centrica

Centrica Energy Upstream Investor Day

Thursday 1st December 2011

Mark Hanafin - MD Centrica Energy

Good morning everybody, and good morning to everybody on the webcast. Welcome to the Centrica Energy Investor Day. Before I hand over to Sam to formally kick off the proceedings let me just say a few words about safety.

Centrica Energy people are working in high pressure, high voltage, high temperature environments, so they're in harm's way. And we remind each other to do things safely or not at all. And my personal view about safety is that there's no contradiction between managing safely and running the business well. If we can manage safety well we can run the business in the right way. Most importantly, though, we just simply believe that our employees should go home at night, or after their shifts, safely.

In terms of the meeting here today in the UBS offices, there are no fire alarms planned. If there is a fire alarm it will be a loud beep followed by instructions. The fire exits in this room are the two exits at the front here and there's one at the back. We go out through reception where you came in, we turn right and the muster point is at Broadgate Circle.

So with that I'll hand over to Sam.

Sam Laidlaw - Chief Executive

Thank you very much, Mark, and good morning everybody, and a very warm welcome to our Centrica Energy Investor Day, and a warm welcome to those on the webcast as well.

This is the final event in our investor programme this year, in which we've set out the prospects for each part of our business; for Direct Energy in North America, for British Gas, and today we look at Centrica Energy, our UK Upstream division. Over the course of the day I hope you'll gain a good understanding of both the prospects we see for the Upstream business in its own right, but also how it fits into the wider outlook for the Group.

We have a comprehensive programme today for you, with the usual mix of both formal presentations and breakout sessions, and I hope you'll take the opportunity to meet members of the CE team and gain an insight into their drive and enthusiasm for the business.

In a moment I'll hand back to Mark for the strategic update, where he'll outline both the great progress that we've made to date and our vision for future growth. We'll then have a look at the business in a financial context with Andrew Le Poidevin, before wrapping up the formal presentations, leaving plenty of time for your questions.

After the break we'll unpack the story for you in further detail with presentations from Jonathan Roger on Upstream Gas and Sarwjit Sambhi on the Power Generation business. Then after lunch we have three further breakout sessions, really designed to bring the whole story to life through a series of case studies. These, I think, will also give you a good chance to meet the team first-hand.

Our strategic priority for Centrica Energy is clear, and it's to deliver value and growth while securing sustainable energy supplies for our customers. The Venture Production and British Energy transactions marked a step change in the scale and capabilities of our Upstream activities. Since then we've continued to make very good progress, delivering value from these acquisitions, deploying capital where we see attractive returns, and most importantly building a pipeline of opportunities to deliver further long term growth for the future.

At the same time the market environment has become significantly more volatile, with rapidly changing commodity prices and a difficult economic backdrop. Our task is to select the very best opportunities across the Group to ensure that we maintain a balanced portfolio, Upstream and Downstream, and across our selected geographies, all with the objective of delivering a high quality of service and competitive offering for our customers, while driving superior financial returns for our shareholders.

The priority for Centrica Energy is therefore to put capital to work, creating both value and growth whilst providing an efficient energy hedge. The energy hedge underpins earning stability for the Group and maintains our competitive position in the downstream marketplace, as well as reducing our collateral requirements.

Given the increase in UK Upstream taxes imposed by the last budget earlier this year it's important for us to look at the hedge both on a pre tax and a post tax basis. As you can see on the chart, our hedge has become less effective, dipping to around 43% on a post tax basis, although this will now recover to around the 50% level once the transaction with Statoil completes in the second quarter of next year.

And we still see some potential to increase the hedge from these levels through ongoing investment, but only where this delivers attractive returns. Mark is going to set out the Upstream growth ambitions in this respect in further detail. However I thought it would be helpful to set out some of the guiding principles we deploy when considering our investment options.

Clearly each project needs to present attractive returns, double digit IRR or more, depending on the risk profile. But it's also important that we consider the cash flow and earnings profile that they'll contribute to the portfolio. As an example short term highly accretive projects such as Statfjord, York and Rhyl, balance longer term projects such as the Round Two and Three offshore wind projects. And of course this all needs to be considered in the context of group-wide competition for capital, and our continued commitment to improve returns for shareholders.

Now in terms of energy policy the UK government is seeking to balance three key objectives: security of supply, decarbonisation and affordability. By 2020 on National Grid estimates the UK will be importing almost 70% of its gas requirements, and over the same period the Climate Change Committee is targeting a near 40% reduction in CO_2 from the power sector. Already we've seen a steep rise in wholesale energy prices, with prices expected to rise to nearly 70p for gas and over £75 a megawatt hour for power in real terms, under DECC's forecast. In this context it's clear that gas will have an increasingly important role to play for many years to come, alongside other low carbon sources of energy.

And our asset mix here is distinctive, with a true dual fuel gas hedge and power hedge, a diversified low carbon generation fleet and a range of attractive investment opportunities across different generation technologies in offshore wind, in biomass, in nuclear and in gas fired generation. Centrica is therefore very well-positioned as the government considers the affordability of the transition to a low carbon generation agenda, directing our capital towards those opportunities that offer the most attractive returns, aligned with government policy.

So to summarise, before handing over to Mark, our immediate priority is very clear: to maximise returns from the existing asset base and to deliver the projects already under development, and we'll show you some of those today. As we look to the future we see considerable potential for further disciplined investment, deploying our capabilities to deliver significant growth and value, both in Upstream Gas, building on the Norwegian transaction we announced last week, and in Power Generation where offshore wind provides the most immediate large scale opportunity to deliver growth in value and earnings. We also have further growth options in power, in new nuclear, in biomass, and in gas fired generation. But we'll only pursue these where we see attractive returns commensurate with the risks undertaken.

So these I think are very exciting opportunities for the business, they build on our established operating model, and also on our competences. At the same time maintaining a disciplined approach to capital allocation remains key, with appropriate competition for capital across the Group to deliver value for our shareholders. So with that I'd like to hand back to Mark. Thank you.

Mark Hanafin

Thank you, Sam. I'd like to start the presentation with a brief recap of where Centrica Energy is today.

In summary the business is performing very well indeed, both in Upstream gas and oil and in Power Generation. We've consistently delivered on our objectives over the last two years, building on the Venture Production and British Energy transactions to form a business with scale and most importantly the foundations for continued long term growth.

As I mentioned in my opening comments, health and safety is central to everything that we do, and we continue to look at new ways to enhance our safety performance. For example we recently reviewed our approach to process safety against the Centre for Chemical Process safety guidelines, and these consider measuring commitment to process safety, understanding of hazards and risk, management of process safety risks, and how we learn from experience. We use this type of initiative to highlight areas for attention, recognising that we can never be complacent and that there's always room for improvement.

