Centrica plc 2019 Preliminary Results Announcement
Thursday, 21 February 2019

Iain Conn – Group Chief Executive
Well good morning ladies and gentlemen and thank you very much for coming to Centrica's 2018 Preliminary Results Presentation. As usual we will be reporting on our financial results and outlook and providing an update on strategic progress. But first as always a word on safety in this building.

[Safety announcement]

We have our new Chairman, Charles Berry here with us this morning. Charles took over today from Rick Haythornthwaite and brings with him a breadth of UK and international energy and engineering knowledge and a long track record of successful leadership of businesses across a number of sectors over the last 20 years. On behalf of the Executive Management I'd like to welcome Charles to Centrica as Chairman of the Board.

But before passing to Charles to say a few introductory words. I'd like to thank Rick for his leadership of the Board over the last 5 years and his guidance and partnership with me over the last 4. Centrica has been faced with a huge number of challenges both external and internal and Rick has astutely assessed them and understood what it would take to deal with them including the need to drive huge change at pace while also ensuring we create a viable future for Centrica. Charles.

Charles Berry – Non-Executive Chairman
Iain thanks very much and good morning ladies and gentlemen. I wanted to take a moment just to introduce myself on day one. Now whilst I am new to Centrica, Centrica is not new to me because I have known the Company since the very beginning in 1997. I knew the Company first as a competitor when I was with Scottish Power from 1991 and then as Chairman of Drax from 2005 and I am delighted to have this opportunity to contribute.

I joined the Board on 31st October and I have visited a lot of the company since that time in the UK and the US. I saw the extent of change that Iain mentioned just a moment ago and I also saw capabilities richer and deeper than I expected. And my expectations weren't modest. So I am looking forward to working with the team and to meeting you all in due course. So thanks for listening and back to Iain.

Iain Conn – Group Chief Executive
Thank you Charles. We've also been undergoing a number of changes to the Executive team and I'll just take a couple of minutes to run you through that. Chris O'Shea has joined as our Group Chief Financial Officer and you will hear from him shortly as we go through our 2018 financial performance. Richard Hookway has joined Centrica as Chief Executive Centrica Business and brings with him a wealth of experience in the energy sector from his 35 years at BP. We also announced in December that Mark Hodges would be leaving the Company to return to financial services and take on a new role as Chief Executive of ReAssure. I'd like to thank Mark for his significant contribution to the Company over the past 4 years. I'm delighted that Sarwjit Sambhi who has been running our UK Home business for the last 3 years will be replacing Mark at the end of this month. I'm confident he will be able to lead the Consumer Division through the next phase of its transformation. Sarwjit is here with us today. Finally, we also announced in December that Grant Dawson would be retiring from the Company at the end of March after 22 years of service. I'd like to thank Grant for his long service commitment and contribution to Centrica. Grant will be replaced by Justine

Campbell, another internal appointment. Justine has deep legal and regulatory experience in customer facing businesses and I look forward to working closely with her. Jill Sheddon, Group HR Director, Mike Young, Group CIO and Charles Cameron who is the Group Head of Technology, Engineering and Innovations are the other members of the Executive Committee.

Now let me move onto the key financial messages from our results announcement today. And the rest of the presentation will probably take about an hour and a quarter.

The environment in 2018 continued to be challenging and our results were mixed. We delivered resilient financial performance despite disappointing volumes in Spirit Energy and Nuclear and slower than expected recovery in North America Business. At the headline level, adjusted operating profit was up 12%, adjusted gross margin and EBITDA were also up year on year and adjusted operating cash flow and net debt were within our target ranges. Despite this performance, which was also in line with our 3 year cash flow and net debt targets and although we are not even 2 months into a new year, our projections suggest 2019 will present us with a particular combination of headwinds.

Our adjusted operating cash flow will be impacted by the UK default tariff cap which was introduced from the 1st January this year which will have a total pre-tax impact of £300 million including an unexpected one-off impact of £70 million in the first period of the cap. We are seeking a judicial review of the retrospective alterations to the wholesale energy cost formula which led to this one-off impact.

Spirit Energy volumes likely in the lower half of their target range, as indicated in November, continuing uncertainty over Nuclear restart dates and higher cash tax payments will be partly offset by continuing a material underlying efficiency delivery.

However all of this means that at current forward commodity prices, which have fallen significantly over the past 5 months, and assuming normal weather patterns, we are targeting adjusted operating cash flow in 2019 in the range of £1.8-2 billion. Therefore although full year 2018 results were in line with our 3 year target ranges, what this outlook for 2019 means is that our target of £2.1-2.3 billion of adjusted operating cash flow on average over 2018-2020 is under some pressure.

Depending on the environment and our actions, it is still possible to deliver the 3 year targeted outcome, but on the current forecast 2019 would be below the bottom end of the range. Something we did signal a year ago might be possible, especially in the first year of the price cap in the UK and depending on commodity price movements.

In response to these current projections and recognising we remain exposed to the usual uncertainties of commodity prices and weather, we are taking a number of further actions to strengthen the Company in 2019 and improve underlying performance in 2020. These actions will ensure that even if the current environment persists in 2019 we can strengthen delivery towards our 2018 -2020 cash flow target and underpin the 3 year target of maintaining net debt in a range of £2.7-3.7 billion which has been restated for the effects of IFRS 16.

Firstly, we've announced today we will be making additional divestments of noncore positions totalling £500 million in 2019 and I'm pleased to say we have signed an SPA for the first £230 million for the sale of our Clockwork franchise services business in North America to Apax, which we announced today.

We expect capex in 2019 to be a billion pounds as we continue to drive quality and choice. We're targeting further efficiency delivery of £250 million in 2019 which means we will achieve our target for 2018-2020 one year early. We're also announcing a further £500 million of annual efficiencies beyond the end of 2019 as we target becoming the most efficient price setter in all of our markets. Delivering on this by 2021 would take our total like-for-like efficiency delivery relative to a 2015 baseline to £1.75 billion per annum and help improve performance in 2020 and beyond. These actions will underpin our performance, resilience and competitiveness against what is a challenging and uncertain backdrop as we begin 2019 and project forward to 2020.

In addition to the results of these actions we expect 2020 to have some fundamental sources of improvement relative to 2019. We will not have the one-off price impact from the cap, we would expect the Nuclear fleet to be performing better by then, the capacity market to have been reinstated in some form and the normalisation of the higher UK gas imbalance charges we are currently experiencing. Finally, we would expect cash taxes to be a little lower in 2020 than in 2019. There will of course be offsets such as lower production from Centrica Storage.

We are only 14 months into a 3 year performance period and not even 2 months into this year, but clearly 2019 appears likely at this stage to have an unusual combination of challenges. We will know a lot more at the time of the Interim Results in July, including having a much clearer view of the likely outturn of commodity prices for 2019, market dynamics under the UK price cap and the performance of both the Nuclear fleet and Spirit Energy assets, including early indications of drilling West of Shetland. We'll also know more at that time about progress with the sale of our Nuclear position and with our triennial pension review, both of which Chris will touch on in a moment.

In the meantime we are focused on what we can control, driving performance and cost efficiency hard and continuing to strengthen the balance sheet. This has served us well over the last 5 years.

This is the chart we showed you at the Interim Results updated for 2018 performance. Centrica's adjusted gross margin, operating cash flow and operating profit have been relatively stable over the period despite significant external pressures and volatile commodity prices. We've had to work strenuously to underpin gross margin through a focus on quality not quantity and on reducing our cost of goods. We've managed to deliver relatively stable adjusted operating profit through the portfolio mix of our businesses and through driving operating cost efficiency. This has resulted in a £2.1 to £2.3 billion range of adjusted operating cash flow throughout the period and it is clear that our current portfolio has been capable of this under a range of circumstances.

Unfortunately in 2019 the particular combination of the UK price cap, lower volumes in E&P and unplanned Nuclear outages, higher cash taxes and weaker commodity prices relative to 2018 are likely to impact this track record. Although at present the outlook for operating cash flow in 2019 has challenges and some of these impacts would also flow through to earnings, through the actions we are taking we will be working hard to improve 2019 and bolster our performance in 2020 and beyond. We will provide a clearer update on this in July.

As we tackle this uncertain environment I'd like to remind you of our performance agenda for 2018 to 2020. In addition to maintaining capital discipline and balance sheet strength we have 4 performance focus areas to 2020. They are demonstrating customer led gross margin growth, driving cost efficiency hard towards being the most efficient price setter consistent with our desired brand positioning and propositions, improving the effectiveness of Centrica's organisation and securing the capabilities we need for 2020 and beyond as the world of energy and services continues to change.

We continue to make progress on all of these areas particularly in cost efficiency and the building of new capabilities. But the most challenging of them is to demonstrate net gross margin growth through the customer. This has obviously not been helped by the UK default tariff price cap. Nevertheless, there are some encouraging indicators of gross margin stabilisation and growth potential and we will cover them in more detail as we move through the presentation.

Before summarising what we intend to cover in the rest of the presentation, let me preface it with a brief summary of where we are on the development of our strategy. Our strategic direction remains aligned to the external trends we identified as part of our strategic review in 2015, namely decentralisation of energy as a consequence of the response to climate change, increased customer power and digitalisation. We still hold these conclusions to be fundamentally correct. The regulatory landscape remains very challenging in energy supply, particularly in the UK. In addition, as we have previously indicated, pure energy supply is commoditising and energy use per unit GDP is falling. We have been developing new propositions which our customers need and want beyond commodity energy. Centrica is now exposed to an expanding opportunity set in terms of customers, channels, margin and geography. We've built material new capabilities in both Centrica Consumer and Centrica Business over the past few years and are seeing encouraging signs of stabilisation and growth potential.

We also continue to simplify and improve our portfolio of businesses. Our Nuclear disposal process is progressing while our 2019 divestment programme of non-core assets will be delivered through the sale of our Clockwork US franchise services business announced today. And the possible recycling of capital in both Exploration and Production and Distributed Energy and Power.

Finally, in Exploration and Production, we are working to improve Spirit Energy's performance and sustainability while limiting the Group's exposure to this sector. As we stated at the time we announced the transaction, we wish to create future ownership options for Spirit Energy including through a possible IPO.

So finally, what will Chris and I cover today? Chris will cover our 2018 financial performance in more detail and our 2019 outlook including Group targets for the year. I'll touch briefly on the external context and its relationship to our strategy. Within UK Home we will address the performance of the energy business and the impact of the UK default tariff cap. And we'll also review our 2018 performance in UK Home Services and how we expect to deliver material improvement in 2019. North America Home delivered profit growth for the third year running, but we saw slower than expected recovery in North America business. Addressing this is a particular priority area for Richard and we will provide a further update in particular on North America Business. We'll cover the sources of growth we're seeing in Connected Home, Distributed Energy and Power and in Energy Marketing and Trading. We'll update on Spirit's Energy and its performance including the role of the Greater Warwick Area, West of Shetland, in the business's future.

