwise, we expect production to decline by around 10-20% each year, which is fairly typical for this type of business.

Neil and the team in Aberdeen continue to develop our plans to repurpose the Morecambe Bay gas field into one of the world's largest carbon storage facilities. Recently, we submitted an application for a carbon storage license. It's the first step on that journey.

In Centrica Storage, Rough is now operating again as a gas storage facility, which is hugely exciting and absolutely critical for the UK. We've got a 10-year storage license. The asset is currently running at a capacity of 30 bcf, which is around 20% of its previous capacity. Martin and the team at Hessle continue to work up longer-term plans to convert Rough to roughly a 200 bcf hydrogen storage facility, the largest in the world. We believe that this will require an appropriate support mechanism from the government before we can sanction that investment.

Our nuclear asset availability was very high in 2022. That is a result of us and our partners investing several billion pounds in recent years to improve operational performance, which resulted in a very strong output. Two of the remaining five nuclear plants are due to close in 2024, although Dave and our team are working with our partners, EDF, and the nuclear regulator on reviewing the case to extend these assets, and we're also exploring options to invest in new nuclear. If we think there's an opportunity to make an investment that delivers attractive returns, we'll discuss that as a board and we'll make a call. It will clearly have to add value.

Our core markets need material investment to achieve net zero. We said at the interims that an estimated £200bn is required in the UK and Ireland between 2021 and 2030 to help meet decarbonisation targets. Don't worry, Centrica doesn't have to fund all of that. Much of this spend will be in intermittent renewables. The increased intermittency will result in a growing need for distributed rapid response electricity sources. With energy security of supply moving up the agenda, gas peaking plants and gas and electricity storage must play an increasingly important role, as must hydrogen. All of these are areas in which we have experience, ability, expertise. The companies best placed to succeed will be those with strong balance sheets, flexible business models, operational capability, and detailed knowledge of the market. In short, companies like us, companies like Centrica.

The regulatory and political landscape is also a factor in our investment decisions, and we welcome the establishment of a new Department for Energy Security and Net Zero in the UK, and we really look forward to working with the government as they develop the pathways to net zero. We're already deploying capital into flexible generation and storage projects, as I've laid out, and we also have the potential to deploy capital into renewables with partners, which provides market access for our route-to-market activities. We've been building further expertise in both hydrogen and carbon capture and storage, taking small nascent positions, as well as developing the material plans we have for Rough and for Morecambe.

With Russell due to take over as CFO in a couple of weeks, we'll provide more detail on our longer-term investment plans and the expected returns alongside the interim results in July.

Let me quickly summarise before we get into the good bit with your questions. Centrica is a uniquely integrated energy company, with a strong balance sheet and strong positions, market-leading capabilities, and exciting growth opportunities across Retail, Optimisation and Infrastructure. We've made good progress in improving operational performance. There's more to do, and we don't get everything right. But we're on a much more stable footing now, and we're able to look forward rather than look backwards. We'll continue to deliver stable and attractive cash returns for our shareholders through our progressive div idend policy, and where appropriate, additional returns of surplus structural capital through share buybacks, such as the extension that we announced today.

Finally, if you'll permit me, I thought it was worth mentioning that our previous record year, 2012, delivered 27p of earnings. At that point, our share price was £3.50, and we had £4.4bn of debt. I'm told it's not good to say to analysts, you're going to work it into your models, but I'm sure that you'll be looking at this and see where we are today versus where we were 11 years ago. But obviously, I think there's a huge amount more potential in our company. I think there's a huge amount more potential in the assets that we've got, in the people that we've got, in the positions that we've got, and our job as a leadership team in the company, and our job as a board, is to demonstrate that to you as we go forward.

Now, we're going to move on, and Kate and I will be delighted to take your questions. We're going to try and manage as a hybrid. We've got screens here that will give us some questions from the webcast, so if it seems less than professional, it's because it's difficult to read the small print on the screen. But we'll start in the room.

<u>Question 1</u>

Jenny Ping, Citi
A couple of questions, please. Firstly, on the Optimisation business. Clearly, you've done really well there in 2022, but can you give us some sense of what you've been able to lock in? You obviously talk about profitable LNG contracts '23 and '24. Any sense in terms of the magnitude there? That would be helpful.

Secondly, you talk about a step-up in terms of capex ‘23 versus ‘22. Again, a sense of the step-up. Then, linking to that, a more longer-term strategic question. I guess when I look at your slides, a lot of the larger capex spend are really coming in longer-term. Things like Morecambe and investments in nuclear, etc. How should we be thinking about the bridge of what you’ve got in terms of cash coming through the door and cash on balance sheet today versus that longer-term need? That would be helpful. Thank you.

Chris O’Shea, Centrica
Thanks very much. Let me try and take the advantage of maybe giving a cursory answer to the first two and then Kate give you the right numbers. Starting on the strategy bridge, we’re very active in identifying areas that are within our capabilities in order for us to develop projects. It’s really quite difficult to say how long term these investments are. We did look at expanding the capacity of Rough for the coming winter. That in itself would have been a material investment. It would have been conducted over a period of one year. We didn’t have the right regulatory framework there, so we decided not to do that. We are disciplined. But we’re working through our plan, so you’ll probably have to be a little bit patient with us on that, but we do have a lot of ideas, and we have a lot of optionality in our portfolio, which is really quite nice.