In the Upstream business we are now a top three gas producer in the UK continental shelf with a strong portfolio of assets. You will hear over the course of today's presentations about the ways in which we have been able to maximise value from our existing producing assets. We do this by focusing on reliability and costs, and also the ongoing progress in bringing development projects online. And in Power Generation we now have a diversified portfolio and a clear focus on maximising returns from the existing asset base while successfully delivering new projects on time and on budget.

Upstream we've demonstrated an excellent operational track record, bringing eight new developments on stream in the last two years. And we've enjoyed considerable success in our exploration activities. Internationally we have made good progress, notably in Trinidad and Tobago, and in Norway where we now have a solid base for growth.

In Power Generation we have an outstanding track record for project delivery. We see this in thermal generation, where we commissioned our CCGT at Langage last year, and particularly in offshore wind, with the Lincs development progressing well.

We've also made very good progress in establishing a pipeline of developments and options that can provide long term growth across the business. Upstream we are now able to deliver sustainable production by bringing new developments online and through asset acquisitions, where we see value.

In Power Generation we're making good progress on our options for further offshore wind development. An investment decision on Race Bank is expected next year. Docking Shoal and Round Three Irish Sea projects will provide a longer term pipeline.

So in summary we've achieved a great deal in 2010 and 2011, maximising the value from our existing assets, building and deploying distinctive capabilities to ensure successful project delivery, and laying the foundations for the sustained long term growth of the business.

We have a great leadership team in Centrica Energy and let me introduce them to you: Jonathan Roger and Sarwjit Sambhi lead our Upstream and Power Generation activities. Many of you will have met Sarwjit and Jonathan before, you'll be hearing from them later this morning. And Andrew Le Poidevin, our Finance Director, will give you an update on the numbers a little later in this presentation. Andy Netemeyer, our MD for Midstream, Niels van Buuren, our Strategy Director, Carol Frost, our HR Director, and David Isenegger, our General Counsel, they're all here today as well, and I'm sure you'll have plenty of opportunity to speak with them and other members of the team during the day.

Turning to the wider environment that we operate in, during the past year we've seen major global events impacting the energy markets. A natural disaster impacting Fukushima. The subsequent nuclear plant closures both in Asia and, for example, in Germany. The Arab Spring, the impact of North American shale gas, and the dwindling production base in the UKCS.

All of these factors remind us that we now operate in a truly global market, and in my view a market in which gas has a pivotal role to play for many years to come. We see tremendous opportunity for our Upstream business against this backdrop, a market in which we can earn attractive returns and are well positioned, with our distinctive capabilities and strong portfolio of asset options. In Power Generation the market landscape is both fast moving and supportive of our strategy. We have an attractive range of investment options across the generation space, and this gives us the ability to pursue the options that offer the best returns, aligned with government energy policy.

Over the past three years our Upstream production profile has been truly transformed. In 2009, prior to the Venture acquisition, our portfolio comprised legacy assets in slow decline. They were heavily reliant on our one operated asset, Morecambe, and with limited development options for the longer term.

Today the picture is radically different, capable of sustaining production at the 50 mmboe level before taking into account our recent Norwegian transaction. For those of you who attended the Langage Investor Day the chart we showed then with a 50 mmboe aspiration relied much more heavily on exploration success. Now we have a significantly deeper base of producing assets, shown in dark blue on the chart. Morecambe currently provides around one third of our total production. Our other cornerstone assets include Statfjord and the fields in the Greater Morecambe area, and NCMA in Trinidad and Tobago.

Next you can see our current developments, which fall into three categories: projects under construction, projects that have received approval for development, and projects which we expect to be approved in the next 12 months. We have eight current development projects in total, which should make a significant contribution to production over the coming years. In fact delivering difficult mid-size projects is an area of distinctive capability for Centrica. These projects tend to be too difficult for smaller operators, and are of less interest to the majors. We have the know-how and the balance sheet to exploit these opportunities, and this is very relevant to our North Sea activities.

The green area on the chart shows production from our future development projects, taking a risked view. We have over 30 opportunities in this category, and we assume here that 20 of them will be developed. In exploration we've had considerable success with the drill bit, with seven out of 14 successes in the last two years. Here we also take a risked view of the prospects, shown in orange on the chart. We prudently assume a success rate of just under 30%, typically with a timeline of at least five years between discovery and first production.

We also have a very strong track record in acquisitions, successfully acquiring and integrating assets into the portfolio, for example the Statfjord and Trinidad and Tobago acquisitions, as well as the venture transaction itself. Being able to identify, acquire, and integrate packages of assets is a very important skill set, providing a further means of sustaining the portfolio for the long term.

In this context our recent transaction in Norway with Statoil significantly increases both the overall scale of our Upstream business and delivers a step change in our Norwegian operations. The transaction increases our 2P reserves by almost 30% and raises our annual production by 12 million boe, or 25%. That takes our total annual production to around 62 million barrels of oil equivalent. The transaction delivers a long term stable production profile, with an attractive blend of existing production and development potential. It's very much a long term deal, delivering value over many years, with earnings expected to step up over time as new developments come online.

We also continued to look at further packages of assets where we can identify value and a good fit with the portfolio. As always we will consider the balance between overall returns and the cash flow and earnings profile delivered.

Across our Upstream portfolio we have outperformed the industry on a number of key metrics. Our average exploration success rate over the last two years is in excess of 50%, due to discoveries such as Rhyl, Fogelberg, Maria and Butch. Our finding costs at £2.70 per boe, are well below the benchmark levels. In 2010 our reserve replacement ratio was a healthy 153%, well above the level required to maintain stable reserves. And our development costs were just under the UK average. Only lifting costs were slightly behind the industry average, due to the Morecambe shut-in.

In Power Generation we now have a well diversified fleet with a distinctive low carbon mix. In the current market environment the importance of having a balanced generation portfolio is clear; generation earning an absolute power price, such as nuclear and wind, has outperformed gas fired generation where spreads have been squeezed. Asset reliability is therefore very important, and we've seen good improvements across each generation class. As we enter a phase of significant evolution of the UK's generation mix, driven by ongoing tightening of the environmental regulations, the low carbon nature of our fleet will be particularly important.

We're therefore positioned, both with our existing asset mix and through options available to us, to invest for growth where we see suitable returns.