On our wider portfolio development we'll provide an update on the Nuclear disposal and on our £500 million divestment programme. Finally we'll also update on our cost efficiency programme in both 2018 and 2019 and our future plans to deliver additional saving towards the goal of becoming the most efficient price setter.

I'll be back in just over 20 minutes. Let me now hand over to Chris to take you through our 2018 financial results.

Chris O'Shea – Group Chief Financial Officer
Thanks Iain and good morning everyone. This being the first results announcement since I joined the Group I thought I'd take the opportunity to share a few of my initial observations. Firstly it was suggested to me before joining that the external environment was rather tough with extremely high levels of competition and regulatory scrutiny in our core energy markets. I am pleased to say that the last 6 months has certainly confirmed that is the case. However it is our job to ensure we are well placed as a company to respond to and succeed in the external environment. We have also got a lot to do and I have been very impressed with the focus we have on our customers, it is a key to our success.

Secondly, those of you who know me know that I am obsessively focused on cash flow generation. And I have been pleased to see there is already a lot of focus on cash across Centrica which you don't see in every company. I think there is more we can do to structurally reduce the amount of working capital we carry in the business but we start from an already strong base.

Probably the most surprising thing to me since joining is that I see a lot of opportunities to further improve the cost base. Now I didn't really expect to see that from a company which has already done so much, almost one billion pounds in savings so far. And not only that the payback period has been world class. In the past if someone brought to me a restructuring programme with a 2 year payback period, that was considered acceptable, possibly even good. But in Centrica we have delivered these cost reductions with investment of around half a billion pounds which is a 6 month payback period. The additional cost efficiency programme we have announced today is unlikely to have the same payback period, but I am hopeful that we can do better than 2 years.

To summarise I'd probably say the external environment is a bit tougher than I anticipated, but the opportunities to drive improvements, the things we ourselves can control, we are confident we are capable of delivering much more.

So moving onto the results. These commodity price curves give some of the context behind the 2018 results and also the outlook into 2019 with the solid lines being the observed market prices and the dotted lines showing the current forward market curves. The flat lines indicate the average annual prices we see.

Average market Brent oil, NBP gas and UK baseload power prices were all materially higher in 2018 than in 2017 which even after the effect of the impact of our hedging programme provided some benefit to our E&P and Nuclear businesses. However as you can see on the charts, there have been some substantial decreases since the 4th quarter of 2018 and we currently expect average market prices in 2019 to be below last year's levels. I am sure most of you already know this but it is important to note that we have a long established policy of economically hedging our oil, gas and electricity production rateably, generally over a 24 month period. As a result of this hedging programme and based on current market curves those commodity prices are quite a bit lower today than they were a year ago. We expect the impact of commodity prices to be more or less neutral in 2019 versus 2018.

Moving on now to our financial headlines. Revenue of £29.7 billion was up 6% reflecting increased commodity prices and activity in Energy Marketing and Trading and increased gas sales volumes in North America Business. Gross margin and adjusted operating profit were up 5% and 12% respectively with increased exploration and production profits more than offsetting reduced profits in Centrica Consumer and Centrica Business.

I will cover each of our three divisions in more detail shortly. The gross margins of 14.3% for the Group were broadly flat. Operating margins increased by 25 basis points reflecting profit mix and the positive impact of our cost efficiency programme.

Adjusted earnings fell by 9% including the impact of an increase in the Group's effective tax rate to 41% with a number of one-off credits in 2017 not being repeated in 2018. Adjusted basic earnings per share reduced from 12.5 pence to 11.2 pence and EBITDA was up 15% to £2.45 billion, while adjusted operating cash flow of £2.25 billion was within our £2.1 to £2.3 billion targeted range.

Group net investment of £968 million increased compared to 2017 due largely to lower disposal proceeds than last year while net debt increased slightly to £2.7 billion but remained well within our 2018 targeted range of £2.5 to 3 billion excluding the impact of IFRS16.

As a result the Board has proposed a final dividend of 8.4 pence per share of which if approved at our AGM in May will result in a 2018 full year dividend of 12 pence per share in line with 2017.

Turning now to Centrica Consumer. Total gross margin for the division was down by 6% to £2.6 billion while adjusted operating profit declined 15% to £750 million. Both gross margin and operating margin reduced by one percentage point to 22% and 6.3% respectively. This reflects a mixed picture with strong performance in North America Home and reduced losses in Connected Home more than offset by lower profits in UK Home where adjusted operating profit was down 18% to £668 million. Within UK Home Energy Supply profit declined 19% to £466 million as lower customer account holdings, the full year impact of the pre-payment cap and higher gas imbalance costs more than offset benefit of cost efficiencies.

UK Home Services operating profit reduced by 18% including additional costs of around £20 million resulting from a record number of callouts and other impacts associated with the exceptionally cold weather we saw in the first quarter of last year, the Beast from the East. We've also invested in growth initiatives in this business which together with further cost efficiencies this year, expected to be in excess of £50 million after inflation, should see improved profits and profitability in 2019.

Operating profit at Bord Gais in Ireland declined by 6% to £44 million largely due to the impact of a scheduled maintenance outage at the Whitegate power plant in the first half.

North America Home operating profit increased by 8% to £123 million largely due to lower losses in the services business reflecting underlying growth together with the closure of the loss making solar business in 2017.

And Connected Home revenue rose by 60% to £67 million as the business continued to expand its range of products, propositions and partnerships across core geographies and gross margin also increased by 63% to £13 million. Including the impact of reduced operating costs in Connected Home, the business reported a lower operating loss of £85 million, £10 million better than we saw in 2017. Adjusted operating cash flow was flat compared to 2017 for the division with reduction in UK Home operating profit offset by lower US tax payments due to US tax reform and improved working capital performance.

This slide summarises the primary drivers of operating profit for the Consumer division as a whole. External and portfolio impacts provided a significant headwind during 2018 including the negative impacts in UK Home of the pre-payment and safeguard tariff caps and the increased gas imbalance charge. In addition, Consumer was impacted by inflationary pressures and a change in how we allocated our centralised functional costs across divisions following the set up of the Spirit Energy joint venture. Our efficiency programme resulted in underlying improvements in profits of nearly £200 million in 2018, around 80% of the Group's total efficiency delivery during the year. However the impact of lower customer account holdings in UK Home Energy resulting from the high levels of competitive intensity contributed to the reduction in operating profit of £110 million.

Turning now to Centrica Business where adjusted operating profit fell by 25% to £121 million. UK Business operating profit recovered to £40 million reflecting cost efficiency delivery and improved customer margins. North America Business headline operating profit grew by 14% to £81 million. However on an underlying basis adjusted for the impact of the 2017 accounting adjustment, profits fell by 39% reflecting unfavourable weather conditions and a squeeze on retail power margins from increased competition in the market. I will touch on North America Business in a bit more detail shortly.

We reported increased losses in Distributed Energy and Power as we continue to invest in establishing and growing this business. However we do expect 2018 to be the peak year of losses for this business and our leading indicators of order intake and secured order book both increased significantly when compared to 2017.

Energy Marketing and Trading operating profit fell by 48% to £54 million driven largely by the losses from our legacy gas contracts as the last profitable long-term contract with the Bruce Field concluded in September 2018. However a strong trading and optimisation performance, particularly during the cold weather in the first quarter resulted in a 57% increase in profitability from our core EM&T activities.

Central Power Generation operating profit declined by 23% to £27 million largely due to the impact of lower nuclear volumes with extended outages at Hunterston and Dungeness. Centrica Business adjusted operating cash flow reduced by 48% to £263 million reflecting the timing of cash flows in EM&T partially offset by improved capital management in North America Business.

You can see here a summary of the primary drivers of Centrica Business operating profit. External factors did not have much of an impact with higher commodity prices benefiting nuclear being moreorless offset by the suspension of the UK capacity market. You can see the impact of a further investment in Distributed Energy and Power as we continue to drive our growth agenda.

We also saw a positive year-on-year variance due to the 2017 accounting adjustment in North America Business, but a negative impact in Energy Marketing and Trading from legacy gas contracts. Efficiencies delivered a £39 million benefit, underlying improvements in UK Business and Energy Marketing and Trading more than offset the £39 million drag from lower nuclear volumes. However the principle underlying issue was the performance of North America Business which I will now cover in some more detail.

We've shown you these charts before which break out our North America Business gross margin by its component parts. Underlying power gross margin reduced year-on-year reflecting the previously flagged squeeze on retail power net margins in multi-year fixed price contracts signed in earlier periods due to higher capacity market charges in the US North East.

In addition power trading and optimisation performance fell below our expectations. Gas gross margin was broadly stable with strong trading and optimisation performance during periods of extreme cold weather in the first quarter, but limited trading and optimisation opportunities in the balance of the year due to warmer weather and some pipeline outages. However the outlook for 2019 is more positive with a forward margin under contract currently higher than it was at this stage last year. And we expect North America Business operating profit to improve further in 2019.

North America Business has had two disappointing years with an average return on capital employed well below our targeted Group range. Our focus remains on continuing the improvement in margins and returns. We have continued to enhance our range of products and propositions to meet customer needs and drive improvements in gross margin. Our new pipeline positions are expected to provide incremental gas trading and optimisation opportunities. In addition, process improvements will help drive efficiencies. Our geographic footprint expanded through three small bolt-on acquisitions during 2018. This diversification is expected to allow us to both improve returns and reduce risk in the portfolio. In addition the impact of lower capacity charges in 2019 will be favourable when compared to 2018 resulting in a forward margin under contract for 2019 being somewhat higher than at the same time last year.

North America Business's customer base also presents a significant opportunity for our Distributed Energy and Power Business as we look to leverage our customer relationships to drive growth from non-commodity based propositions. However it is clear from the current performance that the returns from this business are not acceptable and building on the actions already in place to get back to significantly improved profitability is, as Iain mentioned, one of Richard's top priorities.

Moving on now to Exploration and Production which includes Spirit Energy and Centrica Storage. Adjusted operating profit was up 159% reflecting the net effect of consolidating Bayerngas's assets into the Spirit Energy Portfolio and disposing of our Trinidad and Canada operations, significant production from the Rough field following its conversion from a storage to producing asset and higher achieved prices. Adjusted operating cash flow increased 89% reflecting the higher operating profit, the favourable timing of tax payments and the utilisation of Bayerngas's tax loss position. Free cash flow was up by 22%. We expect to see a significant step up in cash tax payments in 2019 reflecting the fact that Norwegian tax liabilities are typically split across two years. Unit costs were satisfactory although there is quite a way to go before Spirit costs are in the right place. I expect to see better cost performance in 2019 and beyond as the benefits of the recent reorganisation of Spirit's Management Team bears fruit.

