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Centrica Preliminary Results for year ended 31 December 2008

26 February 2009
Presentation Transcript

Roger Carr - Chairman

Ok, well good morning ladies and gentlemen and welcome to the Centrica Preliminary Results Presentation. This morning Nick will review the 2008 numbers in detail and Sam will highlight the key operational and strategic progress we have made. And then we will lay out the direction for Centrica as we continue to move the business forward.

The performance in 2008 was good. In twelve months during which the global oil price rose to over 140 dollars a barrel and then fell back to just about below where it started, in British Gas we delivered strong customer retention, improved service levels, continued cost reduction and maintained a reasonable level of profitability. British Gas Services and British Gas Business performed well and showed encouraging growth in sales and profitability.

In North America Direct Energy expanded its business model and produced a good result in spite of very difficult and to some extent deteriorating economic conditions. In continental Europe we strengthened our presence by acquiring a controlling interest in SPE, but the result in Oxxio was particularly disappointing, due to issues in commodity procurement and billing and a market that continues to favour the position of the integrated incumbent suppliers. The Oxxio senior management have now been changed and we continue to review our European opportunities.

Upstream our production and safety records were very strong during the year and our pre-tax profits benefited from higher market prices, although higher petroleum revenue taxes did absorb much of the earnings effect. This resulted in a significantly higher effective tax rate for the Group of some 53%, I think now the largest tax payer in the United Kingdom. Overall the performance of the Group enabled the Board to approve a 5.4% increase in the full year dividend to 12.2 pence per share.

Strategically we continue to make progress in closing our hedge position with the acquisition of a number of small North Sea assets and the agreement of the MOU with EDF for a 25% share in British Energy. The well supported Rights Issue for £2.2 billion which we successfully completed in December, provided the financing to facilitate the conclusion of an agreement with EDF. I would emphasise that we remain committed to the delivery of value from the deal in its entirety on terms that must be both economically sound and strategically attractive.

The recent reduction in near term wholesale energy prices triggered by the global economic downturn has enabled us to reduce gas prices to our customers. It was necessary to purchase a proportion of gas and power supply for 2009 at the higher prices experienced in 2008 to ensure security of supply, and this will take a little time to fully unwind. However we believe that the reduction we have made is a responsible move that acknowledges the general financial challenges that face our customers, the competitive market and the need to achieve a reasonable margin to ensure long term supply security. In volatile wholesale markets we will continue to monitor the situation to maintain the balance.

Looking forward upstream, Sam and the team are continuing negotiations towards a mutually satisfactory agreement with EDF and seeking to further bolster our hedge position when attractive gas or power opportunities arise.

Downstream, their emphasis will be on further improving our existing model by combining our UK Retail Energy and Home Service Business. This will further reduce costs, but more importantly will enable British Gas to provide a seamless, unified and comprehensive proposition which will greatly benefit our customers. This integrated business will be run by Phil Bentley. With Deryk King retiring, Chris Weston, the Managing Director of British Gas Services will become President and Chief Executive Officer of our North American Operation in the middle of the year. I would like to offer my personal thanks and congratulations to Deryk for his hard work over many years in building a great business in North America from scratch, and well done Deryk.

Under Sam's leadership much has been achieved. Now with the new team in place, 2009 marks the beginning of the next phase of development at Centrica, aimed at securing a long-term robust business model that is both customer focused and shareholder rewarding. I will now hand over to Nick.

Nick Luff - Group Finance Director

Thank you Roger. Good morning everybody. Let me start with the commodity price picture. You will be familiar with this of course, but we all know the oil price reached a level last year that is three times what it is today. The gas price of course doubled and then halved again. And short term electricity prices were particularly volatile right through to the end of the year, even after the general fall in commodity prices. And that backdrop obviously formed quite a difficult environment for us as an energy retailer and I think our business stood up well. The Results, as you are about to see weren't as strong as the exceptional 2007, but the overall balance between the two half years for example was actually more consistent despite that volatility in commodity prices.

If I give you the highlights of the key financials for the Group, starting at the top, revenue up over £21 billion, that is an increase of some 31%. And that reflects the higher retail prices of course, but also some underlying growth in the business and also some foreign exchange benefits with the overseas operations, contributing more to the sterling figures.

Operating profit came in at almost exactly the same level as 2007, £1.9 billion, but with a very different mix as profits shifted to the upstream away from the downstream and I will come back in a second and give you a breakdown of that by business unit.

As Roger said, we did pay significantly more tax in 2008 reflecting the increase in the highly taxed upstream profits and that pushed the overall Group tax rate up over 50% which of course restricted earnings which came in at £904 million, an increase of about 20%.