In a moment we'll set out the scale of our ambition that we see for the business, both in Upstream and Power Generation over the next three to five years. But first I'd like to explain some of the core principles we apply when deploying capital in the business. As Sam said in his opening comments, our clear objective is to invest for growth and value. This means targeting attractive double-digit returns on our investments, and also delivering strong cashflows and earnings growth. At the same time we are strengthening the energy hedge and securing sustainable energy for our customers. Maintaining an appropriate level of hedge is key to our integrated energy model. As you will recall, the Venture and British Energy transactions have brought us more in line with our downstream competitors in terms of the hedge, allowing us to benefit from our scale, our brand and the efficiency of our operations. On a post-tax basis our recent transaction with Statoil means our energy hedge will once again be around the 50% level. This keeps us in an appropriate competitive position, but with a more distinctive, lower carbon, gas rich mix. And in fact we still see some room to increase the energy hedge from these levels, given the right opportunities.

Upstream our objective is to strengthen the existing portfolio, deploying our expertise and knowledge to increase scale, enhancing our production hubs to deliver long-term sustainable production, combining organic growth and acquisitions to enhance the portfolio, and improving our geographic diversification. And in Power Generation we are progressing our options, selecting the opportunities that offer the most attractive returns, leveraging our expertise and options across a range of generation technologies.

In summary we have a very strong base to build on, strengthening our position both in Upstream and in Power Generation with a clear objective of delivering growth and value.

Turning now to our distinctive capabilities. Over the course of today's presentations and breakouts I hope you will gain a good understanding of the skills and capabilities that we're able to deploy in Upstream, including examples of each of the four key competence areas shown here on the slide: maximising value from the existing asset base through world-class stewardship of our production hubs; delivering capital projects successfully, on time and on budget; bringing a wealth of experience and innovation to our exploration activity; and completing and successfully integrating acquisitions and industry-leading partnerships.

In fact delivering difficult mid-size projects is a key differentiator for our Upstream business, as I've mentioned, and we have a great team of professionals at Centrica Energy deploying these distinctive capabilities to maximise the value from our portfolio.

Markham is a powerful example of the value of these capabilities. We identified the Markham opportunity, and redeveloped the area by deploying our hub approach. Production from the Markham field peaked in 1995, and ten years later had fallen by almost 80%. Several carboniferous tight gas fields in the area were known about; however they were stranded due to the absence of the right technology to extract the gas.

Centrica acquired its first production in the area in 2006, and built its position through further acquisitions and via licensing rounds. Subsequently Centrica pioneered the use of multi-fracc'd horizontal wells in carboniferous reservoirs in the North Sea. In 2007 the tight gas reservoir at Chiswick was finally unlocked by Centrica using this technology. Since then seven producing fields have now been tied back to the Markham hub, and we're considering further developments to enhance production.

We've also built distinctive capabilities in offshore wind, where we've built a strong scale business in its own right. And the key competence areas are: effective project development, where we have identified the most advantaged sites; built a high quality project pipeline; and established industry leading partnerships; in project delivery, where we have an established in-house team with outstanding technical capabilities and a proven track record; an efficient asset operation where we bring substantial O&M experience and are able to feedback our learnings into the design and construction process of our next projects.

Our pipeline of wind development projects is one of the largest in the industry, with over 5GW of potential projects. However the competitive edge comes from the quality of our projects these enjoy favourable wind speed, water depth, distance to shore, and with both North Sea and Irish Sea positions, locational diversity.

So what will this mean specifically for our investment plans? Upstream our immediate focus has been on delivering sustained production at the 50 mmboe level. However, as you have seen from our recent Norwegian transaction, we'll seek to increase production above this level where we see attractive opportunities. Our objective is to increase production by 50% to around 75 mmboe over the next 3-5 years. The Statoil deal takes us part of the way there, with production rising to around 62 mmboe/a on completion. And importantly the transaction delivers a solid long-term production profile, with an attractive mix of producing assets and development opportunities. We're also strengthening the existing portfolio through greater geographic diversity, initially for example by expanding in Norway, and potentially adding to a further Atlantic Basin area to the portfolio over time. Jonathan will return to this in further detail in his presentation. This is an exciting development for our Upstream business it's building on our existing capabilities to take the business to a new level, it's deploying further capital for growth and value.

In Power Generation we see the greatest potential for further investment in offshore wind. Here our objective is to increase our share of generating capacity by 300% to 560MW over the next five years. Successfully delivering the Lincs project is the first priority, with good progress to date and first power expected towards the end of next year. As I mentioned earlier, Race Bank is progressing towards FID next year, with pre-FID appraisal ongoing on Docking Shoal and the first projects within the Round 3 Irish Sea development. Sarwjit will provide further details on our progress on this later this morning.

In addition to the opportunities Upstream and in offshore wind we have a range of further potential growth options; in new nuclear, in biomass and in new build CCGT generation. In each case we will only proceed with projects where we can see attractive returns commensurate with the risks undertaken, and where we have the confidence in delivery capability.

In summary, Centrica Energy has made excellent progress, consistently delivering on its strategy over the last two years. We now have a strong well-balanced business both in Upstream and in Power Generation, reflecting our disciplined investment strategy and distinctive capabilities. Our immediate focus is on maximising returns from the existing asset base, and from the current investment programme. We also see the potential to make further investment for growth and value over the medium term, significantly enlarging the scale of our Upstream activities, adding further offshore wind capacity and pursuing options in biomass, new nuclear and new build CCGT where we see attractive returns.

Thank you, and I will now hand over to Andrew.

Andrew Le Poidevin – Finance Director

Thank you Mark. Good morning everybody. I'm going to spend some time talking about our strong financial performance over the past few years, in particular what we're doing to manage our cost base and our tax charge; then I'll touch on our strong cash generation, our capital base and how we reinvest this cash back into the business, using a disciplined capital approval process.

First I'd like to touch upon commodity prices to provide some context. Gas, oil and power prices are considerably higher in 2011 than they were in 2010. Looking forward into 2012 gas and power prices are higher still. We do undertake some forward hedging so as to reduce earnings volatility, but overall current forward curves should benefit operating profit for Centrica Energy, and we are in a good position to capture higher prices, particularly for 2013 where we have minimal hedges. Current forward curves also support favourable returns for our investment pipeline.

Turning to the impact of curves on our gas fired stations, with gas remaining the marginal fuel in the UK generation market power prices have been driven higher, but the net impact is that market spark spreads have been lower this year and they remain depressed going forward. Our stations will be adversely affected but it is worth noting that low spark spreads do not necessarily result in lower achieved spreads. Our plants will be economic to run less often, but a higher proportion of the hours will be sold at peak prices. The level of spreads, as well as the withdrawal of free carbon allowances, means that all gas fired generation assets face significant headwinds.

Operating profit in Centrica Energy has broadly doubled in the last two years, from 525m in 2009 to approximately £1bn this year on consensus numbers. Of course the acquisitions of Venture Production and the 20% equity interest in BE are a big reason for this growth. However higher wholesale prices, stable and reliable production and a tight focus on cost have all contributed. With our Upstream gas and oil operations being so highly taxed it is important that we focus on the post-tax profit number. I will cover our tax charge later, but it is worth noting that, in line with our growing scale, Centrica Energy's post-tax profit has increased each year since 2009, despite the unwelcome increase in SCT earlier this year.