Looking at the drivers of E&P operating profit in more detail. The portfolio change impact of consolidating Bayerngas's assets more than offset the impact of the disposal of the Canada and Trinidad assets. But there is also a benefit to E&P from the change in functional cost allocations I mentioned earlier. Our commodity prices were a big positive year-on-year. Centrica Storage delivered strong production in its first full year since transitioning from a storage to producing asset. However as Iain has already referenced, underlying Spirit performance was disappointing with production volumes well below our initial expectations. This reflects lower than planned volumes of the Spirit operated Morecambe Field as it took longer than expected to complete the reconfiguration of our onshore processing kit and ensuring the necessary safety improvements were delivered. And also unexpected operational issues at the non operated Statfjord in Norway. We also saw a return to more normal levels of exploration activity which resulted in increased seismic acquisition and dry hold costs. We expect to see 2019 Spirit volumes around the same level as seen in 2018. Both the Rough volumes are expected to fall by around one third as the reservoir is naturally depleting.

Moving onto our Efficiency Programme now which delivered a further £248 million of savings in 2018. This more than offset inflationary impacts and other cost increases including investment in growth and customer service improvement. The 2018 efficiencies have been delivered predominantly in Centrica Consumer and the Group functions. In UK Home and North America Home we have focused on further digitisation of our customer operations and increasing the effectiveness and efficiency of our field force. We have now delivered £940 million of efficiencies compared to 2015 baseline and it has cost the Group only 50 pence for every pound of annualised savings. In 2015 we announced a £750 million 5 year efficiency programme and delivered that 3 years early.

In 2018 we announced the second phase of our efficiency programme targeting £500 million of cost reductions over 3 years. We expect to complete that by the end of 2019 a year early resulting in total annual cost savings by the end of 2019 of £1.25 billion. And today we've announced the third phase of our efficiency programme which is expected to deliver a further £500 million spread across 2020 and 2021. When completed our efficiency programme will have delivered total annual cost savings of £1.75 billion. We expect to deliver around one third of the additional £500 million savings announced today through achieving top quartile cost performance in our overhead functions with the remainder coming from improvements in the direct costs we incur serving our customers as we pursue being the most efficient supplier in our markets.

We would expect the costs to achieve these savings to be higher than the costs seen so far, however we still expect the payback period to be compelling and we forecast that the new programme will position the Group very well competitively for the long-run. When we set out our original cost efficiency programme our aim was to keep our 2020 nominal costs lower than 2015 levels after offsetting inflation and forex movements and funding growth activities. Our nominal costs today are lower than they were in 2015 and we intend to keep it that way over the next few years.

Moving onto cash flow now. As you know EBITDA improved to £2.45 billion which after tax and networking capital outflows resulted in an increase in adjusted operating cash flow to £2.25 billion. In addition to the rise in net investment as mentioned earlier, we incurred non recurring interest cost of £139 million associated with the debt repurchase programme completed early in 2018. We also paid a higher cash dividend than in 2017 due to a lower scrip take up and experienced increased exceptional payments largely relating to the efficiency programme mentioned earlier. Reflecting all of this we saw a small cash outflow during the year with net debt increasing slightly as a result.

Moving on now to divestments, including the £500 million non-core asset disposal programme we announced this morning. Firstly Nuclear. Having announced our intention to divest the 20% share we have in the UK Nuclear fleet by the end of 2020 subject to alignment with our partner and the UK Government, we commenced the first round of the sale process in the second half of last year. We have had encouraging levels of interest and we have taken a number of parties through to the next stage and we will update you in due course.

I am delighted that today we have announced the successful delivery of nearly half of our new divestment programme with the disposal of our Clockwork business in the US. This business comprises a number of brands providing in-home serves predominantly through a franchise model. Although in-home services are a key strategic area for us, it is part of a strategy of getting close to and delivering more to our customers. This is more difficult through a franchise model and as such we decided to dispose of this business to Apax which has a strategy of growing its franchise services model in North America. The consideration of 300 million dollars represents a very healthy EBITDA valuation multiple and the disposal is expected to have a negligible impact on North America Home profitability in 2019. We have plans to dispose of further noncore assets during the year including possible capital recycling in E&P and Distributed Energy and Power and we expect to realise combined sales proceeds of around half a billion pounds.

As already mentioned net debt increased slightly to £2.7 billion, well within our targeted 2018 range of £2.5 to 3 billion. It is worth noting that with the adoption of the IFRS16 accounting standard, the 2019 starting position will be approximately £3.1 billion as we bring slightly over £400 million of lease obligations onto the Balance Sheet. Although this accounting standard is economically neutral to the Group and has no impact on overall cash flow, it will result in a number of presentational changes to our financial statements and you can see the estimated impact of this on slide 68 in the appendix.

We improved the efficiency of the balance sheet during 2018 with a debt repurchase programme, plus the IAS 19 pension deficit reduced to £79 million from close to £1 billion at the end of 2017. Our triennial pension review which uses a different set of assumptions to the accounting calculation is ongoing and we expect to conclude it in the coming months. We remain committed as a company to retaining a strong investment grade credit rating and whilst we expect adjusted operating cash flow to be lower in 2019, our asset disposal programme should see a fairly well balanced cash picture during this year.

Moving on now to our sources and uses of cash. Adjusted operating cash flow in 2018 was within our historic targeted range of £2.1 to 2.3 billion. This was enough to meet our interest, investment, pension, cash dividend and other commitments while keeping net debt broadly flat. As we have already referenced we expect adjusted operating cash flow to drop in 2019. However assuming successful completion of our divestment programme our sources and uses of cash this year should be broadly balanced including the impact of an expected increase in our pension contributions at the conclusion of the ongoing triennial valuation. Note that we don't include any potential proceeds from the disposal of our nuclear business here.

Here is a reminder of our financial framework which remains valid over the medium term. Unfortunately we have yet to demonstrate our ability to grow adjusted operating cash flow and therefore the dividend. And as Iain discussed earlier our 3 year AOCF target range is under some pressure. However we are taking actions to strengthen the balance sheet and will continue to work to identify opportunities to further improve financial discipline, release cash from working capital and increase returns.

Finally now in our 2019 Group financial targets. We are targeting AOCF in the range of £1.8-2 billion with a mid-point around £350 million lower than the 2018 result. As you would expect there are a number of moving parts here but the more material elements can be broadly summarised as follows: number one, a reduction of a little over £300 million due to the implementation of the price cap combined with the natural decline of the Rough field, partially offset by number two, a net increase of around £200 million from the net effect of our efficiency programme after allowing for inflation, and expected underlying margin improvements including our UK Home Services and North America Business. And number three, a reduction in cash flow of around £250 million due to a combination of the phasing of cash taxes partially offset by structural improvements in our working capital and the presentation effect of the implementation of IFRS16. The net effect of the first two items mentioned above should fall through to earnings, resulting in a reduction in earnings of slightly over £100 million when compared to 2018.

In our asset businesses we expect Spirit Energy volumes to be broadly flat in 2019 with a reduction of around one third in Rough production volumes as the field naturally declines. Nuclear volumes are currently expected to be around 2018 levels reflecting our current view of the extended maintenance outages we see. As we have done previously, we have published rules of thumb to show the impact on earnings and adjusted operating cash flow, of movements in commodity prices, and you can find this in your appendix.

To date we have economically hedged around two-thirds of Spirit's 2019 production, one-third of Rough's and around 90% of the expected output from the Nuclear fleet. As I already mentioned we expect to deliver £250 million of efficiencies during 2019 including the impact of a direct headcount reduction of between 1,500 and 2,000. And we expect our effective tax rate to be broadly similar in 2019 to that seen in 2018 and to remain in the range of 40-

45% for the foreseeable future, assuming fairly stable commodity prices and subject of course to any changes we make to the Portfolio.

This AOCF and Operating Profit guidance remains subject to the usual factors outside of our control such as weather, commodity price movements and further regulatory change. Cash capital reinvestment, including any small bolt-on acquisitions is expected to be around £1 billion, well within our target of less than 70% of AOCF. As mentioned we are also targeting £500 million of non-core asset divestments. And finally reflecting all of the above, net debt is expected to be in the range of £3-3.5 billion which after taking account of the impact of adopting IFRS16 is consistent with the mid-point of the targeted 2018 – 2020 range.

With that I'll hand you back to Iain. Thank you.

Iain Conn – Group Chief Executive
Thank you Chris. I should say I am already enjoying working with Chris and with the new Chairman and General Counsel to come there are a reassuring number of Celts around in the Senior Management of the Company.

In the rest of the presentation I'll briefly cover the external context of our strategy before moving on to some of the indicators of stabilisation and growth potential in our customer divisions. I'll then spend most of the presentation covering progress and capability development in both Consumer and Business divisions as well as addressing the UK energy supply market and the default tariff cap. I'll review our E&P portfolio and performance before reiterating our Group financial targets and providing an overall summary.

First the external context and the opportunities and challenges it creates for Centrica. In 2015 as part of our strategic review we identified 3 fundamental trends in energy and services. Decentralisation of the energy system as a result of the response to climate change, increased choice and power shifting to the customer and advancements in digitalisation and technology. These trends have if anything become clearer over the last 4 years. Centrica's strategy is aligned to them and the changes required in the energy system as society seeks to address climate change. Energy use per unit GDP in our core markets is falling and we must provide more than just commodity energy supply. This is both a challenge and an opportunity. There are also specific regulatory issues in both North America and in the UK including price controls with the default tariff cap now in place and uncertainty over the future of the capacity market. Being only an energy supplier is unlikely to be an attractive business model moving forward. Adding new services propositions will be important and a differentiator and we are seeing our customers respond positively to this.

And then there is Brexit. We have devoted significant effort understanding the risks and issues for Centrica. Our activities are likely to be less effected than for other sectors and we have taken appropriate precautions in case of a no deal outcome including increasing stock of EU sourced equipment and ensuring we can continue with our European trading activities. This is a complex backdrop for Centrica, but one in which we feel ready and capable to chart a path forward.

While our current priority is firmly on driving short-term operating and financial performance it is important to remember our strategy is formulated to benefit from and contribute to the long-term structural changes required to address climate change.

Centrica has a strong track record in this area. Our strategy is built around the trends in response to it and we have already taken action to alter our portfolio, reducing our exposure to exploration and production and to gas fired central generation. Our new lower carbon solutions and new propositions help customers reduce their carbon footprint and the optimisation of a more distributed energy system. We have been reporting our Scope 3 emissions, those of the customers since 2007. Importantly we have reduced our own emissions by 80% over the last decade. We have retained our A minus rating with CDP for 2018 and over the last year we have been engaging with the Climate Action 100 Plus investor initiative. For the next phase we have developed a new ambition enabling all our customers to use energy more sustainably and targets to 2030 which are aligned to the objectives of the Paris Accord. It is built around 3 pillars to help our customers reduce their emissions, to enable a decarbonised energy system and to reduce our own emissions. Each pillar has specific targets including for example a further 35% reduction of our own internal carbon footprint by 2025 relative to 2015. We will report in more detail on this in the Annual Report and on our progress against this framework on an annual basis.