In earnings per share terms, adjusting for the Rights Issue, that came in at 21.5 pence against the restated 27.2. The full year dividend, as Roger mentioned, we set at 12.2 pence which represents an increase on '07 of about 5½ % continuing to meet our objective of delivering real growth in the dividend each year.

So let me turn to the individual components of the operating profit and you can see here immediately the shift from downstream to upstream. Starting with BGR, operating profit at £379 million. And within that average consumption for BGR per customer was actually slightly higher in '08 than '07. Average customer numbers were slightly down and those two roughly offset each other. But of course we did see higher retail prices with the increases we put through in January and July and that drove the increase in revenue which was up some 20%. Of course those price increases were a response to the higher wholesale gas and power prices that we were seeing and that is reflected in the commodity costs which were up some 40%. We also saw higher transmission and metering costs, although they were partly offset by a continued reduction in our control of operating costs as you see on the right there.

Overall, put that together, gave the operating profit of £379 million which represents a margin of some 4.9%, slightly below our long run target, but we think a good performance, given we are operating off quite a high revenue base in 2008 and of course given the wholesale volatility that we saw.

BGB had another good year, actually adding customers through the year, even before the E4B and Bizz Energy deals towards the end of the year. And that increase in customer numbers, together with high gross margins and continued cost efficiency, delivered that operating profit of £143 million. And that is a particularly good result when you take into account we had a £30 million negative year over year impact from the ending of that historic favourable electricity procurement contract that we talked about in the past.

Services also had a good year, their operating profit up almost 30%. Here we increased product holdings, particularly in plumbing and drains and our home electrical services. And continued cost efficiency allowed us to drive margins up close to our 15% target.

Moving upstream, Centrica Energy, up about a third to £879 million but quite a lot of moving parts behind that. Obviously as you would expect, the gas production business, profits there up quite substantially, but offset by the legacy I&C contracts moving back into loss. As far as volumes are concerned in gas production, volumes are up about 7%, slightly less than we have been expecting as we did not run Morecambe quite as hard in the last couple of months as commodity prices were falling. But of course the average selling price that the gas production business was achieving was much higher through the year, particularly in the middle part of the year, overall up some 90% to 59 pence per therm.

Power generation, our volumes there up about 18%. However we did have some unplanned outages at the wrong time and some forward selling denied us the full benefits of those higher spark spreads we were seeing and as a consequence the result was somewhat disappointing, only just above break even.

Storage, returns here continue to be very high. That £195 million represents a pre-tax return on capital of over 50%. Not quite as high as 2007, we did see a narrowing of the summer/winter gas price differential which did squeeze the SBU price which was down about 25% to 44 p. But nevertheless it was a very strong performance.

Direct Energy also had a good year and we see in sterling terms the result is flattered somewhat by the weakness of sterling against the US dollar and Canadian dollar, but even in constant currency they actually produced higher profits, despite the difficult commodity price environment they faced, up about 4%. Within that the mass markets business actually came in a little bit better than we were expecting. The last couple of months of the year we had cold weather which drove consumption, but actually did not push up the wholesale gas price, so the margins remained strong. And that enabled us to offset the negative impact from Hurricane Ike earlier in the year.

C&I Business is now beginning to produce meaningful profits and is very well placed with the Strategic Energy acquisition we did in the middle of the year and now fully integrated. In contrast the services business is struggling in the difficult economic environment in the US and unlike the UK services business, it is directly exposed to the residential and new construction market which is certainly having an impact.

And upstream, obviously gas production did well with the high prices, but also volumes there were up quite substantially, up some 20%, partly due to the Rockyview and TransGlobe acquisitions that we made in the early part of the year. That was offset by lower generation profits reflecting lower volumes as the spark spreads for our Texas power stations were low.

And finally, in the operating profit, we have the very disappointing loss from the European businesses, all of which was attributable to our Dutch business Oxxio. Oxxio did struggle with the volatile commodity price environment against vertically integrated incumbents. As Roger mentioned, we didn't get everything right internally. We didn't get our procurement right, and we also had some billing issues which emerged towards the end of the year and all that resulted in a loss of £63 million. In addition, you might see in the exceptional items we took a charge for £67 million for Oxxio, £45 million of which is a write down of their goodwill.

SPE, elsewhere in Europe. Here of course still accounted for as an associate, so that is after interest and after tax and just our 25% share, small profit of £8 million. 2009 of course will be quite different for SPE. We now have a 51% ownership. So we will be consolidating it and SPE itself will be benefiting from the Pax Electrica arrangement, under which it gets access to favourably priced nuclear power and power under that agreement started to flow just this week.