Our capital employed in 2011 will be around £6 billion, and the Statoil acquisition will add nearly £0.9 billion in 2012. The nature of our business model means that we will always have an element of pre-productive capital on the balance sheet. We currently have five major Upstream gas and oil projects; Seven Seas, Kew, Ensign, York and Rhyl, all coming online within the next 18 months and helping us maintain production at around 50m barrels. The Lincs wind farm also generates first power in 2012.

In 2011 our pre-productive capital will be around 1.3 billion by end 2013 half of this capital will be contributing to production, earnings and cashflow. We will continue to cycle new capital rapidly through the pipeline. One of our key aims when building our capital plan is to ensure that our project mix delivers a financial profile that is appropriate to cash and earnings as well as value.

Controlling our cost base is critical to ensuring we maximise returns from our assets. And with the oil and gas industry experiencing a tight supply chain, and new fields coming online, costs are rising for all producers. We also have an ageing portfolio of assets, with unit fixed costs increasing as fields decline.

The top two charts show the Upstream cost base and unit cost per barrel, each split between lifting costs and depreciation, depletion and amortisation – also known as DD&A. In line with the industry our unit costs have risen since 2009 to an estimated £20 a barrel in 2011. Lifting costs, which are field, opex and transportation tariffs, are the primary driver of this increase; this is due in part to underlying inflation, but also to a lower proportion of Morecambe production and a higher proportion of oil in the mix. Our big challenge is to maintain a competitive cost structure, to maximise earnings and support our investment pipeline. In the next two years we will benefit in particular from projects coming on stream, and from our Statoil acquisition, which enjoys relatively low lifting costs. In addition we continuously target fixed and variable costs. Our 2011 cost initiative has identified many opportunities, such as upgrading the compressors at Morecambe to save fuel gas, and as one of the largest operators in the UK further leveraging our network of partner framework agreements. The net effect is that we expect stable lifting costs in 2012, and we are targeting a reduction in 2013.

DD&A is charged on a unit of production basis. Our current rate reflects a mix of lower cost oil fields and higher cost new fields coming on stream. Taking account of these new developments and of the acquisition of the Statoil assets our unit DD&A rate is expected to increase to around £12 by 2013.

Turning to power – managing the costs of our power assets is especially important in the current market environment. The two charts on the bottom of the slide show our power operating costs in aggregate, and specifically our gas fired generation unit operating cost per mega watt. A high proportion of these costs are fixed, which means with lower volumes this year unit costs are increasing. In this context we are focused on reducing costs wherever possible and as a result of the low spark spreads we are proposing the closure of two of our older stations, as well as moving some of the other plants to more flexible working conditions. You will hear more of this from Sarwjit later on.

Turning to tax – as you'll all be aware the gas and oil business is characterised by tax rates which are much higher than standard corporate rates, and there are significant differences across regimes. The slide shows the marginal tax rates for the countries we operate in and the share of production for each country. In the UK the unexpected change of SCT in March increased the effective tax rate on Upstream assets. As indicated at the time, this impacted our earnings by around £45 million in 2011, or the better part of a penny off Group EPS. The full-year impact in 2012 is expected to increase to around £75 million, or around 1.5p. Our overall Upstream tax rate is expected to be around 78% in 2011 and 2012; reflecting a full year of higher SCT and the acquisition of Statoil assets. We are looking forward to the average tax rate falling as PRT paying production is replaced with lower tax fields under development particularly as production from Cygnus and Trinidad comes on stream.

Centrica Energy is a highly cash generative business, and I'm going to spend some time on this important slide. The chart shows that we have more than covered our capital expenditure by cash generated in both 2010 and 2011. We also estimate that cashflow for the next four years to 2015 of £5.2 billion broadly covers our planned capital expenditure, as well as the cost of the Statoil acquisition. Around one-third of our current plan is committed to complete upstream gas projects and the Lincs wind farm, as well as to maintain the productive capacity of our assets. The planned but uncommitted element will be spent on further upstream gas and oil projects, and the construction of the Race Bank wind farm, should we take a positive final investment decision later next year.

So how is the £5.3 billion investment split between each business? We plan to spend around £3.4 billion on maintaining and developing our upstream gas and oil assets, in addition to the acquisition cost of the newly acquired Statoil assets of around £0.9 billion. This includes around £50 million per year on maintenance and around £100 million per year on exploration. The balance will be spent on appraisal and development with Valemon, Cygnus and Block 22 in Trinidad likely to be our most significant projects.

We also plan to spend around a billion pounds on our power business over the next four years, with Lincs due to be completed in 2013, the biggest element of expenditure is on

Race Bank. We assume that we will bring in partners for Race Bank, taking our share down to 50%, just as we did on Lincs.

Finally, you'll see on the far right of this slide our estimate of the potential cost of our growth options. Mark set out our aspiration to grow the upstream production to 75 million barrels, we estimate potential investment over the next four years could amount to an additional £1.5 billion.

The development of our power options could add a further £1.5 billion by 2015, comprising new nuclear post FID spend of up to a billion pounds, the balance being split between biomass and CCGT. There would clearly be further investment to come in the second half of the decade on these and other potential options.

These additional investments will only be made if we are convinced that they maximise value and that they are the best available to us. All our acquisitions and projects must pass strict project execution stage gates and meet financial targets. Over the past two years our investment committee has approved 28 upstream exploration appraisal development projects with spend of over a billion pounds. Each followed a standard project stage gate process with risk assessment and peer review and approval for all key engineering subsurface and commercial judgements. We apply a similar methodology to acquisitions.

As well as passing technical hurdles we have strict financial criteria for a project to receive a positive final investment decision. We target at least double digit returns and often higher, depending on the nature of the opportunity and risks involved. And not every project passes these layers of scrutiny I should add, many being reworked to enhance value along the way. To give you a flavour of returns on recent development decisions the chart shows five current development projects sanctioned in the last 18 months. All show full project returns which are well into double digits, the exception being Ensign where the original book cost holds back the project return, but which still shows strong returns on an incremental capital spent basis.

We also test our projects and acquisitions against earnings and ROCI targets as well as the cash flow and credit rating impacts. I'm particularly pleased with the rapid cycling of capital into production, by way of example Rhyl will be two and a half years from exploration well to first gas. This means rapid payback on cash invested.

So, in summary, our current productive capacity can be sustained from our existing cash flow. We also have the capacity to build scale in the upstream and power businesses, deploying capital to drive earnings, growth and value. I'll now hand back to Sam.