Having briefly covered the external strategic context, let me now move onto the development of the capabilities which will underpin our future performance. Let me come back to our performance deliver agenda for the period 2018 to 2020. For the next section I am going to focus mainly on the priorities of demonstrating customer led gross margin growth and securing the capabilities we need for 2020 and beyond.

Chris has updated you on cost efficiency, capital discipline and on our Balance Sheet. We developed material new capabilities in Centrica Consumer and Centrica Business. We introduced new products and propositions over the year in response to customer needs while our enhanced customer segmentation is allowing an increased focus on personalisation and customer lifetime value. As we look to expand gross margins through our customers, there are 4 general themes shaping our actions.

Firstly, cross-sell/up-sell across our strategic pillars. Secondly a shift to digital customer journeys. Thirdly increased personalisation of propositions and finally accessing entirely new gross margin pools through offering new propositions and more choice attracting new customers by selling through new channels and in new geographies. Through this we're beginning to see some early indications of stabilisation and growth potential. The rate of account reduction in the consumer division overall reduced materially in 2018 falling by 249,000 for the full year and only 23,000 in the second half of the year. Within this we delivered growth in the UK services accounts following stabilisation in 2017 and are targeting material profit growth in 2019 through a focus on improved field efficiency and cost reduction. Our protection plans and home warranties continue to grow in North America services. Connected Home added 444,000 customers, an increase of nearly 50%, expanding the product ratio and doubling the number of subscriptions.

Business accounts were broadly flat in 2018 and we saw material growth in margin in the SME segment in UK Business, flowing through into good profit recovery. It is not all going in the right direction, recovery in margin has been slower than anticipated in North America Business as Chris has already covered. In Distributed Energy and Power we delivered significant growth in order intake and the secured order book with growth in all three pillars of energy insight, optimisation and solutions. Also in Centrica Business our core Energy Marketing and Trading activities of trading and optimisation, route to market services and LNG all continue to grow. Taken together, while there is still a lot to do and we need to continue to drive cost efficiency hard there is real evidence of stabilisation and customer led gross margin growth potential. What does this translate into?

This is a slide we showed last year updated for 2018 showing revenue, gross margin and gross margin as a percentage of revenue for both the Consumer and Business divisions. In Consumer gross margin per account fell by 5% but has remained within £104 to £110 range with unit gross margins of over 20% in each of the last 4 years. This reflects our focus on customer segmentation and on value not volume. Clearly the UK default price cap will cause a step down in the results in 2019 and we will have to work hard to re-expand margin with a strong focus on further growth from higher margin non energy proposition and on cost of goods. In Business average gross margin per account increased by 9% in 2018 albeit from a low base given the issues we faced in energy supply in 2017. Business energy supply remains a high turnover activity with lower unit grow margins and can be volatile as a result of the impacts of weather and other factors. Our focus is on improving unit margins and the consistency of returns in this area while ensuring we are positively exposed to market volatility and dislocations. As in Consumer we are seeing encouraging signs of growth from our services propositions.

Let me now turn to each of the divisions. Starting with Consumer. This chart shows the five pillars of our strategic framework and the cross-sell linkages between them. Cross-sell is important. Our data tells us that customers who have more products typically have higher satisfaction and lower churn. Starting with energy supply on the left, a significant number of customers are also taking our in-home servicing products resulting in typically reduced customer churn rates. During 2018 we increased sales of our breakdown only services product to energy customers in the UK, while in North America customers who take energy and services have churn rates that are 14% lower than for energy only. From in-home servicing we can expand into selling 'peace of mind' propositions, offering boiler warranties at the point of installation. And the In-Home Servicing channel has been a major sales channel for Hive products in the 3 right hand pillars. We are also increasingly selling 'Peace of Mind' propositions including leak detection, security through Hive cameras and sensors. And our connected care product Hive Link to customers who already own our Hive smart thermostat. In addition energy supply is becoming increasingly linked with home energy management aided by smart meter technology, intelligent boilers and energy controls. And we launched an electric vehicle tariff in the UK in the second half of 2018.

Our Home Energy management technologies such as Boiler IQ also enable in-home servicing sales. This demonstrates that we are successfully cross-selling across our 5 pillars and there is evidence that our customers are responding well to the suite of propositions we offer.

In Consumer, across these pillars we are also driving the 3 other themes I mentioned earlier, digitisation or digitalisation I should say, personalisation and expanded choice which are enabling us to improve our propositions and the customer experience. And let me start with digitalisation.

60% of our customers now interact with us through digital channels compared to 55% a year ago, while 50% of the UK customer transactions are now online compared to 45% this time last year. We continue to drive enhanced functionality of all our digital platforms with examples from our app in North America shown on the left of the slide. We are now seeing NPS results 5 points higher for digital customers of UK Home than for offline customers. While the enhancements which allow our customers in North America to renew contracts with one click, has resulted in a 30% improvement in renewal rates.

Moving onto personalisation. At our interims announcement last July we focused on how we had improved our customer segmentation capabilities enabling us to drive growth, retention and cross-sell/up-sell through personalised offerings. Our Rewards programmes in the UK and Ireland use data to understand customer preferences and allow customers to select personalised offers. Across the two markets we now have over 2 million members and 150 reward offers. Churn rates for Rewards customers are significantly lower as a result and have halved in the UK.

In UK Home Services we are driving risk reflective differentiation including claim propensity depending on a customer's domestic installation and location based pricing which captures cost differentials such as water hardness, ensuring our premiums are reflective of risk. And improved online claims tool for home warranty customers in North America has reduced touch points while renewal rates are up 7% as a result. Personalised offers to Connected Home customers have resulted in significant increases in the uptake of multi-product propositions.

Turning to increasing customer choice, we broaden choice more quickly through increased speed of product development and testing. We launched more new propositions in both UK Home and North America Home than in 2017 and also introduced 7 new Connected Home products and broadened product features. We are increasing the bundling options available to our customers, while our wider product range means we can target more customer segments and access new gross margin pools. These include new 'Peace of Mind' propositions such as Hive Link, outdoor security cameras or on-demand services including through our Local Heroes platform.

So how is this helping to stabilise the number of account relationships we have? Consumer accounts in total fell by 249,000 in 2018. This is a material improvement compared to 2017 in which we saw a reduction of 1.4 million in total. The second half of 2018 also saw significant improvement with a net reduction of only 23,000. We are still losing energy accounts. We saw a net reduction of 259,000 energy supply accounts of which 127,000 were collective tariff or White Label accounts mostly in the UK. We lost 97,000 pre-payment customers and the balance of 535,000 accounts were mainly standard variable tariff customers in the UK.

The level of losses largely reflects market switching trends, our own efforts to move customers off the standard variable tariff and additional churn caused by 2 standard variable tariff increases during the year. North America energy accounts within all this fell by 25,000 but increased in the second half of the year and we saw a small increase in Ireland.

In Services we delivered account growth of 66,000 overall with growth in the UK for the first time since 2010, including the impact of additional sales of bundles with energy. While North America Home Services accounts also increased driven by growth in protection plans. We also added a further 444,000 Connected Home customers in the year through the expansion of our product range and subscription offers.

As I said previously, our goal is to first stabilise the number of consumer account relationships we have and then look to grow it, while also expanding margin through increased choice and reduce churn. It's very early in 2019 and we do not know what the churn dynamic will be under the UK price cap, but so far we've seen net consumer account growth as of mid-February.

The UK Energy Market, it's design and competitive dynamic is a key driver of our consumer accounts and let me turn to it now and specifically the impact of the default tariff cap. First on tariff differentials. The chart on the left shows the range of pre-payment prices that were available to customers before and after the implementation of the pre-payment tariff cap in April 2017. The maximum differential fell from more than £200 to less than £75 and remains at a similar level today.

The chart on the right shows similarly the range of standard variable tariff prices following the implementation of the default tariff cap on 1st January. The maximum differential has fallen from around £400 to around £160. These reduced differentials provide customers with less incentive to switch and evidenced from the pre-payment tariff cap backs this up. Pre-payment churn is 5 percentage points lower now than it was before the cap came into effect. It is too early to know whether churn levels will reduce significantly under the default tariff cap. It is also too early to know what impact Ofgem announcing a large increase in the level of the default tariff cap from April will have on short term switching rates. However in their draft impact assessment, Ofgem has already indicated the market could see a similar

reduction in churn to that observed in the pre-payment market. Specifically they estimate that at the level the cap has been set, customer switching will reduce by 30%.
The number of suppliers in the market is also now reducing. We saw evidence of a number of suppliers coming under pressure in 2018. In particular as commodity prices rose 10 domestic suppliers exited the market in 2018 and a further 2 have exited so far in 2019, perhaps reflecting reduced pricing flexibility under the cap.

We've consistently said that temporary price controls would not resolve the structural issues of the market and instead suggested ways to address the root issues more sustainably under our 14 point plan of November 2017. This slide shows our 14 recommended actions with our own actions on the left and those we would like Government and Ofgem to implement on the right. Our own actions included withdrawing the standard variable tariff for new customers, providing new offers responding to customers changing needs, proactively offering customers a choice of fixed price tariffs, introducing a new fixed term default tariff and engaging customers on the standard variable tariff to encourage them to switch. We also said we would introduce simpler bills while continuing to drive improvement in customer service and cost efficiency. We have delivered on all of these. We now have less than 3 million customers on the standard variable tariff, down from 5 million 2 years ago. Customer service levels improved again in 2018 and we remain on track to achieve £20 per customer of efficiency savings by 2020.

On the right, there has also been some progress in terms of market reform. In particular with regard to levelling the playing field on environmental and social policy costs and for vulnerable customers. We will continue to engage constructively with the Government and Ofgem. We have been less successful in the market wide phase out of evergreen tariffs or persuading the Chancellor to move funding of policy costs from people's bills into taxation.

To conclude the Consumer review, I will provide two short updates on UK Home Services and Connected Home. Although our UK Home Services business delivered a disappointing financial result in 2018 partly due to the effects of the Beast from the East, we have built significant momentum. Our investments in customer service and offer development have been delivering growth in both accounts and gross margin. Excluding the impact of additional costs from the Beast from the East, underlying gross margin was up. UK Home Services is also becoming increasingly important as a sales channel for Connected Home, while efficiency delivery in 2018 was able to offset inflation.

Moving to 2019 we are targeting further account growth through bundled propositions and partnerships. On-demand remains a significant opportunity including utilising our Local Heroes platform, while our more sophisticated pricing models provide additional potential for gross margin growth.

Finally a significant proportion of the Group's cost efficiency programme is expected to come from UK Home Services and we expect savings to accelerate in 2019 from further improvements to planning and despatch and improvements in infield effectiveness. In 2019 after inflation we expect to deliver savings of at least £50 million.