So that's it on the operating profit. If I will turn now to the cashflow and quite a lot of moving parts here as well. But to pick up the highlights for you. EBITDA remains strong, getting close to £2.6 billion. However we did have to invest over half a billion in working capital, reflecting the increase in retail prices which pushed up receivables in the downstream businesses. And we also had some very significant swings in margin cash with the commodity price volatility, we had a lot of margin cash coming in during the first half of the year and out during the second half of the year. The net result, an outflow for the year as a whole of £500 million, £556 million. And at the year end, if you look at the bottom there, we were sitting in a position of margin cash out of £626 million.

In addition, of course we had higher cash tax payments because of the increase in the upstream profits. We also invested more in the business Capex of £1.2 billion and I will come back and give you a breakdown of that in a second.

Foreign exchange also affected the net debt of course as our dollar debt and our euro debt was revalued with the fall in sterling. And of course on the cashflow you see the proceeds from the Rights Issue coming in at £2.1 billion just towards the end of the year. All that left us with net debt at the year end of just over half a billion and if you adjust for that margin cash of £600 million, we actually had no net debt at all.

Coming to the Capex and starting with '08, obviously the main items as you see are in the UK power business. We have the continued stage payments on Langage, the gas fired power station that we are building in Devon that is now expected to come into service towards the end of 2009. And in addition we had the payments on the wind farms that are in Lynn and Inner Dowsing Windfarm which we completed towards the end of '08.

As well as the internal Capex, you see down the bottom there, we had 430 odd million of investments in acquisitions, the main ones being Strategic Energy, the US C&I business, Heimdal the Norwegian gas acquisition, Caythorpe, the UK onshore storage project and the two Canadian upstream deals that I referred to earlier.

If I look forward into '09 you can see we are expecting to spend significantly more on upstream gas for the UK market and that reflects the development programmes that came with the Newfield and Heimdal acquisitions and of course we have got the final stage payments on Langage as that's completed. This year, also if you look at the acquisitions figure, £760 million, that is the acquisitions we have done or are committed to so far and of course it is mainly SPE. It does include the capital contributions that SPE itself has to make to the Pax Electrica arrangement. Also note that we are expecting to spend significantly more on ROC's and emissions in '09 than we did in '08. None of those '09 numbers of course include anything for British Energy nor indeed any other acquisitions we might make. And also it is worth saying we might, depending on the economics, we might invest in more in the UK wind business as well during the year.

Turning to the balance sheet where you can see capital employed up to close to £5.5 billion, reflecting investments we have made in the business. Our tax liabilities on the balance sheet actually came down reflecting the deferred tax credits on the derivative mark to market position at the year end.

On pensions, the schemes have moved back into deficit, reflecting the fall in the equity markets, albeit that was cushioned by the increase in corporate bond yields, which IAS19 requires us to use for discounting the liabilities. I think it does have to be said that the position for funding purposes it is likely to be somewhat more conservative and we do anticipate increasing cash contributions into those pension schemes over time.

Net debt, half a billion as I described earlier, leaving net assets around £ 4½ billion. We have of course had a very strong funding position as well as the Rights Issue, we issued £1½ billion of bonds in the second half of the year and during the first half of '08 we had already extended over a billion pounds of bank debt out to 2012. And that left us with a very strong position at year end of a total of £4.3 billion of cash in undrawn facilities. We are planning, assuming the BE deal goes ahead, we are planning to cover half the cost of that with using the new debt facilities or possibly partly through asset sales, those new debt facilities being additional bond issues or potentially acquisition finance from banks. The other half we would cover out of our existing facilities and if you take the effect of using the facilities for that purpose and adjust for the cost of buying SPE as well, then that year end figure comes down on a pro forma basis from £4.3 billion to £2.2 billion and that is sufficient to allow us to cover our, the swings in working capital margin cash we have to deal with in business and leave us room for further investment as well.

And finally from me, the outlook for 2009. The year has started well. We had a combination of cold weather which of course is driving consumption both in the UK and the North American downstream businesses, but has not flowed through to the wholesale gas price and as a result margins have been quite strong.

Looking out for the rest of the year, the lower commodity prices have enabled us to reduce retail prices both in the UK and in Texas, and will also help us to absorb the increase in bad debt we do see as likely to happen, given the economic climate.

The lower gas price of course will mean lower returns from the gas production businesses on both sides of the Atlantic and also from storage and in addition the power generation business, although we do expect it to do significantly better than 2008, it will be impacted by the lower spark spreads we are seeing and of course by the delay in the coming into service of Langage.

Against that the legacy, I&C contracts of course are significantly less painful at low gas prices. And you might have seen in the announcement, we have closed out one of the more significant loss making contracts within the I&C segment and that will help the reported result. And notwithstanding the economic climate, we do continue to see prospects of good growth from BGB and BGS helped by the integration with BGR that Sam will talk about. Direct Energy will benefit from its recently reported result from the weakness of sterling. And in Europe we have taken action to stem the losses in Oxxio and we will benefit from consolidating SPE and it in turn will be benefiting Pax Electrica as I described earlier, albeit that has come perhaps a couple of months later than we had originally had hoped for.