Sam Laidlaw

Thank you very much, Andrew. As you've seen, I think we've made very good progress in the business over the last three years with the distinctive capabilities that we have and I think a very strong portfolio of assets and opportunities. Looking ahead we see considerable opportunity to build on the established business model with further investment for growth and value. Upstream in gas we've already significantly increased the scale of our business through our recent Norwegian transaction, and as you've heard from Mark we plan to develop the business further where we see attractive opportunities to deploy capital for value.

In Power Generation we'll look to progress our round two and round three offshore wind projects, bringing Lincs online next year and subject to a positive investment decision commencing work on Race Bank. We also retain further options across biomass, new nuclear and new build CCGTs, and we'll invest in those only if we see appropriate returns to deliver value for our shareholders.

So I think with that it's a good place to actually pause and take your questions please.

Question and Answer Session

<u>Question 1</u>

Gus Hochschild – Mirabaud Securities LLP: Biomass

In view of the government targets, just on power generation, of having to have 30% from green, if you were to build out all of your Irish Sea licences and Docking Shoal and Race Bank it seems to me that still you would, especially if you were to partner at 50%, you would still be very short on meeting such a government target. So perhaps you could give us a bit more flavour about maybe the biomass.

Answer: Mark Hanafin

Yes, well I think there's a difference between the government target and the requirements that are placed on us as a supplier. Obviously the requirements for us to have renewable energy are linked to the amount of ROCs that you have to deliver for supplying electricity to your customers and that's increasing at about 1% a year. Part of our investment strategy around renewable power is generating those ROCs from our own resources. From that point of view I think the investment pipeline that we have very much meets those types of needs. Now, whether the overall UK plc plus external investors can meet the requirements of 30% electricity from renewables by 2020, that's going to be a very tough target to meet, but in terms of our business targets I think we're in good shape to meet those requirements that are put on us.

<u>Question 2</u>

Iain Turner – RBS: Onshore wind

Can I ask you about onshore wind which obviously you've got some but you don't seem to have any options to take that further forward. As I sit here as an analyst, onshore wind looks to me as if the returns might be a bit better, the technical risk might be a bit lower and they might be a bit faster to get going, so why aren't you pursuing them?

Answer: Mark Hanafin

I would say that it is easier to do, there is an easier task in terms of building them and maintaining them, there's obviously a much lower revenue coming from onshore wind. The biggest challenge if you want to have a scale wind business is getting the projects. We have more than five gigawatts of offshore wind projects in the pipeline to aim at, very advantaged projects, and I think it would be very difficult to get anything close to that or anything material onshore, just in terms of the scale of the projects, the local opposition to wind farms. I think we're pretty happy unless, Sarwjit, you want to add anything to that answer?

Answer: Sarwjit Sambhi

Yes, I think it's to do with the scale and in terms of meeting the UK target of renewables by 2020 we're going to need to see 20 gigs of wind and not all of that can come from onshore, a big chunk has to come from offshore.

Question 3

Bobby Chada – Morgan Stanley: Upstream project IRRs

Thanks. I just wanted to go over first of all slide 33, the IRRs and in particular to understand, I mean am I reading this right, does this show that every project except Ensign has had an unlevered post tax IRR of north of 20% on total capex? So how come Ensign was like 4%? What was the difference with that project?

Answer: Andrew Le Poidevin

Ensign is an interesting field because it's actually one of the very first fields that was actually discovered in the North Sea back in the 60s. It wasn't developed for a long time, Venture acquired an interest in various licences, pieced them together and then did some appraisal drilling, two wells, one of which failed. The reason why the total project return dating from the original venture acquisition was low is because of that failed appraisal well. When we come to investment committee we look at both total project returns and on an incremental capital spend, it's vital that overall we get total project returns well above our WACC, but in this case the right thing to do was to make the spend and develop the field and get the strong return that we're getting from the incremental capital.

Further question

And just to explore that a bit further, these are all fields that effectively you explored and developed yourself, right? These should not be compared with acquisition IRRs whenever you buy a block of producing assets?

Answer: Mark Hanafin

Yes, these are our developments, yes.

Andrew Le Poidevin

These are distinctive because they're operated by ourselves and a couple of them are just pure exploration that we're converting into production.

Question 4

Edmund Reid – JP Morgan: Gas & oil split and windfarms

Two questions. The first one is on the split between gas and oil in terms of production. The second one is regarding levelised costs for your offshore wind farms both Round 2 and Round 3, and I guess more generally whether you think that you can meet the sort of government aspiration of £100 per megawatt hour.

Answer: Mark Hanafin

So, on the first question, the split, what was your actual question?

Edmund Reid

So, what proportion of the production would be oil versus gas?

Answer: Mark Hanafin

So the position today is that we're around 20% oil in the portfolio in terms of production and in terms of looking ahead that's a comfortable place for us to be. I wouldn't want to see it going much below 20%, so 20% to 30% range for our oil share of the portfolio I think is a good place to be. And the reason for that is that some of the costs in the Upstream business in terms of the inflationary costs are linked to oil and the oil price. So it just gives us a bit of a hedge in the overall portfolio, our overall gas production portfolio.

Answer: Sam Laidlaw

And not all that is oil, some of it liquids and condensate.

Answer: Mark Hanafin

In terms of the Round 2 and Round 3, let's just sort of step back and look at the high level basic numbers, you probably need for a decent project, a good Round 2 project, you probably need £130 a megawatt hour of revenue for that project on a levelised basis to make a double digit return. Obviously it depends on the project, how good the project is, how well you've done in terms of building it, but that sort of number. The buyout price for 2011/ 2012 is just under £39 so add the recycle which it varies, but it could be around the £4 level, so you're above £40 in terms of buyout price and the recycle price for the ROCs. If you had a £50 per megawatt hour power price then you're at the £130 plus level.

So I think the economics are currently sound if you've got the right projects and obviously what the government has done with its ROC banding is it's started to signal that it'd like to see some of those costs coming down with new technology and Race Bank should qualify if we get all of the consents and if we move forward as we plan to do with that project it would be a 1.9 ROC project. It would be different technology to Lincs and I think it should be a good project. So that's how we look at it.

Answer: Nick Luff

Round 3?

Answer: Mark Hanafin

Well Round 3 it's something we're working on right now in terms of the appraisals, trying to figure out where each project would be in our consented area. What the feature of Round 3 is it's deeper water, it's the more difficult projects, but as I say technology is moving on so we're seeing the next phase of turbines as sort of 140, 150 metre turbines, whereas Lincs was considered cutting edge at 120. So we'll have to watch very closely in terms of how does that technology and that cost curve work against what's happening in terms of the ROC banding. But we're two or three years away from an FID on that first project.