Connected Home delivered strong revenue and customer growth again in 2018 with a 37% increase in products sold, a 49% increase in cumulative customers, a 19% increase in year-on-year customer additions and a 60% growth in revenue with growth rates accelerating materially during the second half of the year. We are moving the model towards subscription based offerings and you can see with that orange line at the bottom we saw cumulative subscription relationships more than double in the year. We launched a number of new propositions including our 'Peace of Mind' connected care offer, Hive Link and our leak detection offer, Hive Leak. We continue to increase the number of sales channels we sell through with new partners and retailers activated while utilising existing channels including through our British Gas engineers in the UK.

The wider range of products and offers has seen an increase in the number of products sold per new customer from 2.3 to 2.7. As a result we saw increased gross margin and an improved financial result for Connected Home in 2018.

We showed this slide a year ago and it updates our competitive position in Connected Home. The internet of things market has thousands of participants but we are well placed. In terms of smart thermostat sales we still rank 4th globally and remain the market leader in the UK and Western Europe. We rank 5th globally in terms of integrated multi-function ecosystem deployment with our growth in 2018 moving us up 2 places from 7th. We remain the leader in the UK and number 2 in Western Europe. So we are competitively well positioned in Connected Home and it materially strengthens our other core propositions.

Let me now turn to the Business division. In a similar way this chart shows the 5 pillars of our Business strategic framework and the linkages between them. Customers taking energy supply in both the UK and North America are increasingly interested in propositions to address resilience, sustainability and overall energy management needs. Our route-to-market solutions for power producers can lead to gas supply contracts and installation of generation capacity. Energy insights give our customers greater understanding of their businesses enabling them to pursue solutions and optimisation opportunities. Customers who install solutions may require our optimisation services while customers who have installed technologies such as combined heat and power require a fuel supply. As in Consumer, our propositions, enabled by the integrated solutions platform we built and the Centrica Business Solutions marketing platform, are driving cross-sell across the pillars to existing customers and attracting new to brand customers.

We have continued to enhance the integrated solutions platform and to deepen the full suite of services it offers. Customers can now access services to help them with their energy usage, operational efficiency, demand management and optimisation, demand response and operations and maintenance services all through a single user interface. We believe the platform provides a unique and differentiated customer offering for distributed energy products and services, with the key differentiators being ease of interaction and Centrica having the full suite of capabilities to offer. The platform incorporates the capabilities gained from our targeted acquisitions of Panoramic Power, REstore, NEAS Energy and ENERG Cogen. It provides us with a real competitive advantage in the fast growing distributed energy sector. We are beginning to see real sales momentum.

In Distributed Energy and Power our order intake was up 158% compared to 2017 and the secured order book ended the year up 51% compared to a year ago. These figures reflect investment in our Centrica Business Solutions brand and sales channels across the US and Western Europe, with the non-UK order book now accounting for 68% of secured revenue compared to 50% at the end of 2017. Revenue was up by a comparatively low 14% as sales were skewed towards the second half and encouragingly we saw an increase in the proportion of recurring revenue sales.

You can see from the chart on the right that at the end of 2018 £183 million of 2019 revenue was already secure and I am pleased to say that by the end of January had already exceeded 2018 levels. We have also secured material revenue for 2020 and beyond.

So what scale of portfolio have we been building in Centrica Business outside of energy supply and energy wholesale? This chart shows the growth and geographic spread of our energy insight, optimisation and solutions propositions. We have seen consistent growth in the number of customer sites with Panoramic Power energy insight sense as an app and while the revenue we generate from these sales is typically small, they provide a powerful up-sell channel for energy solutions.

Our energy optimisation capacity of flexible generation and demand response have grown materially and I believe Centrica is the largest demand response capacity holder in Europe. We have increased our energy solutions capacity under management to over 700MW and encouragingly much of the growth is outside the UK.

Finally our route-to-market capacity under management has increased materially in all our core regions and now stands at over 23GW. Let me give you 2 examples in route-to-market services and in demand response. The map on the left shows our route-to-market footprint across Europe. As you can see we have a significant presence in a number of markets serving 13.7GW of installed mainly renewable capacity.

What are we doing and how does this work in practice? The two main drivers for the customer to seek route-to-market services are to secure financing to develop a project or the need for someone with appropriate expertise to sell their power into the wholesale market. Centrica has built up the infrastructure, trading capability, data and analytical capability to deliver this service for customers. The schematic on the right of the slide shows how this works in practice for the 950 megawatt Moray East Wind farm for which we signed a 15 year contract to trade and balance the majority of electricity which will be generated when the project is operational.

Another area where we believe we have a competitive advantage is in demand response. Our acquisition of REstore in 2017 has given us all the software, hardware and expertise to help customers manage their energy demand to either generate revenue or save costs. This example shows how we can save customers money in North America by forecasting peak load by using our advanced REstore software and algorithms and then helping customers identify flexible load which can be turned down during these peak times. If the customer wants us to we can also directly control the customers load within pre-agreed perameters. We would typically take a share of these savings or revenue.

Let me now touch on another growth opportunity for Centrica, LNG. From our position as a major procurer of gas in the UK we have made good progress in developing a global LNG business over the past few years. We have a number of off take contracts to buy LNG including from Cheniere and Qatar Gas, market LNG from North America for Tokyo Gas and 2 weeks ago we announced that we had agreed to jointly procure in strategic partnership with Tokyo Gas 2.6 million tons per annum of LNG for up to 20 years from the Mozambique LNG project. We now have the positions and capability to lock in value from location gas price spreads and from optionality to send divertible cargoes to other markets. In total we have transacted 200 cargoes across more than 20 countries in the last 4 years. The LNG business represents a material future growth opportunity for Centrica.

I have now covered highlights from the customer divisions, let me touch on E&P. Exploration and production continues to play a role in providing cash flow diversity and balance sheet strength for the Group. Spirit Energy has now been successfully established creating a self financing European E&P business. Spirit Energy's production was disappointing in 2018 and as we said in our November Trading Update we currently expect 2019 production to be broadly in line with 2018 levels. Our focus remains on improving performance and strengthening the portfolio. Spirit Energy continues to make progress on its development projects and exploration with Oda proceeding to plan, a positive final investment decision being taken on the Nova Field and exploration success at the Hades/Iris and Lille Prinsen prospects. As we have said previously, Spirit Energy will continue to look at the potential for further opportunities to strengthen the business which could include further consolidation with another party and we will look to create options for different future shareholders including the potential for an IPO.

The E&P division also includes Centrica Storage which in January received consent to produce all recoverable reserves from the Rough field. Rough production of 11 million barrels of oil equivalent was at the upper end of the expectations we had although given the finite reserves in the field we expect production to fall to the range of 6-8 million barrels of oil equivalent in 2019. In August the CSL operated Easington processing plant was awarded a contract to process gas from the Tolmount field which secures its future until at least 2030. In September we announced that Spirit Energy would invest in exploration and appraisal in the West of Shetland for the first time after farming into 50% of Hurricane Energy's Greater Warwick Area. Although commercialisation of this type of hydrocarbon prospect carried risk, it could be of material importance to Spirit. Spirit Energy will fund a 180 million dollar campaign to drill 3 wells 100km west of Shetland due to begin in the second quarter of 2019 to further prove up the potential of an area which holds an estimated 2 billion barrels of oil equivalent in prospective and contingent resources. We plan to tie into Hurricane Energy's floating production storage and offloading vessel in the Greater Lancaster area for the first successful well.

This is an exciting opportunity for Spirit to participate in the early phases of resource maturation in one of the last known world-class oil development opportunities in the UK. Hurricane will conduct an extended test on Lancaster in the coming months and we should have some well results and know more about the commercial prospects of our own acreage by the middle of the year.

I have now covered progress in the three divisions. Before I summarise let me turn to the here and now and our current outlook as I see it today. What we are doing about it and our Group targets for the year.

Our 2018 performance was mixed. At the headline level adjusted operating profit was up and we did deliver the Group financial targets, including being within our targeted ranges for adjusted operating cash flow and net debt. We also made a lot of progress in building key capabilities for the future which are beginning to drive improvements in gross margin and we successfully delivered significant further efficiencies. However some parts of the business were weak. As we enter 2019 we are facing an unusual combination of factors, including a total £300 million pre-tax impact from the price cap, continued lower volumes in E&P and Nuclear and the recent commodity price correction which added to the pressure on our 2019 outlook relative to a few months ago. As a result our 3 year target for adjusted operating cash flow is under some pressure and some of the underlying impacts will flow through to earnings in 2019.

Although we are less than 2 months into the year I am therefore preoccupied with urgently strengthening 2019 and 2020 by focusing on what we can control and taking appropriate additional actions now. The Executive team is very clear about what we have to do. As we have outlined, this includes making the additional non-core divestments we've announced, accelerating out cost efficiency programme so that we deliver our 2020 target a year early and pursuing £500 million additional efficiencies towards our goal of becoming the most efficient price setter. We will also keep tight control on capital investment. We will have a much clearer view on how 2019 is actually turning out including the key uncertainties of commodity prices and the UK market dynamic under the price cap when we get to the Interims in July.

Let me now turn to our Group targets for the year. We are targeting as Chris said to deliver adjusted operating cash flow in the range of £1.8 to 2 billion including the impact of the UK default tariff price cap, continuing lower Nuclear volumes and Spirit Energy volumes in the lower half of the target range and higher cash taxes. This assumes current forward commodity prices and normal weather. We expect to deliver a further £250 million of efficiency savings and a reduction in direct headcount of 1,500 to 2,000. We expect cash capital reinvestment of a billion pounds and we are targeting £500 million of divestments of which nearly half has already been signed and announced today. 2019 net debt is expected to be in the £3.0-3.5 billion range as Chris outlined which is consistent with the mid-point of our previous net debt range after including the impact of adopting IFRS 16.

Now let me summarise. As I have just described, 2018 financial performance was mixed. We are targeting adjusted operating cash flow in 2019 in the range £1.8 to 2.0 billion at current forward commodity prices. As a result our 3 year average adjusted operating cash flow target range across 2018 to 2020 is under some pressure. However our 3 year net debt range is underpinned. We are taking actions in 2019 to improve underlying performance and the balance sheet and to strengthen 2020 including driving further cost efficiencies, keeping tight control on capex and making targeted non-core divestments. This continued focus on performance delivery and financial discipline will enable us to offset some of the near-term challenges while maintaining a strong balance sheet. We are continuing to refocus and simplify the portfolio both through the nuclear sale process and the 2019 non-core divestments. And our Exploration and Production business is being strengthened while limiting Centrica's exposure and creating options for the future.