Kate will talk to you about the step-up in capex, and I would say, in terms of what have we locked in, the easy thing to say is that we don’t expect to have the same year in Optimisation in 2023 as we saw in 2022. That goes without saying. But we also don’t expect to go back to what we saw in 2021, so we would expect to be north of that. I’m pretty sure that Kate’s going to tell you that she’s not going to tell you what we’ve locked in, but we have locked in the Cheniere cargoes at a profit. If you remember, a couple of years ago, we were having a conversation about it could be £300m. You do start £300m behind the eight ball, so to speak, so to have them locked in at a profit in ‘23 and ‘24 is great, but I’ll pass you over to Kate, who will probably tell you no numbers.

Kate Ringrose, Centrica
Thank you very much for the question. With regards to Optimisation, just as a reminder of what the pillars behind that business are. You’ve got the route-to-market activity that we talked about in December, the LNG activity that we have as you’ve referred to and the gas and power trading. The underpin around the gas and power trading in particular is the investment we make in storage position. This is predominantly in Europe. The way I hold that business is when you’ve got volatile and elevated commodity prices, the optionality of that investment comes through in the LNG, the ability to move gas and power across continents and the like. So that’s the way to think about it, combined with the track record that we have over a number of years when you take that ghastly gas asset book aside and you look at the underpin.

So that's the way I would hold it is, what's the track record? What kind of environment are we moving into? How did we demonstrate that we operate in that environment? Then hold that as to how you look forward. As Chris said, I'm not going to give you a degree of underpin on exactly what sits in LNG as an example. There's a lot of route to go, I think, in 2023 in terms of how that portfolio unfolds. Cheniere is a meaningful contract, but we moved 280 cargoes in 2022, so Cheniere is a portion of that, but not the only thing we do.

Question 2

Martin Young, Investec
If we can pick up on what you were briefly alluding to around the regulatory backdrop for supply in this country, Chris. I guess there are three things I wanted to explore there. Firstly, around the differentials between the cost in the tariff cap of those who pay on prepayment meters and those who pay via direct debit. I think you look at the latest price cap, there is an £80 difference, give or take, 4m households, so a little over £300m additional cost there for those customers. Surely that's the type of number that should be socialised across all customers, with an appropriate mechanism to make sure that those who have the prepayment meter customers in their portfolio are adequately reimbursed for the additional costs. I just wondered what your thoughts were on that.

Then that leads me neatly into social tariffs. I would suggest that they are probably now an inevitability in some way, shape, or form, so I just wondered what Centrica's views were on the structure, and who should ultimately pay for a social tariff?

Then the final question is around the prepayment meters. I just wondered what you were doing before The Times forced your hand, so to speak, to change practices around prepayment meters, given that it is an issue that has been bouncing around for quite a while. Thanks.

Chris O'Shea, Centrica
Thank you very much. I'm always nervous when an ex-employee of Ofgem asks questions about regulation. On the last part, the prepayment meters, we've got an investigation ongoing, so I can't get into details to what's going to happen in that investigation, but I would say you probably have to take it up a level.

Firstly, last year we installed just under 100,000 prepay meters. 20,000 under warrant; almost 80,000 voluntarily. Prepayment meters in and of themselves are not the issue. That links into your question about socialising the cost. The cheapest electricity you can buy in the UK under the price cap is on a prepayment meter. The second cheapest gas you can buy is on a prepayment meter. There is a bit of misinformation out there that prepayment meter customers are paying a whole lot more than others. It used to be the case, but it's not the case anymore.

The reason the distinction between those who choose to go on to a prepayment meter and those who have them fitted involuntarily is important, at a higher level, you talk about how do you socialise this extra cost if such an extra cost exists. How do you socialise it across people that are not on prepayment meters? If you were to simply do that through the price cap, everybody would go on to a prepayment meter and there would be nobody to subsidise because it's voluntary. You have to really think about this in terms of the overall structure.

The question we've got to ask ourselves is, as a society, what do we want to do for people who cannot pay their bills? Remember, where we install a prepayment meter involuntarily, we've tried for about six months at least to get in touch with the customer. We've visited their house, but we haven't been able to make contact. The only options that we face at that point are you let a customer continue to run up unsustainable debt that you know they can't pay, which in another industry would get you in a huge amount of trouble, or you install a prepayment meter to stop that debt accumulating. Neither of those are particularly nice options, but this is not really in the gift of Centrica or British Gas to fix, and it's actually not really just limited to energy. This is something that goes far broader. People are struggling to pay for food, they're struggling to pay rent, they're struggling to pay their mortgage. It's a question for us as society. What do we want to do for those people who can't afford the basic necessities in life?