<u>Question 5</u>

Martin Brough - Deutsche Bank: Nuclear

Can I just ask a bit about the nuclear, the potential capex there, a billion over four years. Is that just for the first EPR or if everything goes well would that start including material spend for further projects? And if it is just for the first one then potentially you'd have another five or six years after that before you turn the thing on, so what does that mean for the overall project costs?

Answer: Andrew Le Poidevin

Yes the billion pounds we referred to in the growth options would be not just Hinckley but the beginnings of the spend on Sizewell as well, so it's a combination of two major spend projects.

Answer: Sam Laidlaw

Across four reactors, yes.

<u>Question 6</u>

Lakis Athanasiou - Independent analyst: Nuclear

Just going back again to nuclear on the committed spend on pre FID, so far up to the end of this year you've indicated £150m, do you have any more pre FID and new nuclear spend to go? And is it possible now or is it too early to say when you could get to the FID? And if you decide not to progress is it possible again at this stage to give us any idea about your exit strategy?

Also, on the same subject, on Cygnus which is a major field, could you give us any indication at this stage if you'll be looking to expand reserves this year in Cygnus and when do you think you'll do the FID for Cygnus?

Answer: Mark Hanafin

So on your nuclear FID our exposure in terms of pre FID spend is £200 million, that is the limit of our exposure. We're targeting FID at the end of next year so that's the simple answer.

Further question

And the exit strategy?

Answer: Mark Hanafin

I'm not going to speculate on exit strategy, we've sort of set out and you'll see in Sarwjit's presentation, we set out very clearly what the conditions are that will be required for us to go ahead with the investment and there are three key areas around permissions, around the returns and around the build-ability and the confidence that we have in the project delivery. So if those conditions are all met and it's a good project then we can go ahead, if they're not we don't go ahead.

In terms of the Cygnus question, we are working with GDF, our partners on that towards a FID, I think in the first half of next year. And I'm not aware of any changes to the reserves at this point, although obviously we're working on NGO reserve figures.

Question 7

John Musk – RBC: Carbon floor price

A question on the carbon floor price, obviously that forms a major part of the economics probably of future wind projects, do you see any risk to that being amended by government in any way, given what's happening with the European price?

Answer: Mark Hanafin

All of the projects that have some kind of ROC regime or carbon floor or other CfD mechanism are subject to government policy, the government needs to get investment happening so it needs to provide those kinds of conditions. I think in terms of the carbon floor, this specific question on the carbon floor, it impacts the economics to some extent through the actual power price but as I laid out earlier in the typical economics of a Round 2 wind project that's quite a small part of it because it's really the two ROCs and then the power price that drives the return. So I think with the European ETS in disarray in terms of the pricing signals that it's giving I think it was the right thing for the government to do, to just give that price signal although carbon prices are set to increase over time. They've made their amendments or are planning to make their amendments to support heavy energy users so I think it's the right signal and it's broadly supportive but it isn't the main thing that underpins the projects.

Question 8

Paul Spedding – HSBC: IRR and reserve replacement

Two questions one on the internal rate of return and the second one on reserve replacement. On the internal rate of return slides could you perhaps talk about the materiality of each of those projects because a small tie back can actually generate very high internal rates of return? And secondly within that could you also perhaps give an indication of the Cygnus internal rate of return you're expecting.

On the reserve replacement would it be possible to give us the reserve replacement without acquisitions and how your risked exploration outlook and unrisked exploration outlook over the next several years might change that?

Answer: Mark Hanafin

Okay so just on the materiality do you want to comment Andrew?

Answer: Andrew Le Poidevin

Yes these are pretty material in combination, we're talking £500 to £600 million, the biggest is York which was nearly £280 million in aggregate I think across the whole project. Minimum size was Goosander I think that was £45 million so they really are material and so material deployment of capital but very rapid payback in terms of production and release of cash, something I think it's fair to say those five projects which are 'the five' that we operate was something of a sweet spot for us and they do reflect the nature of opportunities that we've sought to target in our Upstream operation.

Answer: Mark Hanafin

Okay and on reserve replacement you're going to see in Jonathan's presentation in a moment us laying out the funnel of how we see reserve replacement for the business model as a whole. And broadly speaking it's a blend, it's a balance between acquire and develop and an exploration model and we think that gives us the most flexibility. As I mentioned on the call after the Statoil acquisition although we're still working on the numbers and there's obviously still some moving parts, broadly speaking we expect to replace reserves this year and that principally has come from moving 2C resources into 2P and it's come from some of the geological work that we've done around some of our existing reservoirs and some upgrades to those reservoirs so given where we were last year with the outperformance that's a very pleasing place to be.

Answer: Nick Luff

Don't you mean without acquisition.

Answer: Mark Hanafin

Without acquisition. And then on Cygnus as with all of our projects we're going to be looking for double digit returns and clearly it's one of those projects as with all the UK and North Sea projects that were badly impacted by the change in the SCT and we're talking to the government about that and other developments in terms of what better conditions that we can expect from government so that's all part of the lead up to FID.

Question 9

Ashley Thomas - MF Global: Energy hedge

On the Energy Hedge slide within the power component obviously at the moment you've got the existing two Drax contracts what is your viewpoint as they near expiry? Are you agnostic towards the generation type or would you have a preference to shift that balance more towards lower carbon generation?

Answer: Mark Hanafin

I think that we're probably agnostic to it in terms of we'll look at the commercial conditions at the time. I mean what's actually behind that element of the structural hedge is that we're in a very competitive environment in the UK, we had just really a gas-fired generation fleet and it was about broadening and diversifying that sort of structural hedge. So getting a core element into the mix in terms of the hedge but without the investment actually in coal plants and I think we would review that closer to the time if we see other things that can provide the gas hedge more effectively for lower risk then we'd be looking at that as well.

Question 10

Peter Atherton – Citigroup: Energy efficiency

I think it's a big picture question for Sam, Sam on your slide you touched on the latest government estimates of the impact of all their various policies on bills and what the government basically said was bills will rise by about £350 in real terms but don't worry because energy efficiency means that you'll use a lot less energy and bills will fall by around £380 I think from memory, or something like that and there'll be a 7% saving. Interested in your views on the energy efficiency side of what the government said but if we look forward to this coming few years the proposition seems to be that this industry's going to vastly increase its investor capital and therefore substantially increase its debt, the unit cost of production is rising hugely as all these new assets come on stream. The unit cost of sales to consumers is rising substantially and volumes are going to be falling by 20%, how on earth do you manage that situation to make this an attractive business for investors?