The strategic direction we have chosen is aligned to external trends exposing Centrica to an expanding opportunity set. We have developed material new capabilities in Centrica Consumer and Centrica Business with indicators of stabilisation and growth potential. We are dealing with a challenging situation in 2019. But we have a clear agenda in response and despite the near term headwinds I am confident we now have the tools, capabilities and team to compete successfully in the medium term and create enduring value for our shareholders. And I look forward to updating you on our progress in due course.

I would now like to invite Mark Hodges and Richard Hookway to join Chris and me on the stage and we look forward to taking your questions. Thank you.

And thank you all for listening to such a lengthy presentation. In the circumstances you can understand why we wanted to go through all that and as usual if you can identify yourself and your affiliation before your question, that would be very helpful. We will go to Mark Freshney.

<u>Questions and Answers</u>

Q1. Mark Freshney, Credit Suisse

Three questions. Firstly on the adjusted operating cash flow guidance. Can you give us some colour as to exactly what is in that? In particular capacity payments and whether they come back to you?

My second question is on the pension deficit and the actuarial review. I note from your accounts that you took the unusual step even before the review has been concluded of putting £75 million extra into the pension scheme. Does that signal that it is going to be a very high deficit? And if you can give us some colour around that.

And just thirdly Iain on your communication surrounding Spirit. Previously you indicated we need that for balance Sheet strength. Until the handshake with growth has been done. Today you are talking about an IPO and potential changes to the capital structure, is that just my interpretation or has something changed in your thinking?

Answer: Iain Conn
So let me take the third of those Mark and then I suggest Chris addresses what is in the AOCF guidance. I will come back later no doubt and talk about the dividend if that is of interest. But the pension deficit also Chris if you could cover that.

So firstly on Spirit. We haven't changed what we are saying. When we created Spirit we said yes as you said, it's role is in terms of cash flow diversity and balance sheet strength, but we also said we wanted to create Spirit as a self-financing European E&P company. We have successfully done that. We have divested our Trinidad and Canadian E&P business and we have created an E&P business in North-West Europe, which is about, for Centrica's interest, about two-thirds of what we used to have in E&P. At the time of setting up Spirit we also said that Spirit would look to and we would look at the possibility of further consolidation in the industry and we were open to other shareholders in Spirit. If Spirit became larger we would reduce our own shareholding in Spirit so that we would not net become increasingly exposed to E&P. And we also said that we were open to other shareholding options including preparing Spirit for the potential of a different ownership structure such as through an IPO and the way Spirit is set up with Stadtwerke Munchen we have the option from as early as 2020 to do that and they have the option nearer 5 years out so 2023. So that is how Spirit is set up. It is not new but clearly we are interested in strengthening Spirit including through other potential industry consolidation without increasing Centrica's exposure to it. And the potential of creating a different shareholder mix in the ownership of Spirit at some point. Chris.

Answer: Chris O'Shea
I will deal with the pension first. At the last triennial review we made a commitment that if we hadn't reached agreement by 31st December 2018 we would make a payment of £75 million. So that was a commitment that was made almost 3 years ago. I wouldn't read anything into that in terms of a level of commitment. We are having discussions with the Pension Trustees, as you would expect they are pushing for more money. The negotiations are ongoing. I would expect the payments will increase but I would not want to speculate to what level as that means I have less negotiating leverage with the Trustees. So that was a commitment.

On the capacity payments, our assumption is that the capacity market will be reinstated in some form so that is included in the range of £1.8 to 2 billion.

Q2. Ajay Patel, Goldman Sachs

Can I have three questions please? Firstly on the legacy contracts. Is there any guidance you can give on whether those losses stay at those levels from '19 onwards?

On the SVT customers, the 3 million customers you have at the moment, is there any scope to further reduce that customer base?

And then finally on Hurricane, I am not completely sure exactly what we will get at the mid-year stage post drilling. So will we have a better feel for what reserves are available or maybe is it more of a timeline or process to get in that?

Answer: Iain Conn
So between Chris and Richard on the legacy gas contracts. Who would like to pick that up?

Answer: Richard Hookway, Chief Executive, Centrica Business
Shall I kick off Iain. So on the legacy gas contracts. A little bit of context first of all. We had a number of those contracts that have progressively rolled off. One of the ones that rolled off in 2018 was one of our more profitable legacy gas contracts which leaves us with just one

remaining that still has a good handful of years left to run. Obviously the future mark to market of that depends on your particular view on price. On any given day it goes up, it goes down. We look to actively manage that. I would anticipate that '19 is not quite as bad as '18 but that is involving a crystal ball that of course isn't perfect. But broadly in line is a reasonable assumption I would say. Chris anything you would add?

Chris O'Shea
No I think that's right.

Iain Conn
And Mark on the SVT 3 million customers and any scope for further reducing it, I think was the question.

Answer: Mark Hodges, Chief Executive, Centrica Consumer
Yeah definitely is the answer. So our commitment when we made them, Iain went through the 14 commitments and our 7 was to engage our SVT customer base. We do that on a regular basis with alternative offers including the rewards programme, but alternative fixed offers. And we will keep doing that. SVT isn't open to new business as such. So we will keep trying to get the customers to engage with their energy choice around a fixed tariff deal and I would hope that would be impactful and reduce that number over time. And you will have noted I hope from the energy accounts that the fixed book, year-on-year was broadly stable which goes to why we want to move people into those fixed products where we can have a more ongoing relationship with them.

Answer: Iain Conn
And on Hurricane, look I don't want to get into too much technical stuff here, but this is a, it is a pretty unusual opportunity we farmed into. This is a thing called a fractured basement play which is basically a huge amount of oil that is sitting in fissures in basement rock. There are very significant volumes there. What the commercial prospect of it depends on is being able to extract the oil without extracting a load of water with it. From what we understand there is a very large oil column which increases the chances of being able to extract oil without the water. Hurricane have got their own field called Lancaster and this next 6 months they are going to be doing an extended test on one of the wells linked up to a floating production vessel that is already either going there or on station. That test will tell us whether or not the commercial solution for that huge resource is actually feasible. Very important bit of information.

Secondly we have got an interest in two fields, Lincoln and Warwick and we will be drilling the first or maybe even 2 out of the 3 wells that we are or Spirit is intending to drill initially. That will tell us how much oil is available from a similar play to Lancaster. So with those two bits of information we will have a much better idea of the commercialisation potential and the likely resource base there. It is not without risk as I said, but it is very important. And to link it to the divestment programme as Spirit managed to farm into this and the competition for this was actually from some of the very large oil companies and we managed to win it through a bilateral process. Clearly we have given, the shareholders have given Spirit more money to invest in this. Equally we want Spirit therefore to start looking at some of its tail assets and saying, okay can we divest some of that and that is what we are doing. So part of the divestment programme will involve packages of assets from Spirit but not exclusively limited to them.

Q3.   Chris Laybutt, JP Morgan

The first question is directly I guess on the dividend. Could you provide us with your elevated pitch to investors today on medium term dividend expectations? You have given a lot of commentary today on operating cash flow. How does that tie to the

dividend and what exactly are we going to hear from you through the year on the dividend because that is a key consideration?

And I guess secondly a little easier, slide 48 you have got some numbers on UK services. Are we expecting a £70 million improvement adding those two numbers together?

And lastly, Chris would you mind if we come back to the capacity market. In terms of the numbers you've missed out on some revenue in 2018. We know what you're broadly expecting in 2019 and 2020 given your contracts. Your comments before, what is in that range? Is it sort of from zero up to the number, my numbers are around £80-90 million. Is that a fair number? And can you give us some more clarity there is you can, that would be great? Thank you.

Answer: Chris O'Shea
I am happy to start on the capacity market. So we expect around £50 million in 2019 of income in the capacity market. We also expect to collect just under £100 million in suppliers. So we collect £100 million, we pay it over to the administrator and we get £50 million back. That is the basis, that is the planning assumption for 2019.

In 2018 we saw a suspension, it was only for the 4th quarter. We have, that was actually a net benefit to us. So we had collected more money from customers than we had expected to get as a generator. We provided for that net benefit. We didn't include that in our results. We thought that wasn't right. So the 2018 numbers are prepared as if the capacity market was in place for the full year and our 2019 expectation is, that is what we have been told by Government. But it would actually be as we continue to collect in the suppliers' areas, actually a benefit for us in the very short term. Clearly longer-term we would like it to be back there.

Iain Conn
Thanks Chris and Mark on UK Home services. And this is your last chance to leave Sarwjit on the hook for some big numbers so over to you.

Answer: Mark Hodges
Well I think the guidance was clear. We are expecting efficiencies to beat inflation by £50 million so that should be a net add and we are expecting normalised weather which was the £20 million in the Beast from the East. So all other things being equal I think it is a reasonable assumption. The other place I would get you to look is at the Half 2 performance of UK Home Service where I think the profit was £130 million. Now Half 1 was affected by the weather, Half 2 the efficiency started to outstrip the inflation. So Half 2 2018 is a good guide potentially for what we will do in 2 halves next year and that £70 million, all other things being equal is a good guide for the uptick in performance we expect.

Answer: Iain Conn
And Chris on the rather important question of the dividend I am going to take a bit of time just to unpack this for everybody. First of all we gave clear conditional guidance on the dividend in 2018 out to 2020. And obviously it was conditional because it was 3 year guidance. And those conditions under which we would expect to continue to pay the dividend at 12 pence related to staying on average in a range of operating cash flow of £2.1 to 2.3 billion and net debt being in a range of £2 ¼ to 3 ¼ billion and that has now changed with IFRS16 but it is the same fundamental range.

Why those two conditionalities? You have often heard me talk about, there are two trip wires that I keep an eye on that would cause us to wonder about the dividend. One of them is clearly not generating enough cash flow to pay for our strategy and pay for our other obligations like pension funds and pay the dividend. So that is clearly why one of the conditions relates to operating cash flow.

And the second trip wire is clearly if we were starting to borrow materially in order to pay all of our obligations including the dividend.

What we are obviously signalling today and I will come back to it, is one of those is under some pressure because of the conditions we find ourselves in 2019 and the other one underpinned through our actions. We did signal a year ago that 2019 would be a low point in our adjusted operating cash flow and if you remember we said under some circumstances it could even be below the range.

What we are signalling today obviously in 2019, our current view is £1.8-2 billion and if you think that our last year's guidance inferred that we would be at or below the bottom end of the range, so let's call it £2.1 billion. We are now signalling £1.9 billion. What has made up that £200 million difference? What has changed since last year? It is really 3 things. The size of the price cap impact which is £100 million pre-tax more than we thought. Call that £70 million. The lower exploration and production volumes, call that in the current environment another £70 million. And nuclear which is an impact of about £50 million and that is the £200 million that takes us from guidance last year of around the bottom of the range to this new range with £1.9 billion in the middle.

So operating cash flow guidance is under some pressure. We have indicated that we could still deliver on the target over the 3 years. I said that very clearly, but it depends on circumstances, not least commodity prices and our own actions. So what we are doing, our main focus right now is to underpin operating cash flow and free cash flow through our actions as we have outlined.