You talk about social tariffs. There are a lot of voices involved in this debate, and we are one of them, but I would prefer to do that in the background. A social tariff is a possibility, and it could mean that those that are less able to afford their energy bills are subsidised by those that are more able to afford. The devil then gets into the detail, which is, is it administered by companies or by government? Is it something whereby one energy consumer subsidises another? Is it something that comes in general taxation? If we go down the route of a social tariff, I think the easiest way to have this administered is through the Department for Work and Pensions because they know who's financially vulnerable and who's not, and it's easier for them to manage it. But I'm sure that the new energy department and the Chancellor have got loads of people giving them advice.

What's clear is we have to fix this. What's also clear is that what was exposed in The Times was unacceptable in terms of the language that was used for customers. That's not how we want to do business. Whether you work for us or you represent us, you cannot talk about customers like that. You have to treat customers with dignity. If it's happened to just one customer, that's one too many. When we get the results of the investigation, we'll fix it, we'll make it right, and we'll contribute to the ongoing industry debate.

<u>Question 3</u>

Deepa Venkateswaran, Bernstein

I have three questions. One, just picking up from the regulatory backdrop, what are your thoughts on the current EBIT consolidation from Ofgem which proposes to move from the margin being variable to maybe hybrid, and then revisiting some of the assumptions on capital employed, etc.?

Second question on British Gas Services. Obviously, you have invested £80m last year, but can you give us an idea of long term? What is the kind of profitability we should expect versus historic? What is the ramp to get there, given the current economic backdrop?

My last question is for Kate. Just on the customer deposits that Chris mentioned which have been ring-fenced, I just wanted to make sure that that's not included in your cash position, or is it? Then can you also tell us what's the balance of your margin payment? You've made a lot of outflows this year, but last year was an inflow. Is there a balance of how much margin net you still have to pay or receive from your various counterparties?

Chris O'Shea, Centrica
Thank you very much. Let me take the first two questions and then Kate can take the question of customer deposits. On the profitability, as you say, given the economic backdrop, it's very difficult to give you a clear picture because I don't know how long this cost-of-living issue is going to go on, I don't know how long inflation is going to be, and it gives us decisions to make in terms of whether we absorb inflation. What I can say is this is a fantastic business. It's been damaged because we manage it for in-year profitability, so what I don't want to do is to say this is when we're going to get this thing back to the profits that we saw in the past. I'm confident that we can get it back to what we saw in the past.

Very few industries have their entire customer base having to replace their product over the next 10 years. Every one of our customers is going to have to do that. Hydrogen boiler; heat pump. We've got 6-7% of the boiler install market. I don't think that's enough. I don't know why it's not more. I don't know where the number would be. It's not going to be 50%, but it could be 20%. We could have that in the heat pump market. We've got 1% of the radiator install market. Our focus in some parts of that business has been quite narrow. How do you install a boiler? Actually, what we think now, how do you install a heating system? How do you maintain that heating system?

What we've seen recently, which is quite good, is we're ramping up our sale of on-demand products. We've run this business in the past trying really to match capacity with customers, and anybody that has ever run any operation knows that you've got to have excess capacity in there. We're looking at it on a different basis, which is how do you build in the excess capacity to give the customer the service that they want? Then when you've got that excess capacity, how do you have the right commercial team who's going to sell that excess capacity?

You've got engineers. One of the things we talk about internally is we'll know we've got it right when we see engineers sitting in lay-bys and we're comfortable with it because they're between jobs and we've got a commercial team that's trying to sell them. We've seen a substantial ramp-up in the first part of this year in those on-demand jobs. They're sold direct to consumers through digital channels. There's a lot of good work going on in there, but I can't give you a straight path because I just can't tell you what the economic backdrop will be. I can tell you the boiler installs performance in the first month of this year was stronger than we expected. There's a lot of demand out there. We have been our own worst enemy in this business. It's why we're investing so much in fixing it. It's a fantastic business.

On the EBIT consultation and capital employed, so Ofgem last year said that some companies were using customer deposits like an interest-free credit card. Then they completely flipped their position and said we're not going to make companies ring-fence customer deposits. I have no idea how they could have such a flip in their position. I saw that the FCA announced bizarrely this week that they should have fined Atom Bank £73m, but they didn't because they would have gone out of business, which I just think is the weirdest thing for a regulator to say.

Our view for other companies in the sector, not all of them, but a lot of them, including some of the largest companies, was that if they were forced to ring-fence customer deposits, they would be forced to raise capital. Ofgem explicitly said they couldn't raise capital in this market. The only conclusion I can draw is that the companies in our market today that are arguing against ring-fencing customer deposits have already spent that money and cannot afford to ring-fence it. And they're not making a profit. Therefore, you've got to ask, what's going to happen in this market? The reason I think that's linked to the EBIT consultation is I can't think of another energy retail market that has had the turmoil that we've had in the UK. The very simple view I take, and I encourage the regulator to take, is if no one else is as broken as this, why don't you look at what others are doing? In other markets, the EBIT margin is between 4-6%. You can get that through having an EBIT margin, or you can get that through having a return on capital, but if you underestimate the capital that is required for this business, you'll underestimate the return that's required.