Answer: Sam Laidlaw

Well I think the answer, Peter, is if you look at the different parts of what our view is, and we need to fully unpick the government's numbers but I think there are a number of pieces in there. Firstly, things like the renewable heat incentive have actually been taken out of the bill in their calculations. Secondly, of course, their calculations are all done on a real basis and actually our customers will pay nominal bills at the end of the day, that's what they're interested in, and we think energy efficiency has got a really important role to play but we would be doubtful that it's going to offset the cost that you've described. So I think we are in a world where bills are likely, over the long term, to move up absent to any fundamental change to the gas price caused by shale gas or whatever. And I think in that environment obviously it's up to us which is what the honest conversation is all about, to try and get as much transparency of those costs as possible. Some of them are relatively immediate, this is not all 2015 and beyond if you look at the CERT obligation that's actually going up quite substantially 2012 on 2011 and I think it is about being much more transparent about that, it's actually going to be critical to bringing customers with us.

Now in terms of whether this is a good investor proposition that will actually entirely depend on whether we can continue to invest for strong double digit returns that are actually going to give us not only long term growth in value but if we can pace it right so that we get growth in earnings through the cycle as well and that's a very fundamental part of our strategy, which is why we need some of these short term, short cycle, high return projects to actually continue to fund the growth of some of the longer term lumpier investments such as whether it's offshore wind or possibly nuclear.

Further question

So you think there is a way through that you just don't get locked into a very unattractive investment proposition?

Answer: Sam Laidlaw

Yes I think there is and actually if you look at what's distinctive in our mix too and if you step back and look at the big picture, actually where you are exposed to, if you like, that regulatory risk that you're describing is in the UK power market, you're not exposed to it in the upstream gas market because that's a deregulated market, nor are we exposed to it in the deregulated markets in North America to the same extent because actually that's a well supplied market. So if you step back and look at the Centrica Group that's why I think we like to keep building the power business in the UK if the returns are there but actually it's not if you look at where all our capital is going it is only a part of it because of course what's not shown on this slide is the capital we're continuing to put into North America.

<u>Question 11</u>

Mark Freshney - Credit Suisse: Wind and oil & gas production

Just two quick questions. Firstly on wind we've spoken a lot about the revenues but the big bugbear is much more costs I think. From memory I think you sanctioned Lincs at about

£2,600 per kilowatt, what do you sense those costs are doing right now and what does your predevelopment work suggest that those costs are now?

And just secondly you alluded to taking the oil and gas production potentially up to 75 mmboe/a up from 62, in the past you've done that through a combination of acquisitions and more recently through generating value at the drill bit what do you think the mix would be? Do you think you'd need another acquisition or transaction the size of the Statoil assets?

Answer: Mark Hanafin

So let me answer the last question first and then ask Sarwjit to talk about wind costs. As I mentioned on an earlier answer I think one of the strengths of the Upstream business model is that we've got an acquire and develop approach combined with an exploration approach so we're not driven to over explore and then suffer less than attractive returns and performance from that, so we can balance between the two and I think in that growth form from 62 to 75 there will be a blend of continuing to explore, probably at similar sorts of levels of investment that we've been at, around the £100 million level in terms of exploration drilling, and there's likely to be acquisitions in that as well. Sarwjit do you want to comment on the wind costs?

Sarwjit Sambhi

Yes. So the industry now in terms of the developments that it's looking at it's putting a capex per megawatt number of around £3 million in most of its investment cases. Now when you compare that to Lincs, the Lincs number that you just quoted was with the 107 metre rotor so with using larger rotors more output. So net effect in terms of the investment case, levelised costs are still largely the same and then the edge in terms of one asset to another comes about from how windy the resource is.

<u>Question 12</u>

Bobby Chada – Morgan Stanley: Capex

It's a question for Nick because he hasn't had any so far and it's a sort of little picture question as opposed to big picture. I tried to add up all these numbers on capex, it doesn't seem to me that the capex for the Group will be much changed to your current guidance given the things you've said about Upstream spend, about Generation spend etc. and with that £1.5 billion rough guidance that you've given for capex as opposed to debt increasing substantially actually your leverage is likely to remain relatively flat in the medium term isn't that the case?

Answer: Nick Luff

Yes the 1.5 is probably still good, it will go up a bit with the Statoil acquisition which will add to that next year in particular we'll be a bit above that because of the timing of the projects but obviously we're also generating more EBITDA because of the investment in Statoil. So you're right broadly speaking we can fund that level of capex out of cashflow.

Question 13

Gus Hochschild – Mirabaud Securities LLP: Wind and Capex

In view of that I was wondering if you could answer two rather further questions if I may, in the first case going back to the wind assets what sort of ballpark load factor are you anticipating for those potential assets?

And then secondly could you perhaps give us an indication of what sort of capex you're looking for, Statoil especially again as said before if you're looking to increase the barrel of oil production? Thank you.

Answer: Sarwjit Sambhi

If we look at the Lincs project using the 120 meter rotor then we are looking at load factors of around 44%, that's offshore wind. In terms of developments beyond that if we're looking at 140, 150 metre rotors then there is another step up in energy yield.

Answer: Mark Hanafin

And I'm not sure I fully understood the question on the capex but I think if you wanted to do an acquisition from 62 to 75 then broadly you're talking about another Statoil type deal.

Further question

So is this just on what you've done with Statoil what sort of guidance would you give looking up on certain stocks?

Answer: Mark Hanafin

Additional capex? **£**100 million.

<u>Question 14</u>

Peter Bisztyga - Barclays Capital: Shale gas

Can you talk a little bit about shale gas do you consider the potential for imports from the US in the second half of the decade and also potential indigenous production as a threat or an opportunity going forwards?

Answer: Mark Hanafin

Okay so if you look at the first projects that are getting sanctioned, you look at Chennai's project that's been in the news. Broadly speaking the commercial terms around that, around $3 for liquefaction, about 115% of Henry Hub in terms of an FOB gas price and that's for shrinkage and losses and so on. So at $4 Henry Hub for FOB gas you're looking at, let's say in round numbers, $3.60. You've then got to ship it, you've got to re-gasify it, obviously those projects will be targeting the Far East but if you brought it to northwest Europe at a $4 Henry Hub price you'd be landing it at over $9 which is over 60p per therm. So I think in terms of the development of shale gas if it plays out with those kinds of numbers we're at about sort of current gas prices. Obviously if gas prices go up in the US then that will pass on. What's interesting is that the regulators sort of said that they want to limit export to a point where it's not actually driving domestic gas prices so it will be interesting to see what that means.

I think from our point of view, is it a threat or opportunity? From an opportunity side it's something that we've been studying. When we talked to you a couple of years ago I think we talked about shale gas and the jury was a little bit out what were the full cycle costs really going to be whether it was really as low as people were saying and there was some doubt about that. I think two years on with the technology improvements those costs really are being borne out and obviously the price has followed.