Chris also indicated that relative to 2018 a little more than £100 million was likely to flow through to earnings. So we are clearly indicating an impact on earnings this year. But we are only 2 months into 2019 and you ask, so what will we know and when will we know it? Look at the time of the Interims we will know how commodity prices have evolved. They have come down a very dramatic distance since September. We need to see where they are at. Secondly, we don't know the dynamic of the UK energy market under the price cap and that is a very important determination of our cash generative capability. We will know more about the Nuclear sales process and how that is progressing and we will know much more about the Nuclear assets that currently are offline and whether they are going to be allowed to be back online. And lastly, as Chris outlined, we will have a sense of our triennial review and its implications on our cash flow.

So what we are going to do in the meantime is focus on what we can control to defend adjusted operating cash flow and free cash flow and through doing that defend the balance sheet and the strength of our covenant to underpin all of our obligations for cash flow including the dividend.

Q4. Fraser McLaren, Merrill Lynch

4 very quick questions. First of all you spoke about LNG but I recall that you mentioned previously that you had largely hedged the overall position in the early years of the contract. So given recent moves in commodities and spreads, do you expect the various contracts to be actually profitable in 2020 and 2021?

The second question is if there is any indirect effect from the extreme weather in the US in recent weeks?

Number three, how do you feel about your credit metrics in light of the cash discussion? Will these extra disposals be enough for the rating agencies?

And lastly, could you update us on your views about breakeven at Connected Home and DE&P please?

Iain Conn
Very good. So I suggest Richard if you can touch on the first two, Chris on credit metrics and I will come back and talk about in general terms Connected Home and DE&P.

Answer: Richard Hookway
Great, Fraser thank you for the question. Let me start with LNG. We traded around about 100 cargoes last year just as the context for that. Obviously a number of them spot. What happens this year is that the Sabine Pass contract comes into play, that starts in September. We have got about 7 cargoes this year, there will be about 30 next. Almost all of those are covered either through hedges or direct sales or other forms of optionality. In fact we have still got a little bit of flexibility. And what I can say for those 37 cargoes with one or two minor assumptions are, I am going to be writing in black ink, not red ink, put it that way for that period. Further out obviously we have more exposure, but equally further out some of the softness we are seeing in the spreads today start to abate and you get back into positive territory again. So we actually like the look of the portfolio. We have said before that of course in any given moment in time the market will be what it will be and it swings around quite wildly. The team have been successful in managing to pick those moments to lock in the spread at the right time. So that is basically LNG.

Weather in the United States, clearly there was a, I'll call it a mini polar vortex, it wasn't quite as significant as the last one. It tended to centre around you know Chicago -30, Dakota -37. Most of our action tends to be in that North-East corridor and in New York it went from -10 to +10 in the space of a few days around that period so very limited impact. You know you can barely see it in the numbers.

Answer: Chris O'Shea
On the credit rating metrics, a lot of the reduction in our cash flow in 2019 is going to be cash tax and the rating agencies tend to use book tax in the numbers. So we achieved the metrics that we had been set for 2018 and as Iain said, and I mentioned as well, it is very important for us to retain our strong investment grade credit ratings. We think that having a fairly well balanced cash position in 2019 should be satisfactory. If we need to do more we will do more. I am never too confident about these things because there is also the business risk question. But we absolutely strive to hit these targets and we have done so consistently and it is the very strong base that I referred to having found in the company.

Answer: Iain Conn
And on your last part Fraser, on Connected Home and DE&P objectives, we set a pretty big goal of getting to £2 billion of revenue in 2022, a billion each from these two businesses. Now obviously those are pretty big round numbers and when you have got businesses starting out like this with very high growth rates, but uncertain pathways, we are not throwing a dart at a dartboard, we were actually being reasonably judgemental about what we thought these businesses are capable of. I still believe these businesses are capable of £2 billion of revenue in 2022. What I don't know is whether the mix between the two is going to be exactly the same. I think it will be highly unlikely that it would be. If I had to be a betting person at the moment, the potential of Distributed Energy and Power to deliver more than a billion is growing and I think Connected Home is probably looking less likely to deliver a billion, but I think the total is still likely to be of that order and that is what I think these businesses are still capable of.

On the breakeven question, we were quite careful to say, as early as 2019. It looks highly unlikely that we will break even in 2019 in these businesses as I look at it today. However we are still saying and I have just said, we see a pathway potentially to £2 billion of revenue in 2022. I think the breakeven point is probably, the potential breakeven point has probably moved out at least a year. So the curve is going to have to be steeper from 2020 to 2022. But we are still holding to that objective. It is quite hard to plan because we are seeing some very high growth rates with some very high take-up in geographies we haven't operated in before. I am very encouraged by that actually and we will keep updating you every 6 months on our progress.

Q5. Nick Ashworth, Morgan Stanley

Hi thank you, morning everybody. So I guess 3 questions from me as well given everybody else has. Firstly can we just go back to the customer numbers on the standard variable tariff? I think it was Ajay who asked around how it moves from here. And I think you went from 4.2 million to just under 3 million in 2017, sorry 2018. Is there a number commitment or assumption or target for the end of this year?

And then just going back to 2018, of the 1.2-1.3 million that you switched off, how many have you actually kept and how many have you lost? Looking through the statement I am a bit unclear about customers versus customer accounts, so a bit more colour around that would be very helpful/

Secondly going back to Fraser's question on Connected Home and DE&P. So you talk about the breakeven point being pushed out at least a year. What does that actually mean for EBIT in 2019? Are we through the peak of losses? Should that start to improve or would you expect it to maybe stay at that level and then shoot up sharper post?

And then finally, I guess another question somebody has already asked, the dividend. Just to be clear, you have talked this morning around weaker free cash flow, operating cash flow in 2019 and then we will see where we get thereafter. It feels to me like you are a little less certain around the average cash flow over the next year or two. So then when we talk about the dividend are we still saying that 12p is possible or is the conversation around where that dividend will go to when it comes to Interims?

Answer: Iain Conn
Thank you. Well let me take that last one and then I will just finish what I was saying about Connected Home and DE&P and ask Mark to cover the analysis of SVT.

So firstly, I mean clearly we are saying that the operating cash flow in 2019 is £1.8 to 2 billion and therefore the 2.1 to 2.3 is under some pressure. Clearly that is therefore indicating that one of the conditionalities for the dividend is under some pressure. But I also said earlier we can still deliver on that target range. We are only 14 months into a 36 month performance period. But it's our duty to be clear when we think this year is going to be under pressure for the reasons we have just outlined, that is what we have done. I think it will be, for the reasons I outlined earlier, much clearer about how 2019 is going to outturn when we get to the middle of the year. If you take the upper end of our £1.8 to 2 billion range, it becomes pretty clear we could still be, i.e. we would still be in the average range, just right at the bottom. If we end up at £1.8 billion we would clearly have averaged for 2 years about £2 billion as opposed to £2.1 to 2.3 billion. So it is just too early to be sure. We are not giving any firm guidance beyond what we have already done. I mean the guidance is clear and it is a matter for the Board and we will need to chart our progress as we walk through 2019 to see how much the dividend guidance is under pressure. What we are able to do is underpin the net debt conditionality and we haven't given up on the operating cash flow conditionality, but clearly the situation that we have entered this year with, and in particular the fall in commodity prices since September which has changed our outlook somewhat, relative to that time, is giving us cause for concern and we are having to redouble our efforts to underpin it.

On the Connected Home and DE&P EBIT point, we did give a commitment that 2017 would be the low point for Connected Home and we have just demonstrated that in 2018. We indicated that 2018 was likely to be the low point for DE&P. We haven't demonstrated it yet because it deepened into 2018 and we will have to see how we do this year. But yes our forecasts are for us to have turned the corner as we go through 2019 on both of those businesses, having actually turned the corner on Connected Home last year.

Mark, SVT customers?

Answer: Mark Hodges
Yes so in terms of targets no we are not setting a target for SVT for the year. It will be an outcome of our engagement activities and an outcome of really what goes on in the market. Iain referenced the very unpredictable nature of the market with the tariff cap coming in. So it will be what it will be but we will continue to engage with those customers to try and drive that number down to get them onto more fixed term deals so that we can have a deeper relationship with them.

In terms of the customer accounts reconciliation, I mean we are down on SVT by 2.1 million accounts in the year. Half a million went to the safeguard tariff when that was introduced. I will do round numbers rather than absolutely precise. A million has gone to our fixed temporary tariff that we introduced as one of our engagement methodologies. We lost net, that it was on the chart that Iain produced, around half a million. And the balance which is a couple of hundred thousand went to the fixed book. That is how it breaks down.

Nick Ashworth
Okay, thank you very much.

Q6. Gus Hochschild, BEIS

It is largely a follow-on question really from one of Fraser's questions and a bit thematic, but with regards to the rotation of assets so the case is obviously fairly clear for Spirit. But seeing you have made such a compelling case for DE&P, as a nascent business it seems to for want of a less vulgar adjective, a bit cannibalistic if you are going to start thinking of selling off bits of that, no?

Answer: Iain Conn
So just to be clear when I used the phrase capital recycling, this is about optimisation of the capital base in DE&P and it is certainly not impeding its future growth. We are absolutely committed to DE&P but the hard assets in it, we have a range of assets from peaking plant, one small CCGT that is due to come back on later this year, we have got a large battery that we have just built, we have two 50 megawatt rapid response gas engines that have just come online. We have got the uncertainty about the capacity market. We are putting more assets on the ground all the time in DE&P and as you'd expect like in all the businesses, we just want to make sure that we have got the optimal returns going forward.

Richard do you want to want to add anything to that?

Answer: Richard Hookway
Well the only thing I would add is you know the nature of the business is often, you can make your money in the construction phase. You can make your money through a PPA off-take

type agreement. You can make your money through an O&M type contract or you can make your money through actually owning the asset. It is not absolutely necessary to always own all the assets for their entire life to be able to unlock the majority of the value. And so therefore I see capital recycling as not just a one-off feature that might occur this year. But as we progressively build the business so we'll net invest yes, but that does not always mean we won't be actually looking to free up capital further invest just because of the way that the returns occur in this business. So you don't have to own all the assets into perpetuity basically.

Gus Hochschild
Thank you.

Iain Conn
And Gus the clue is in the term non-core. We are not going to be selling the Crown Jewels.

Q7. Iain Turner, Exane

Thanks, Iain Turner from Exane. Can I just ask a couple of questions. Firstly can you give us a bit of an update on how Connected Home is going outside the UK? I think you have talked about that in the past.

And then just on this judicial review into the hedging in the SVT. Can you just talk about, a) the timing of that and b) how you assess the political risk from taking on Ofgem in that way? I think Rachel Reeves called you cloth-eared, which might be the nicest thing she has ever said about you, but it clearly does highlight some of the issues around that.