We will contribute to the review, but as I mentioned earlier, we think a root-and-branch review, so this is not about changing one or two little things, we need to step back and say, what do we want from this market? It has to be a market that works for consumers. It has to be a market whereby if companies fail, shareholders pick up the tab. Every consumer is paying £88 just now for the cost of failure, excluding Bulb and excluding any future failures. It also has to be a market where profit is not a dirty word because without a profit, companies will fail. I think we've got a long way to go on this and I think moving to some kind of fixed EBIT margin, if the idea is that you reduce the EBIT, why you would think reducing the EBIT in a market that has lost half of its participants and is structurally loss-making, why you think that's a good thing for consumers is beyond me, but we'll continue to contribute and Kate will talk about customer deposits.

Kate Ringrose, Centrica
I think I got the slightly easier bit, so it's just a couple of numbers to point to. With regards to the credit balances, it was just around £640m of credit balances we had at the end of the year. It is included in our cash numbers. It's ring-fenced. It's in a separate bank account. But it's not treated as yet as regulatory capital, but it is included in our cash balances.

With regards to the margin, £820m margin out is where we were at the end of the year. That's a movement of £1.1bn in a year. At the beginning of the year, we were margin in, so with derivatives, more in the money than out the money. Just as a reminder, the driver behind those margins, remember, this is the accumulation of our hedging activity for upstream and our downstream businesses, as well as the trading portfolio. As an example, that very steep fall that we had in commodity prices at the end of December meant the hedges that we'd put in for our downstream business switched to very heavily out the money.

Question 4

Alex Wheeler, RBC
Just one from me, please. Just on the Retail business. You've spoken a lot about plans for 2023. I'd be interested to understand what you would consider to be a successful 2023 for that business in terms of what you actually want to achieve, obviously, outside of any regulatory changes.

Chris O'Shea, Centrica
You mean in energy or in general?

Alex Wheeler, RBC
Across the board in the Retail business.

Chris O'Shea, Centrica
Very simple. Higher profits, higher customer net promoter scores, better customer service, more customers. That's what I would consider to be a success.

Question 5

Mark Freshney, Credit Suisse
Thank you for taking my questions. I have two. Firstly, a very pointed question on capital deployment. Even after the on-market share buyback that you'll work through this year and perhaps next year, you'll still have some billions of capital on balance sheet, and you've given us a sprinkling of what you can invest in, but clearly, the big ones are Rough and potentially a slice of Sizewell. These are very big investments. The alternative is to give it back to your investors and let them find the return. It's the

age-old debate between investors and management teams. Who can get the best returns? We saw the slide that you put up at half year going through the various options, but can you talk about how, if you do invest in these big projects, how we can be sure that they're not going to lead to the same problems of a decade or 15 years ago that led to value destruction, which has ultimately come right, but led to a lot of the problems

Secondly, just on nuclear retirements, Kate, and I know you sit on the Lake board, just regarding the timing for the two retirements in March 2024 and the capacity auction, I was just wondering what you would expect the retirement date to be?

Chris O'Shea, Centrica
Thanks very much. The first question is a really open-ended question. I'll do my best to give you something that's not a long rambling answer and then Kate can talk to you about retirements. But remember, I said in the presentation that we're working on extensions to these, but you require the nuclear regulator to approve that, so there's a lot of work going on there.

Hopefully, you'll agree that the prudence that we've shown, the caution that we've shown, has been the right thing to do. As we've focused on our three phases of the turnaround, which is ultimately, how do you walk before you can run? The Americans say, how do you walk and chew gum at the same time? We have deliberately been cautious because we recognise that we haven't always got things right in the past, but what we also want to do is we wanted to get the portfolio in the right place. A bunch of assets that we wanted to own that, by design, they sit together, they make things better. We also then wanted to make sure that we fix the underlying issues in those assets rather than look for something new and shiny that takes your attention away from the underlying issues. Whilst we're not there, and I don't think we'll ever be there on the customer service, you can always make it better. We are better than we were.

Now, we turn more to say, where do we invest the cash that we've got? I don't think it's a difficult debate with shareholders because it's only difficult if we want to invest in something that doesn't make them an adequate return. If we want to invest in something that doesn't make an adequate return, it's not actually a question of capital, it's a question of whether you've got the right management team. If you make the right return, I think shareholders would prefer that you invest. What they want us to do is to invest in things that are within our wheelhouse, so to speak. Things where we can focus, where we can bring expertise, things where we can add value. What they don't want us to do is to just invest for the sake of it.

I would say we do have a good portfolio of opportunities. You missed out Morecambe as a carbon storage facility, and the reason that that's really interesting is because geographically it's in the Irish Sea rather than in the North Sea. There's a lot of carbon storage facilities in the North Sea, but Morecambe is actually quite uniquely placed. It can help to decarbonise the west coast. It's slightly more difficult because it’s not adjacent to an existing industrial cluster, so the concept we’re looking at there is to ship CO_2. To give you an idea of some of the complexities. You’re not allowed to ship waste products across borders in Europe, and CO_2 is a waste product. We’ve been talking to the government about if you want to have a revenue stream, allow the shipping of CO_2 and then stick it in the reservoir in Morecambe. There’s quite a bit of work still to be done there, but that’s another material investment opportunity.