With the shift of profits back to the downstream at least based on current commodity prices, that would lower our tax rate of course and taking that as a whole, the existing business is on track to deliver growth in 2009. The main variable of course as ever being how wholesale gas and power prices turn out and how they impact on the retail prices.

As you have seen, we are sitting on significant cash right now, with interest rates being quite low that is obviously a significant drag on earnings. We are looking to deploy that capital into British Energy and into other potential investments. But of course, the timing of those investments will have a significant impact on how EPS turns out for 2009.

And with that I will hand you over to Sam.

Chief Executive's Review
Sam Laidlaw - Chief Executive

Thank you very much, Nick. Good morning everyone. As Nick showed, 2008 really was an extraordinary year and one that I never envisaged when I took over at Centrica in 2006. The crisis in the global financial markets and the recession that followed, rapidly reversed the direction we have seen recently in commodity prices.

Brent Crude which at the beginning of the year was 90 dollars a barrel went right up to 147 dollars a barrel and by the end of the year was down below 40 dollars a barrel. And it is this volatility that is really the very reason that we have been working hard in transforming the business over the last two years. And I think that the changes that we have made have really underpinned the strong financial results we had in 2008. So while much has been achieved, we have got a lot further to go and we need to keep moving the agenda on.

So let me share with you this morning, both progress to date and how we are adjusting our emphasis to stay ahead of market developments. The priorities I set out exactly two years ago are to transform British Gas, to sharpen the organisation and reduce costs, to reduce risk through increased integration and to build on our growth platforms. Now let's look at each of these in turn.

Firstly the transformation of British Gas. We fundamentally changed the performance and internal structure for British Gas over the last two years. We have redesigned the organisation around our customers. We split the business into three segments, focusing on our customers needs to better understand where the value is created and to drive accountability. Our operational changes have made us much more efficient. We've continued to increase our service levels and two of the key processes, call handling and billing have improved materially.

Innovation in our processes means that they are now much clearer, better targeted and quicker to market. Our fixed price products help us to retain customers after the price rises of 2008 and we now have over a million customers who service their own accounts online. We are also helping 1.4 million vulnerable customers through our Essentials tariff, our CERT commitment and our social programmes such as 'Here to Help', And as you know all this has produced real results. We are now answering the phones much more quickly and consistently. Our inbound call traffic is down over 40% and our share of industry complaints at 25% is now well below our energy market share. And in a year when gas prices rose by around 50%, we held our customer base relatively stable. These service improvements have not come at the expense of cost control. In fact the opposite is true. Better service means lower cost. Since 2006, we lowered headcount by 2,800 positions and we have reduced operating costs by over £200 million.

So now we move on to Phase 2. It was important to separate the energy and services businesses back in 2005 to allow us to really concentrate on fixing the basics. Although we continue to work very closely together and the two businesses share a common database, the intention was always to bring the two back together when the time was right. And that is what we have announced today. We are reuniting British Gas to maximise the opportunities that a single brand and business present. As Roger said earlier, Phil Bentley will now assume full responsibility for the retail operations in the UK.

Today we know that British Gas has around 12 million households that we service who hold 24 million products. But of the 12 million, only 1.9 million hold both an energy and a services product. This is a huge opportunity for us and the structure we are putting in place will make sure that we grab it. Our goal will be to expand this overlap significantly as well as to attract new customers to both energy and services. Our customer data tells us very clearly that the value of a customer increases when they take both the services product and an energy product. This will be no surprise.

But the level of the difference might be. Our analysis suggests that energy churn alone is over 20% lower when they take both products. And we experience a similar drop in churn when we add an energy product to a services relationship. As customers add products, their lifetime value increases due to increasing revenues, lower churn and of course decreasing marginal costs. When you combine the benefits of reduced churn with the increased customer spend with British Gas, the potential value creation is significant. Specifically the lifetime value of a British Gas customer who holds both energy and services can be more than double that of the customer holding a single product only.

And of course this will also help us to remove duplication and cost from the single organisation. We have made strong progress in reducing our costs to date and we expect to carry on the momentum we have achieved recently. Although our plans here are still developing, we believe the opportunity here over time is to reduce the cost base by a further £100 million. In summary, this single unified structure will enable us to increase customer loyalty, better target our sales and marketing to drive value, further improve customer service and remove cost. British Gas is now well positioned for growth.