Answer: Iain Conn
Let me deal with that last one and then ask Mark to update on Connected Home outside of the UK. So look I don't know whether it's cloth-eared or not, I don't think so. We were given some pretty clear guidance by Ofgem in the first consultation period of how they were going to calculate the wholesale pricing mechanism just for that first period. Crucially they didn't give any indication of any other basis, just one. We acted on it. We therefore changed our hedging practice in line with that indicative framing that Ofgem had given us. 6 months later they then changed that basis retroactively so that we couldn't do anything about it. I mean they basically moved the pricing period back to February. You can't go and suddenly buy February energy when you are in September. So we have an issue with that and we think that, and we have clearly got clear demonstrable damage and a number of the other participants in the market have supported us in this as well. I don't know whether we are going to win it, but it is absolutely something that we believe is a matter of principle and needs to be contested. And one of the only reasons why we having to do it through a JR is because the traditional route of appeal through the Competitions and Markets Authority was unusually removed for this bill as it went through Parliament, which is another slightly unusual set of circumstances.

Just back on your cloth-eared bit, I mean we have been very clear with Ofgem and the Government that we are doing this constructively. We are not trying to challenge the whole cap and I agreed with Dermot Noland 4 years ago that, we have 4 principles that guide our relationship and one of them is we can disagree occasionally and up to and including taking legal action or a challenge, that that will not be disrespectful or played out in the newspapers. And that is basically what we are doing.

On the timing I actually don't know, I think it is too early. I think we have only just submitted the papers, we have only just got a date for an initial hearing. I just don't know how long it is going to take. Mark Connected Home outside of the UK?

Answer: Mark Hodges
Yes so the two focus areas are Italy with the ENI deal and the US. In Italy included in the 444k, there are a couple of thousand sales. If I am honest it is taking a bit longer to get momentum. I think we have achieved momentum in Q4, we have been doing joint marketing campaigns with them, we are accessing all of their channels. It just took some time to get to know each other to figure out how to best work with their broader team. So we are expecting more from that channel this year. It is very similar in its potential to British Gas in the UK in terms of the customer base.

In North America we sold 43,000 last year, again that is an area where we think there can be significant growth. Obviously it is a much more crowded market and it is more competitive. But we got our energy star rating which means that we qualify for some discounts from some of the utilities which should help sales. We are working with, obviously internally with Direct Energy on bundling, cross selling and that is picking up and we are working very hard on landing third party distribution deals and we are on a number of the core websites and the digital channels you'd expect us to be. So I think 2019 is a big test year for us in the US in terms of being able to prove that we can grow the Connected Home proposition. And the other thing is we are not just going in with the me too products, things like the external camera, things like Hive Link in the care space. You know trying to give us some kind of differentiation in what is a very busy market.

Q8. Alex Leng, UBS

Two quick questions from me. First a follow-up on the 2019 cash flow forecast. Your report mentions with IFRS16 there is a £100 million operating cash flow improvement. Can I confirm if that is adjusted out the £1.8-2 billion target?

And secondly on Spirit, I understand the reserve levels are a fair amount revised down. Can we expect a write-down against this or a change to depreciation going forwards? Thank you.

Iain Conn
I think these are both for Chris.

Answer: Chris O'Shea
So the guidance of £1.8-2 billion includes everything. It includes the IFRS16 impact as well so that is included within there.

On the reserves, we saw a reduction in Morecambe, that is really down to the availability assumptions in there. We moved the Hejre field to 2C which was not developed as quickly as we would like. And we did have some disappointment at the Maria Field so we saw some poor reservoir performance and we moved that now. We did actually net write up the fields in Spirit, we had a £90 million reversal apply on impairments. That reflects prices, it reflects forward production assumptions, it also reflects these reserve movements. So that is all within the £90 million write-back. We will see an increase in depreciation in 2019 principally in Spirit. That is all non cash. But part of that is driven by the write-back. You should expect to see an increase in depreciation of between £50-100 million. When you work that all the way down through the tax and minority interest, it is actually quite a small number.

Further question

Thank you. Can I quickly follow-up on the IFRS16 effect. Was that previously expected in the £2.1-2.3 billion target or is that sort of incrementally?

Answer: Chris O'Shea
No that was there, the £2.1-2.3 billion as you would expect coming in as a new CFO I have been through lots of prior documents. Iain and the team have been very patient as I have asked lots of questions. This was well trailed, the accounting standard setters don't move particularly quickly and so they gave us lots of notice and that was one of the many, many factors that was in the £2.1-2.3 billion.

Alex
Thank you.

Q9. Ahmed Farman, Jefferies

Amit from Jefferies. I have 3 questions. Firstly when you talk about the moving parts of the operating cash there is a big moving part relating to the phasing of cash taxes. Could you maybe just elaborate on that, what has driven that and how should we think about that into 2020?

And then I think on the commodity price, obviously you highlighted the weakness of the drop in the commodity prices that we have seen so far. But did I understand this correctly that for 2019 you actually don't see much of that because of the hedging effect? So what is the impact let's say on a mark to market basis and how much is related to 2019 and then how much is 2020?

Finally on the Nuclear disposal. Could you maybe talk about the next steps or how is the process likely to go forward from here and whether that is already assumed in your net debt for 2020? Thank you.

Answer: Iain Conn
Can I just comment on the Nuclear. Basically we are in a process on a timeline that we agreed with our partner, EDF. We obviously had to talk to the Government about it first and we are in a process where a number of counterparties have actually come forward and with expressions of interest. And we are currently evaluating those expressions of interest. It is just too early to say anything more on that. But just to be clear we have not assumed in our sources and uses of cash flow any proceeds from a Nuclear sale.

And just on one comment on the commodity prices. What I said was the outlook for 2019 has clearly worsened to a few months ago. And that has obviously added pressure, but Chris on the actual net effect with hedging?

Answer: Chris O'Shea
Yeah so you are right essentially the prices at which we hedged, the market prices we see just now we see that being flat. What we achieved in 2018 versus what we achieved in 2019, albeit lower than we expected a year ago. So we don't expect to see a year-on-year a substantial movement. You can see in the cash flow statement we paid £61 million in tax last year. So about £140 million of that relates to activities in 2018. £80 million credits from prior periods. Now part of that is successful conclusion of prior tax cases and part of that is also PRT refunds essentially. So when the Morecambe field is down, it has paid about £2 billion in PRT, petroleum revenue tax over its life. When it is down you are still incurring costs as we were in terms of asset integrity. You carry that back and you can get some PRT back. It is quite complicated actually the way that it works but we saw some benefit in there. In 2019 we will be looking at about £300 to 400 million increase. Some of that is, we have got, obviously we are estimating we are going to pay some tax on some of the disposal proceeds, but we will obviously work to mitigate that. But we will look at having about £160 to £170 million of tax paid for 2018 results. And probably roughly the same in terms of 2019 results. And then we have got some open tax cases which I'd prefer to conclude before talking about and the

tax on the disposals. All in all you would expect to see tax in 2019 being in the range of maybe £400 million cash tax, you should see that coming down a bit in 2020, but a normal level for us with the current portfolio and current commodity prices is probably somewhere in the range of £300-350 million.

Q10. Verity Mitchell, HSBC

Actually it is a more strategic question because I have been looking at your capital allocation for the last couple of years and it seems to me that in terms of the most difficult business that you are working on with the least momentum is the Business side, both the US and in the UK. So I just wanted some high level comment on, is it worth it given all the capital that you are investing in business, given the returns you are making?

Answer: Iain Conn
Well it is a very good question. Capital allocation is very important, fundamental that we make the right choices. And the Business Division actually, many of the businesses actually don't consume a lot of capital. They consume collateral, they consume working capital but not asset based investment. Clearly the LNG business to some degree does although we tend to lease vessels. And the capital, the main capital element would be in Distributed Energy and Power. We have got very strict minimum returns levels we look to achieve. The returns are attractive and therefore what I would encourage you to do is not paint the whole Business Division with one brush. And clearly some of it is hard capital and some of it is working capital. Clearly we have indicated earlier, Chris did and I did that we are not very satisfied with the returns we are getting out of North America Business, we need to improve it. But we are also clear that its customer base is an extremely important route to market for Distributed Energy and Power in the United States which, the way we see it, it is the largest market for Distributed Energy and Power that we have access to right now.

So we will update you in the middle of the year Verity if that's okay about how we are getting on, on the Business Division. Richard did you want to add anything to that?

Answer: Richard Hookway
No I think the only thing I would say is as you said you can't just paint a broad stripe across the whole Business Division. You talked about the UK business. That has improved substantially, the momentum is with that business and we expect continued improvement. DE&P is actually on track in terms of how the order book is growing and the way the margin structures are also developing. That is positive as well. We are not going backwards on margin, if anything we are edging forwards. So we like the trajectory that that business is on and that is the business that is consuming some capital. A lot of the working capital and collateral goes into the trading business. Yes you know it is a bit like swimming with an anchor around you with the legacy gas contract, but actually the underlying performance has been impressive. The 100 cargoes of LNG we have sold. The point of that is actually we are building a web of assets, a web of longs and shorts. That brings with it optimisation and extrinsic value, plus the longer term contracts that will be coming onto the book so quite like the look of that as well.

We do have an issue in the United States quite clearly. We have been very clear about that. I am determined that we get after that particular issue, I know the team in the United States is as well. There are some issues relating to market curves that I won't go into now that will start to unwind in the second half of 2019, that will give us momentum. We are in action on efficiency, we are in action on new products that will help us manage gross margin better and we are diversifying the risk geographically. We are adding new optimisation options in the East. And so whilst it won't be an overnight fix, we do believe that that business, its scale, the importance of the North American market, the link to DE&P is going to be somewhere where we want to stay. We are determined to win for customers, we are determined to win for shareholders.

Closing Remarks

Iain Conn
Thank you Richard. I want to thank you all very much for coming in and for putting up with a slightly longer presentation.

Just three things to say at the very end. I mean I do want to welcome Charles Berry once again as our Chairman as of this morning. I am glad you dodged the questions on the dividend Charles, but I think, I hope I was able to address those clearly.

I would also like to take the opportunity again just to thank Mark Hodges for what he has done for the Company. I don't think we would be in anything like as strong a position if it weren't for what Mark has done over the last 4 years.

And then finally, just on the outlook, clearly the last thing I want to do is stand up in February saying the outlook is looking difficult. But it is as I said to Nick, it is absolutely our obligation to be clear. We are only 14 months into a 3 year performance period, but the cash flow is looking under some pressure and it is clearly putting some pressure on one of our targets. But there is a lot still to work through in the next 6 months. And clearly by July there will be a lot we can say about where we are and how we now see the prospects.

Thank you very much indeed for your patience and look forward to updating you then. Thank you.

End