How do we guarantee that we don’t repeat the sins of the past? I think you’ve got to look at this business through the long term, through the cycle. At some points we were saying, God, I wish we hadn’t done this, and now we’re saying, actually, we’re quite glad that we’ve got it. You look at Rough, for example. What did we pay for Rough? £300m or something, if even that. There have been some real successes, and there have been some things that have been less successful, but remember, as we proceed and we proceed with caution, we’re very disciplined on returns. The fact we didn’t invest in the capacity expansion for Rough I think demonstrates that discipline because that was a difficult decision not to do that, but it didn’t make financial sense. But there’ll be a mix. We want a mix of regulated and merchant assets. The more regulated the assets are, the lower the return you’re willing to accept; the more merchant, the higher return you need, but then we can also bring further value through the fact that we’re in Infrastructure, Optimisation and Retail. That’s value I think we can bring to assets that nobody else can really.

We’ve got a real opportunity there, but just be patient with us. We’re not hoarding it for the sake of it. One of the dangers you get when you have more capital in your balance sheet is it burns a hole in your pocket. One of things we’re lucky we have a very engaged board, so even if I got a twinkle in my eye to spend the money poorly, I’ve got Kate and then Russell to say you must be nuts. I’ve got my chairman sitting here who’s probably looking at me thinking, he sounds like he’s nuts. But we’ve got a very engaged board, so we’re really disciplined, and we want to just take our time to work through all of the opportunities. The great thing is we’ve got the opportunities.

Kate Ringrose, Centrica
I say you want the nuclear question, Mark, I’m not going to be able to add very much. I’m really sorry. I don’t actually sit on the board, but notwithstanding, that’s not relevant, but as has been reported, there are desires to extend, but I’m certainly not in a situation where I can give you any indication by when or how or how much.

Chris O’Shea, Centrica
The key thing on that is you’ve got to do it well in advance. One of the Heysham stations closed last year and we were asked by the government, could we look at extending it? We had to say, look, we just don’t have the time to get the safety case in the right place. What we’d like to do is to focus all of our efforts on the safety case of the two that are going to close in 2024, so we’ve been working on that already for a while. But hopefully, it’s not a six-month extension. If you’re going to spend the

time on the safety case you want, it's not going to be 10 years, it's not going to be six months, so somewhere in between.

Question 6

Ajay Patel, Goldman Sachs
I guess mine is more of a strategic question. EMT, fantastic performance, and I just think, well, are you happy with the way that the portfolio is set up at the moment? I'm thinking like EMT, LNG contracts. The business was bigger in the past and relatively that made more sense, and now, if you think about an ongoing business, maybe in an environment where commodity prices normalise, does that still make sense to have that portfolio, or does it belong with a bigger company and you realising that profit and taking advantage of other opportunities? I'm just wondering what your thought process behind that is.

Chris O'Shea, Centrica
I think EM&T is the glue that holds the group together. It helps us with our Infrastructure assets. It helps us with our Retail business. Remember why we set that up. We had that business in order to hedge our downstream exposure, our upstream exposure. I genuinely think we've got world-class capabilities in there. We've got world-class people. If we didn't put risk capital to work in some of the optimisation activities, we'd still have, by and large, the same group of people doing the hedging for the downstream and the upstream. You're never ever going to get away from that.

My view on this is that we manage this very closely. We've got a very talented team led by Cassim at the front. We manage it very closely, and we have very strict limits on the risks that we take in the optimisation capabilities. I think that's an area that I would like actually to grow rather than to shrink but grow in a controlled way. As we see as we grow forward, we look, for example, at all of the systems and infrastructure and controls we've got in place, and the bigger you get, the more you step those up. You get this forward momentum. You get better profits, you get more to invest, you get better underlying systems, and you can grow more.

What we're not going to do is to grow in an uncontrolled way, but the opportunities there are absolutely huge, and there are many companies that can and do trade gas. Being able to trade power is a very different skill set and being able to optimise that and doing that across 24 countries in Europe is really quite something. This scale is going to get more and more valuable as you see more and more renewables coming onto the system.

But it also gives us the confidence to deploy in Greg's area. Greg is deploying capital in flexible generation storage projects. The fact that we've got Cassim's team that can do the optimisation gives us more confidence that we can get a better return. It's not just the asset return. It's how do we get return out of optimisation? It all really knits together very well. It’s a core part of our group, and as I say, I think it’s the glue that holds us all together.

Question 7

Sam Arie, UBS
Can I make one comment and then a question for each of you? The comment is hopefully helpful, you can let me know what you think about the question. The comment is on something we haven’t touched on in the Q&A which is the buy back. There has obviously been a lot of media focus on this this morning. Can I share the analyst perspective on that? For me the buy back is not controversial. The controversy is around windfall profits and taxation, and we have been through that as a country last year and we have a proposed approach which you are complying with. Given the windfall taxation is what it is, the buyback isn’t controversial. Let’s see where the discussion goes, but I also think from a valuation point of view, from an analyst perspective, it’s neutral. It’s the shareholders money whether you give it back or not so it’s more of a message about your ability and opportunities to invest. I hope that’s helpful.