Now on our second priority, to sharpen the organisation and reduce costs, we have talked about the progress here we've made before. The upper management has been rationalised, a more transparent structure to our business now better enables us to really drive performance. The processes around capital allocation, individual performance management, planning and cost control have all been overhauled. And we continue to be relentless on cost control. In 2008 we actually reduced our Group like-for-like costs, in addition to the £70 million we took out of British Gas by some £40 million. And it is important to understand that cost control has gone well beyond the residential energy business and is embedding right across the Group. Even in the original growth businesses, we have always considered it vital that we keep the lid on costs by improving efficiency while we encourage growth.

As you see here, on the important measure of operating costs as a percentage of gross margin, we have made great progress across all of our businesses. Efficiency and cost control will never leave the agenda.

On our third priority to reduce risk through increased integration, we have moved things on considerably in upstream gas. Over the last two years, we have successfully acquired additional gas and oil properties with potential reserves of around 800 bcf equivalent. That is almost three times our 2008 gas production levels. And we have invested around £1 billion of cash in these acquisitions and in accelerating the development programme from other North Sea assets. Our North Sea properties now make up 40% of our total gas production.

We also now have a focused set of exploration opportunities in the North Sea and Morecambe bay to assist with the replenishment of reserves over the longer term. The drop in Asian and North American demand for gas imports and the decline in the UK domestic production, have made the UK a much more attractive market for worldwide LNG imports. At the end of last year we commissioned our capacity at the Isle of Grain and we have already landed three LNG cargoes at this facility. So taking all these steps together you can see the net result is that we have actually increased our overall energy hedge, which is our measure of gas price exposure, from 21% in 2006 to 34% in 2008.

Now in power we have also made excellent progress. We will soon have a gas and renewables fleet in the UK of 5.3 Gigawatts. And we currently cover 58% of our peak electricity requirements from our own stations. As the lowest carbon fleet, this positions us well as we move towards an increasingly carbon constrained economy.

Two major projects have been underway in 2008. At Langage our gas fired power station in Devon, the project is around 90% complete, but on this fixed price EPC contract, the contractor has suffered some delays and we now expect this to be fully commissioned towards the end of this year. Our second project has been managed in-house, Lynn and Inner Dowsing. This is the world's largest offshore wind farm project. And it began exporting power to the grid in the fourth quarter of 2008 and has already started to make an important contribution to the earnings in the segment. Wind could be an increasing part of the future fuel mix if the economics of offshore wind stack up. Now recent cost increases and construction services are challenging the returns, but we have a pipeline of 1.4 Gigawatts which we expect to progress if we can reduce costs and enhance the returns.

Looking forward in the upstream, we will stay focused on building our hedge in the UK. In a world where there are now fewer credit-worthy counterparties and the cost of credit to provide margin requirements has increased, the physical hedge provided by integration has become increasingly important. With gas we will continue to focus on acquisition and development opportunities in the UK and Norway, where we currently have a £1 billion development plan over the next three years. The Norwegian continental shelf is less mature than the UK and we have a sizeable presence there now with a highly skilled team and a full operators' license.

And as I mentioned earlier, LNG is coming to the UK and over the next twelve months we expect over 40 BCM of additional annual LNG to come onstream worldwide. This will become an increasingly important facet of our business providing vital diversity of our sources of gas supply. On this front our discussions with National Oil Companies are continuing. And the growth in LNG supply over the short term, potentially outstripping the growth in demand, the importance to producers of securing demand has increased.

And we are pushing ahead on the power side as well. We need to raise our asset cover to capture the value as it moves between the upstream and the downstream, and to enable us to absorb the extraordinarily high intraday volatility that we see in the power sector. This will strengthen our earnings, but also benefit our electricity customers. Adding to our generation fleet is important in absolute terms, but it is also important that we diversify the input fuel type. As the electricity price correlates closely with the price of gas, adding non gas fuel generation and moving towards a more market neutral fleet, provides a hedge for our gas customers and again reduces the volatility of our earnings.

During 2008, the power price was extremely volatile, but the forward price has been more stable. Although short term prices have softened significantly, the medium term outlook remains less bearish as the pressure on reserve margins will build as opted-out coal and oil plants have to shut down in the middle of the next decade. And the British Energy deal could move us a long way in terms of both power cover and overall energy hedge.

As Roger said, the compelling strategic case here still exists. But we will need to ensure that as we progress negotiations with EDF that the deal in its entirety adds value for Centrica shareholders. For the medium term the transaction could give us access to at least 25% of the current nuclear output and for the longer term, the right to participate in 25% of EDF's new nuclear fleet in the UK, raising our power cover to over 90% and taking our overall energy hedge up by over 10 percentage points to around 50%. We will however not be content to stop here if we can find value to further close the structural hedge through gas acquisitions and we do see more opportunities coming to market and as they come we will pursue them if we can pursue them for value.

We also consider gas storage to be an effective hedge against the impact of seasonally volatile gas prices. And this is an area where we have real competitive advantage. Rough has been an excellent asset for Centrica for many years and is providing the UK with essential security of supply. However, the next step is to pursue a storage strategy which involves multiple assets in different storage locations. The portfolio effect that this will bring enables us to deliver extrinsic value well beyond the value of the individual stand alone assets.

To this end, with this morning's announcement about the Baird Field, we now have three major new storage assets, totaling around 85 BCF, over half the UK's current storage capacity. This would entail an investment of around £1½ billion over the next four years and would produce a large long-term business opportunity.

We have also been performing strongly on our growth platforms. We had record years of profits in British Gas Business, British Gas Services and Direct Energy. All of these businesses also grew both revenue and customers, and as I mentioned earlier, drove down their costs as a percentage of gross margin. The result is that overall we have raised profit by 50% over two years in these businesses and they now make up 30% of Group operating profit. Going forward BGB and BGS will roll into the single British Gas organisation and I believe that this will only enhance the growth possibilities from here.

In Europe we now have a controlling 51% interest in SPE in Belgium and following the approval of the first significant tranche of Pax Electrica 2 which provides us with lower cost nuclear electricity, this business is now fundamentally more competitive. This is a very valuable position in Europe. Nick explained the detail behind the Oxxio results. This was undoubtedly disappointing. We acted decisively and took appropriate short term measures to ensure that the mistakes are not repeated and the management team has been replaced.

In North America, Direct Energy will soon be under new leadership. Deryk has developed a great business over eight years. He has built this from nothing to a business serving over 5 million customers with almost £6 billion of revenue and delivering an operating profit of over £200 million. Across Canada and the US we now have a substantial presence in mass markets energy retail, home services and upstream gas and power. And the Strategic Energy acquisition in 2008 makes us the third largest commercial energy supplier in North America. And I believe that Chris Weston can build on this platform and really take it forward from here.

We have two clear goals as we go forward. Although we will never ignore opportunities as they arise, we will focus the business on the key geographic areas of Canada, the US North East and Texas. In doing this we will concentrate on states where we have a strong presence through the Direct Energy brand, backed up by a centralised low cost support model. In conjunction with this, we will further integrate the Direct Energy business in these key energy supply areas through the development and acquisition of upstream assets, both in power and growing the output from our North American gas production business. We will also concentrate our services business on our key retail energy geographies to support the marketing positions we built up and again provide us with valuable growth opportunities. North America will continue to be an important part of the Group growth story.

So in summary, we delivered good results in the most difficult commodity environment we have seen in Centrica's history. The next phase of the British Gas transformation is now underway and I believe that this will really differentiate British Gas from the competition. Developing the energy hedge in the UK remains important and as always, we will only acquire assets where we see value. North America is an important growth avenue for Centrica and now that we better understand where the rewards are here, we will focus the business and further strengthen it through appropriate levels of asset cover. I believe the progress we have made to date and the future direction I have outlined, position Centrica very well for the next phase of our development.

Thank you.

Roger Carr

Thanks Sam. Fine, Q&A. You will remember, I am sure everyone has used them, but you have to activate the microphone by pressing the button, when you finish the question and press the button again to allow somebody else to come in.

So who would like to be the first question? If you could say who you are and where you are from, that would be good.

Questions and Answers

Q1. Nathalie Casali – JP Morgan

Nathalie Casali from JP Morgan. Two questions if I may. Firstly on the European business. When you acquired the second tranche of SPE, you indicated 240 million euros EBITDA going forward including the Pax Electrica. Are you confident you can still deliver that, given the move in power prices in Europe? And secondly if you could give us some more detail on the £470 million FX cash outflow, if you can give us a breakdown of that? Thank you.

Answer: Sam Laidlaw

Let me take the first question and I will hand the second one over to Nick on the FX. The answer is, as you saw and as we said, Pax Electrica as you saw from Nick's Presentation, about two months later than we had forecast and therefore you need to reduce that 240 effectively by about 20 million.

Answer: Nick Luff

The power prices have had some impact on the value of Pax Electrica but we're making up a lot of that in the value of the downstream. Net is probably slightly down but not significant. And on your second question Nathalie, the FX and other is mainly FX, we carry a large proportion of our gross debt in dollars and Canadian dollars to offset the net assets we have over there. And so when the way sterling has fallen, the value of that dollar bit has gone up substantially so it is almost all FX.