On to my questions. Kate, some of us here were delighted to see you get your job a couple of years ago, and obviously wish your successor every success, and we are sorry to see you go. I wonder if you could give us some perspective on the decision to leave and what’s driving that? It’s a question that I’m often asked.

And Chris, my question to you is a bit of a follow on from Ajay’s. I’ve wrote something down which overlaps a little bit with what Ajay was saying but I’m going to read this out to you then I won’t mess it up. The question is on future returns for Centrica. You have posted effectively 10x earnings verses last year and some of that is driven by the trading business, but some is also from the business units that you explicitly wanted to get out of a few years ago. And the British Gas activities that were the core of Centrica, from many people’s understandings, a couple of years ago, start to get weaker every time we see them, with half your competitors leaving this space and the energy crisis being what it is. I know you are going to talk more about your plans at Interims but could you say a little bit about where you see things heading? Is it really a big turn around like the one we saw at BP with renewables, and the natural end game now is you stick to the infrastructure and upstream asset businesses, mostly fossil businesses I suppose, and eventually you exit the downstream activity as SSE have done. Or do you stick with your intellectual position of a few years ago that you wanted less commodity exposure and more of a sustainability focus and you take the opportunity to exit some of the commodity activities at the top of cycle instead of when you were under pressure at the bottom of the cycle.

Chris O’Shea, Centrica
No, no, look, it’s fine. Thanks for the comment on the buyback. I agree with you, it’s valuation neutral. It’s not just a comment on our ability and opportunity to invest, it’s

also a comment on where we see the valuation of the company. If we thought the company was fully valued, we wouldn't be buying back shares. The fact that we are is that we think that it's materially undervalued.

I was the CFO before I was the CEO, and we were actively looking to get out of nuclear and out of Spirit. Whilst I could understand the Spirit thing, I could never really understand Nuclear, if I'm being honest, because it was zero-carbon electricity, baseload, with a very good operator in a country that was short of energy, short of electricity. So it never really made all that much sense.

When the Chairman asked me to be the CEO, I said, can we keep Nuclear? I didn't say anything else. I said, I've never really understood it. I felt uncomfortable. There are not that many buyers, so it's also a bit of an issue to sell, but I thought it made perfect sense. I thought it gave our portfolio stability. He said, okay, no problem, but we'll have to look at the value of it, of course. We then looked to sell more assets than we actually did sell. Not because we didn't like them, but because we had to do something to stabilise the company.

You remember when Scott became the Chair and I became the CEO, our market cap was lower than a company whose sole activity was renting us smart meters. That's how bad it was. So we had to stabilise the business. We looked at selling Spirit in its entirety. We didn't get decent bids for it. Then we decided actually to split it up. We looked at optionality and we saw optionality in the Morecambe Bay gas field.

In big infrastructure businesses, if you own 100% of a field, pipeline, or asset, it almost never happens. Now, we've got a partner in Spirit, but we control the Board of Spirit. We have four of the seven Board seats, so we effectively control the entire value chain. When we looked at them and said, actually, you can shave years off this process because you don't have partners that are disagreeing, you've got two partners at the corporate level, we were very comfortable in keeping that, and some other assets we're very happy actually that we didn't sell.

Not only did I think we got it wrong, we sold a power station, and I made a mistake on that. I think it was Peterborough or King's Lynn, I can't remember which one. That was just because it was the start of Covid and we were trying to figure out how to stabilise the group, how to make sure that we stayed afloat, and that was a cock-up. We should have stopped that because the same logic applied to the sale of that business as applied to Nuclear.

I think the way the portfolio sits just now, with the Infrastructure business, with the Optimisation business, with the Retail business, I think it works actually really quite well. I would like the profits in Retail to be higher. Clearly, we would, but we set the business up so that some bits do better, so there's a bit of balance in there and I think that's natural. But we're working really hard and we're investing in profits in improving customer service in the downstream businesses.

The issue in services is in our own hands. How much of this market can we grab? We believe we can grab a bigger share of the market than we've had historically. The issue in energy, to some extent, is in the regulator hands. However, you've got to look and say the UK must have a functioning energy market. At the moment, it's not been great. Since the price cap came in, it's not been great.

Our engagement with the regulator and with politicians is to say rather than identify a problem, come up with a solution and try and sell it to us. Why don't you identify a problem and get people together who know what's going on and come up with multiple solutions? Ultimately, the government, the regulator, they're still the decision-makers. The price cap had deep flaws when it was introduced. It's quite clear what we've seen in the energy retail market was inevitable when we brought the price cap in designed as it was. That's why we're calling for root-and-branch review.

But if we don't have a properly functioning energy retail market in the UK, I think we've got a whole bunch of other issues. Long term, I think that's going to be a good market. However, we're not in it for sentimental reasons. We're in it because we think we can make a return, we're in it because we think we can do the best for consumers. Whilst we don't discuss every time we have a Board meeting, should we be in this business? We also don't sit and say we're in this business for 100 years no matter what. It's got to make sense. It's got to make a return for our shareholders. We're considered, we're patient, we're engaged, but we're not sentimental.