Q2. Nick Ashworth – Morgan Stanley

Hi, it's Nick Ashworth at Morgan Stanley. Also two questions if I may. Firstly on the residential energy business. Just interested to get a bit more colour around the hedging you took on last year throughout the winter and how you have been able to reduce gas tariffs in the middle of February, that is a little bit earlier than I thought maybe it could be and the implications that may have for the rest of the year, given that you have delivered nearly a 5% margin last year as well? And then secondly on British Energy, have you got a timeline when you expect that to be completed and I know EDF a couple of weeks ago were a little bit more optimistic with their outlook saying it could potentially be done by the end of Q1 and I wondered if you had any further thoughts around that?

Answer: Sam Laidlaw

Let me take both of those. In terms of our gas hedging, we are very careful for competitive reasons that we don't get specific about what our current hedging position is, but you are absolutely right, we were able to open up some of the position towards the end of last year, which enabled us to achieve the results we did but also enabled us to reduce our prices earlier than anybody else. I think it would wrong to comment on our hedge position going forward.

In terms of the timeline on British Energy, you are absolutely correct, that EDF have said that they aim to conclude this by the end of the first quarter, and that remains our aim as well one way or another.

Q3. Ajay Patel - UBS

Ajay Patel from UBS, three questions if I can. Firstly could you give us guidance to the gas production change year on year for the UK business? And in terms of your slide in regards to getting greater overlap between British Gas Residential and the Services business. To attain the £100 million of cost opportunity, how much of an overlap are you projecting for the two years, 1 million customers ½ a million?, or is there any sort of indication you can give me on that? And then thirdly on Oxxio, is there any residual impact to '09 on the back of Oxxio's performance in '08?

Answer: Sam Laidlaw

Let me give you a guidance first on gas production. I think a good number is to say that Gas production will be down by about 15%. It is more than that on Morecambe, just over 20% on Morecambe. But the new fields are really starting to contribute and the decline on the North Sea fields is significantly less. Interestingly actually, if you look at Newfield and if you look at the Heimdal acquisition in Norway, we expect them to contribute about 15% of our gas production this year, so those fields are doing very well, but overall 15%.

Your second question I think was on cost reduction from the combined business. I mean we are still at a very early stage of working through that, but we can see in marketing spend, in driving more customers online that there are significant opportunities here, but I think as we put the businesses together and as Phil and the team start to work on it, we will sharpen up those targets.

Answer: Nick Luff

And on Oxxio, we still have to work through some of the procurement issues from '08 so there will be some impact in 2009. So we might lose £10 million. I mean nothing like the loss we experience in '08, then that should be behind us.

Q4. John Musk – Nomura

Hi there, it is John Musk from Nomura. Can I ask two questions please? Firstly on the industrial and wholesale contracts. It is very difficult obviously for us to understand where that may go for next year. If I go back to '07 when you made profits, average gas prices were about in the low 30s. This year, when you are making large losses you were about 55 pence for average gas prices, what can we expect for 2009, is there in inflexion point you can give us? And then secondly, again on Oxxio, just trying to understand the strategy there and perhaps you can give us an indication of how you expect to compete going forward? Obviously we have seen Vattenfall and RWE enter the market, is that going to make it even more difficult for you?

Answer: Nick Luff

John, on the first one. The difficulty on the contracts is that there is so much optionality in them for the customer and therefore it is quite hard to predict exactly what the volumes will be. A lot of the indexation in the pricing is linked to oil so actually the selling price is actually being hurt by the low oil prices. As guidance on current gas, forward gas prices, we would expect to lose about £175 million in the I&W segment after the changes we have made. Clearly it could move around depending on where the gas price turns out.

Answer: Sam Laidlaw

And I think your question on Oxxio is that as we said in the Statement, clearly in a world where the market hasn't yet unbundled that business model is challenged. We have two things and we will clearly look at all options going forward. I think we do have two things in our favour. One is that unbundling is starting to happen during 2009 and secondly of course, when we bring Rijnmond on in 2010 that will provide us with a source of integration in power so those are the elements in the mix but we are clearly exploring all the opportunities.

Q5. Edmund Reid - Cazenove

Hi. Edmund Reid from Cazenove. I have three questions. The first one was on working capital and margin movements in 2008. Would you expect any of that to unwind in 2009? And the second question was, I think you mentioned asset sales as a potential means of funding and I just wondered whether you could give us slightly more details on what you were thinking of there? And then the third question was on margins in British Gas Residential, not numbers, because I know you don't talk about that, but in terms of the split of margins between gas customers and electricity customers. I think historically your electricity customer margins have been much higher than your gas margins. And I was wondering if you saw that maybe changing going forward, given the price reduction announcements from your competitors?