I wouldn't want to comment on what the group could look like in the future other than to say it's going to be different, but the balance that you get from having this huge retail business, with 10m plus amazing customers, this great infrastructure position which we want to transform, this fantastic optimisation position, which hopefully you learned a bit today is way more than just some people on a screen, I think it's unique. I think it's difficult to replicate. I like the portfolio. I'd like to grow. We've got eight business units. All eight of them have got growth opportunities. We've got the right management in there. We're pursuing the growth in all eight of those business unites.

Kate Ringrose, Centrica
Sam, we've walked a bit of this journey together. It's been almost 20 years. I've done 10 jobs at the time that I've been with Centrica, and I think I have been there through thick and thin. I would say this is a moment that I genuinely am really proud of. Since I became CFO, the share price has doubled. If you look at the quality of the balance sheet it's just unrecognisable, and I leave a really good, incredibly capable function in Russell's very, very capable hands. It's really all credit to Chris and the Board for the support that they've given me in making this decision and allowing me time. I'm hoping that I'm not going to be bowing out forever. That's certainly not my intent, but I am certainly intending on taking a break.

Question 8

Harry Wyburd, Exane
Morning everyone, thanks for taking my questions. My line dropped for a few moments, so it may turn out that these have already been asked, in which case I apologise, but I've got two. Firstly, just on the buybacks, more a clarification. Did you say you were 40% through the original 250m buyback, in which case you'd have 450m left to do? Just to make sure I heard that correctly.

The second one, this is really more of a follow-up to Mark's question on capital deployment. If you think through towards the end of this year, if you get maybe some of the margin cash back, if you do 20p of EPS and you find that the cash you have on your balance sheet exceeds what you can reasonably invest organically in a short period of time, you basically have a quality problem of too much cash. Would you consider an acquisition, transformational acquisition for the business, or would you rule one out, conversely? If you wouldn't rule one out, is there any area that you think an acquisition might work well for Centrica? Any particular industry or vertical that you think would suit you from an acquisition perspective?

Chris O'Shea, Centrica
On the buyback, you're absolutely right, we are 40% through, so we've done 100 of the first 250, so 450 to go. On the capital deployment, you say it would be a high-quality problem to have. If I have a natural bias it's towards organic rather than inorganic development. However, that's not to rule out acquisitions, they just would have to be the right acquisition. They carry more risk. Historically, you can see that they don't create as much value as organic development. If you look at the business that we've got in EM&T, a big part of that is the business we've got in Denmark that we bought in 2017, I think, Neas. 2016 or 2017. It's been an incredible acquisition. You look at Centrica Storage, that was a great acquisition. You look at Bord Gáis, that was a great acquisition. We've got a history of doing some really good acquisitions. We could probably have done probably some more questionable acquisitions as well, so I would neither rule them in nor out, but I would say that my preference would be to do organic acquisitions. It just carries less risk.

Harry Wyburd, Exane
Okay, that's clear. Thank you.

Question 9

Ahmed Farman, Jefferies
Thank you for taking my question. A few from my side. I just wanted to first ask, could you just help us understand, as the business stands today, how much balance sheet headroom do you actually see that you have for capital investments and further shareholder returns? The way that I'm thinking about it is there are probably two parts to it. One is the cash that you have on the balance sheet, and there's probably £1.2bn, and we maybe add back a few of these collateral outflows, but then

deduct customer deposits. Then there's maybe potential capacity to re-lever but interested in your thoughts on that.

Then secondly, I wanted to come back to I think another question asked earlier about the Retail division. It's been volatile and you've given some explanation on that, but can you just help us understand the baseline. How should we think about a baseline for the profitability of this business into 2023?

Then finally, Energy Marketing and Trading, the £1.4bn, can you give us some more granularity on how that number splits between the various sub-divisions of route-to-market, LNG, trading?

Chris O'Shea, Centrica
Thank you very much. The last question is the easiest, which is we wouldn't give a further breakdown on that, but all of the parts of our Optimisation business had a good year in 2022. Those results are not dominated by one part over another.

Retail baseline, that's really difficult because our aim is to increase the market share in the services business and in installations, and it's to grow the addressable market. We've got about 50% of the market of people who pay to insure their heating systems. I don't think we can grow our market share, but we can certainly grow the market because there's only, I think, less than one in four homes in the UK that actually have that product, so there's a lot more we can go after, whether it's on-demand or whether it's growing that market. Our aim for services is to make it better than it was. That's why we're investing a huge amount of money.

In energy, again, it's in part dependent upon the regulator. As Kate mentioned, you've got weather volatility in there as well. It depends, is it warmer than normal? Is it colder than normal? It depends what part of the year. But the thing I would say to you is if you added back the things that we voluntarily did – the £50m investment in energy, the £27m furlough – you'd see that that business would have been £150m last year. I'm not saying that's what it's going to make this year because we're only six weeks into the year, but you have to look at the decline from 2021 into 2022 in the context of things that we voluntarily did to support our customers. But our aim in every one of our businesses is to make it better.

To be clear, the Infrastructure businesses rely on price. Commodity prices are lower. I'm not expecting the same result from them this year. The Energy Marketing and Trading result, we want to grow that over time. Cassim's smiling here. We're not taking £1.4bn as a baseline and looking to grow off that, but we're also not expecting to go back to where we were in 2021.

On balance sheet headroom, I think that's quite a difficult one, but it's probably one for you, Kate. I would say that when I was here, where I was quite conservative in the balance sheet, Kate is quite conservative, and I'm hoping with another Scottish accountant, that Russell will be quite conservative as well. I always think about how you structure a balance sheet is, if you think about what I was talking about earlier on, when Scott was appointed chair, when I was appointed CEO, we had to do stuff. We got good prices for the things that we had to do, but when you have no choice, you're a price taker. Whereas what we've tried to do and what Kate's done well over the past couple of years is to have the balance sheet in a place where we have choice. If we want to sell an asset, we sell an asset because we want to because we create value. We don't sell an asset because we need the cash. That would be the context in which I would look at our balance sheet. For as long as I'm CEO, hopefully it's something that we will carry on because to be in charge of your own destiny is so important and so valuable.

Kate Ringrose, Centrica
Chris has described the philosophy around the balance sheet. I think during 2022 we've demonstrated the value that that flexibility comes to pass. If you just reflect on the degrees to which commodity prices have changed, just as an example, you can see why holding that additional liquidity, flexibility, cash to hand has been something that we've both benefited from a risk perspective, but also very consciously invested on and got very good returns from in terms of how we've deployed that within EM&T. For now, I wouldn't see that philosophy changing very materially. However, I certainly wouldn't want to put the new CFO in a box in terms of how he would look at the degrees of capital and choices and uses of that, and I'm sure there'll be more on that to come later in the year.

<u>Question 10</u>

Bartek Kubicki, Société Générale
Thank you for taking my questions. Just two, please. Firstly, on Rough, whether you can tell us how Rough as a storage facility is operating right now, i.e., are you withdrawing gas and selling it on the market, or are you simply, given the fact that prices have gone down, are you buying back hedges over this winter and, for instance, rolling it forward to next periods and consequently prolonging the life of Rough as it is right now? This also gives me the second question related to Rough. Are you going to have Rough operating in the same mode in the upcoming winter?

Secondly, on retail and competition, are you seeing any emergence of competition on the UK retail market given the fact that prices have gone down? Are you expecting actually competition to emerge, or do you think the market has more or less stabilised for the next couple of quarters or years?

Chris O'Shea, Centrica
Thanks very much. In the retail market, we are growing organically. It's very small numbers, and I'm always nervous to say this because I don't ever want us to think that we're declaring victory, but we grew organically in most weeks in 2022 and we're still picking up additional customers. Very, very small volumes, so customer churn rate is very small. I think a lot depends on where the government sets the EPG, the price guarantee, from 1 April, as to whether you see an increase in churn.

The Ofgem actions to stabilise the market, the market stabilisation charge, and ban on acquisition tariffs makes it more difficult for companies to go back to the behaviours of old, which I think is a good thing. Ofgem are also monitoring people that come into the market. They've denied a bunch of license applications, but they're also monitoring the financial resilience for new entrants probably more rigorously than they are for existing entrants. All of that suggests that we should have a more orderly market, but we are still growing.

On Rough, there's a mixture in terms of, again, it's one of these things about it being very flexible. You make your nominations, I think, three times in a day. You nominate at six in the morning, noon, and four in the afternoon. I can't remember. We can go between all three modes during the day. Rough is a very, very flexible asset. Martin Scargill, who leads that business, his team works very closely with Cassim, who leads the optimisation business, and we make a decision in real-time. Do we withdraw gas? Does the market need gas? Do we inject gas? Do we buy back the hedges and roll it forward?

I think the first withdrawal was 30 November, when the weather was very, very still, quite cold, and no sun whatsoever. Cloud cover that sat over us for a good few days. Since then, we've injected, and we've also bought back hedges. We intend to operate Rough in the same way at the same capacity for the coming winter, so winter '23/'24. Remember, we've got a 10-year storage license for it. Although we're only talking about this winter and next winter, we have a license for 10 years. We would intend to operate that as a 100% Centrica asset in the coming winter, as we continue to progress plans to have the full field redevelopment and get this up to being the world's largest hydrogen storage facility, kickstarting the UK's hydrogen economy. So that's our long term aim.

With that, I don't think there's any other questions. Thank you very much for coming along. Thanks for being with us, despite the longer Q&A session. We were actually kind because in the press call this morning we limited the journalists to two questions each, but you all demonstrated quite a lot of discipline by doing that yourselves.

But just to remind you, very strong year. We expect another good year in 2023. We don't expect to be at the same levels that we saw for 2022, but we have growth opportunities in every one of our businesses, and we're going to continue to invest in our Retail businesses because they're good businesses, they're very strong, and we're in them for the long term. As long as the regulation is in the right place. Thank you very much.

END OF TRANSCRIPT