Answer: Nick Luff

On working capital obviously with retail prices coming down, we would expect to see some working capital coming back. It clearly depends a lot on what consumption is towards the end of the year in terms of exactly how it turns out, it might be £100 million or £200 million from that. The margin cash is even harder to predict. Obviously the £625 million or so margin cash out relates to contracts that roll off over 18 months or so. So if all the prices stay the same then a lot of that will roll off, but of course, we are putting on new contracts all the time, so depending on whether prices at the end of the year are higher than they are during the year or lower, then that will drive where the margin in cash goes, but that is always trending back to nil as it were if prices are stable. And asset sales?

Answer: Sam Laidlaw
I think we are not telegraphing any asset sales before we actually do them is the simple answer to that. And we do continue to look at all of the portfolio to make sure we are getting robust returns from across the business on a regular basis. So I don't think we will comment beyond that.

On your third point Ed in terms of electricity versus gas margins, you are absolutely correct that historically you know we were in fact, in many periods losing money on gas sales. And what we have done is restore the level of profitability on gas to the equivalent to that on electricity and that is the aim. We need to make money on both fuels.

Q6. Andrew Mead - Goldman Sachs
It's Andrew Mead at Goldman Sachs. I just have one question. Could you provide some detail at all on your exposure to industry in terms of decline in economic activity, particularly your business sales in both UK and North America?

Answer: Sam Laidlaw
I mean it is a very good question, what is happening to our business book, our BGB book as a result of the economic downturn. I think the first important point to make is that unlike some of our competitors, the vast majority of the earnings and profitability that we have in our BGB business is actually SME's, it is small businesses, commercial businesses, shops, retail and so forth. And therefore we haven't had the big reduction in industrial load that some competitors have had, where steel works have been closed down or car plants have been closed down and so forth. What we clearly have to be concerned about is an increase in bad debts. Actually we are not seeing any significant increase in bad debts. We are making appropriate provision and we do think that they will be higher this year versus last year and we clearly had some well publicised companies going into administration, particularly at the end of last year. But at the moment we are continuing to see the business hold up.

Q7. Mark Freshney – Credit Suisse

Hi, it's Mark Freshney from Credit Suisse. I just have two questions. Firstly you mentioned the reasons for power generation result being down year on year. I mean could you give us a feel for what the normalised contribution from those, particularly that fleet of CCGTs could be? And secondly, regarding assets in the private secondary markets, particularly gas. Are you seeing a softening of prices for gas assets in terms of what you are seeing coming up for sale?

Answer: Nick Luff
Yes on the power generation, I think for '09 the consensus is about £120 million at the moment, that's a little out of date of course with the sparks spreads coming down and the Langage delay. But I would still hope we could make two thirds of that which is obviously a big improvement on the 2008 result.

Answer: Sam Laidlaw
And on your second question on asset sales, we are starting to see more packages of assets coming onto the market. There really has been very little done if you like in the new price environment. A couple of the transactions, actually the transactions we have done ourselves, I mean if you look at the share of the Peik Field that we bought and the share of the York Field we bought in the North Sea, these are both undeveloped gas reserves. You know at around the two dollar a barrel level, we haven't seen that in a long time. So I think that does indicate that this is moving to become a buyer's market after many years being a seller's market.

Q8. Ajay Patel - UBS

Ajay Patel from UBS again. In the release there was a statement about re-indexing an existing contract, the total being around 4 BCM. I am just wondering in what way, is it more volume linked, is there more of a fixed element, is the underlying variable components different? How has the exposure changed? I know you can't give us exact details, but kind of a maybe a bit more of a top down?

Answer: Sam Laidlaw

I think the fundamental point here is that we want to get away from having too much gas linked to month ahead pricing. So we are going to a variety of different indices without getting into the specifics, some may be half yearly, some maybe a yearly index. Some may be linked to other things than just gas price, they could have an oil or CPI component. And it is more the 4 BCM that you refer to is actually more than one contract, it is a variety of contracts. I think there is an important structural point here and that is that as gas markets soften, we are finding that many more producers are interested in doing long term supply contracts on different bases that they have been reluctant to do hitherto and clearly the security of demand and the demand that we offer right through to the end consumer is something that is becoming increasingly attractive.

Q9. Iain Turner – Deutsche Bank

Hi, it's Iain Turner from Deutsche Bank. Reading what you said about still seeing the strategic need for the BGY deal and what you said this morning about how it needs to meet your hurdles for shareholder value. Am I right in thinking that it is implying that you still want to do it, but you need to get a different price?

Answer: Sam Laidlaw

I think you are right in the overall premise that strategically it makes sense and we need to see value in the entirety of the deal.

Answer: Roger Carr

I mean just to add to that I think we are clear that whatever we do would need to go to shareholders for approval and as a Board we are clear that we would not put anything to shareholders that we did not think was in their interest and would not win their wholehearted support.

Closing Comments

That is probably a good place to end. Thank you all very much for coming. We will keep you posted. Thank you.

End of Presentation