So in terms of an opportunity would you transact with one of those deals? Clearly something that you should study but without production behind that you are taking a very big spread between Henry Hub and international price. So I think the people who will be looking at doing that trade will be people with significant gas production behind it.

<u>Question 15</u>

Thierry Bros – Societe Generale: Growth strategy

Most of my questions have been taken but I come back to the growth strategy in Upstream, if I understand while you want to grow by 13 million barrels per year by three to five years which is big and in a short period of time you're saying £100 million will come from exploration which is minimum, so most of it will come from acquisition? You've given £1.5 billion for acquisition and you are mentioning Atlantic Basins so what kind of fields would you target, will it be a producing field in which area? Thank you. I'm sure you have an idea it's in a social period of time.

Answer: Mark Hanafin

Okay so we have Atlantic Basin is a large geographical area. We have customers in the UK, we have customers in North America and clearly those areas of great interest to us, in northwest Europe, UKCS, Norway, the Netherlands are areas that we're already in. There are some interesting new basins within those areas that would be of interest. And as I said we would study conventional and unconventional in North America as well. So I think the strategy is consistent with what we've said over the last couple of years that the linkage is probably... why is it Atlantic Basin the link is through LNG to our markets.

Answer: Sam Laidlaw

I think just building on that I think there's an important here and this is not a production growth target. This is all about an aspiration that if we can see real value we think that the model could be further strengthened but it has to compete with other opportunities in the Group. So we're only going to do this and that's why it's absolutely not in the firm plans, we're only going to do this if we can actually see really strong returns and as Mark says it would be to satisfy UK customers could be to support our North American customers or we could just do on investing in power or other parts of the business. All returns to shareholders.

<u>Question 16</u>

Peter Atherton - Citigroup: Storage

Just a quick question on gas storage actually. Where you stand currently it would like the strategy needed for the UK has over the next decade or so to increase gas storage but also obviously they're not very good economics at the moment. What is your own ambitions in that area?

Answer: Mark Hanafin

The first part of your question I would say that the UK does need more gas storage. Given the pipeline connections we have the indigenous supplies we have it's probably not the same benchmark as some of the major European countries but I do think we need more storage. The problem from an investment point of view is that the old world of very simply gas going in in the summer, coming out in the winter, flexible fields in the North Sea that's all changing and we've seen a flattening of the winter/summer spread. So in a sense what we might be seeing is that storage is needed more as an insurance product and the market finds it very difficult to price that insurance product in terms of making a return on quite substantial investments. So we do feel that in Baird we have one of the best, if not the best projects out there. It's a significant project. We think that from a UK plc point of view it needs to get built. We're going to have to work with government and figure out how does it get built, how do we get the right market signals.

Further question

So is there any sign of the government dusting off their sort of strategic gas reserve option which they've discussed at the various white papers but have always dismissed?

Answer: Mark Hanafin

I think there's a whole range of options that government could consider. I'm not seeing them dusting off that specific proposal. But we're just having a very open conversation with them that something needs to get built and probably because it's looking more like an insurance product the market's not going to provide it with these winter/summer spreads. And they're very interested because they're very interested in security of supply which is why they were so supportive of the Statoil deal.

Question 17

John Musk – RBC: Energy hedge

On the strategy around the Upstream business probably a difficult question to answer but what makes the 50% to 60% hedge the right level? And is it purely as a hedge if the returns are 20% IRRs what's to stop you going further if you're only going to be getting low teens on wind investments and other types of power investments? Why don't you change the mix of the business altogether?

Answer: Sam Laidlaw

We come at it in lots of different directions. We come at it firstly in terms of what is supportable from a financial perspective, what is supportable from an organisational land management bandwidth point of view in terms of where we want to be. But also what's going to give us a competitive hedge in the downstream business. And if you look at most of our competitors that's where they are. Now what's distinctive about our hedge is that it's gas and power rather than just being power. But when you look at most of our competition that's where they are.

You also have the fact that given, even after tax, if you're just doing this on a sort of per therm basis then actually you're getting higher returns per therm than you're getting in the downstream, and therefore you don't need a one for one hedge. So I think when you think also strategically of the DNA of this business and what's our distinctive, not only investor proposition but selling proposition to people we go and buy gas from, this is a downstream led business with the customer first and we are looking to support those customers and supply as low cost energy to them as we can, rather than seeking to go the other way and become an upstream company first which is a very crowded space. And where we can compete is actually in the market place.

Question 18

Edmund Reid - JP Morgan: Energy hedge

Actually a question on the energy hedge as well. When you look forward at your competitor's position with the coal stations probably coming off with more of the generation linked to subsidies one could argue that their hedges will naturally fall as we look forward. So it won't staying on the 50% to 60% level mean that your over hedged versus them on a forward looking basis?

Answer: Mark Hanafin

I think there are two parts to the hedge; one is a commodity aspect so it's are you short gas prices and do you cover that by having long gas equity position or a coal position. That's been part of the debate around the vertical integration and the hedge. And as you say if more of the investments in a decade's time are generating revenue not from a commodity price does that still hold. But there's a second part to the argument which is around just general earnings hedge and the idea that if you have a broader portfolio, if you are making good revenues from a number of sources you don't find yourself in the position that perhaps we were in in 2006 where competitors were making money outside of the downstream and giving us a pretty torrid time there. So I think it's just about continuing to strengthen the business model. But indeed as you look a decade out there is less in terms of the commodity aspect that's going to be driving the revenue of that.

Further question

Can I ask Nick a question as well because he looks bored? In terms of how the rating agencies look at the business for a long time there's been concerns about the lack of asset backing in the business and it seems to be coming more asset backed and hence more stable in terms of the cash flow. Does this mean that you can potentially take your leverage slightly higher and still retain your credit rating?

Answer: Nick Luff

Well they're actually in the room so I shall be careful what I say. But both S&P and Moody's in their published statements have recognised the risk reduction in our business and what that's meant for us. I would say they've also, at the the same time, seen the sector as having more risk than they previously assessed it to be five or six years ago. So what they're demanding from companies generally and look at the ratings in the sector have come down, whereas ours has stayed stable of course. So yes is the answer. They recognised that more integration means less risk means you could all other things being equal have higher leverage, but there is a limit to that because they are taking a more cautious view on the sector generally.

Mark Hanafin

We've got time for one more question.

Question 19

Bobby Chada – Morgan Stanley: Energy Hedge

So Mark you just explained the hedge in two principles; the commodity hedge which I understand. What exactly do you mean by the earnings hedge? Do you mean you expect to see Downstream earnings decline because that's clearly not what your stated targets are. Or is it some kind of complex piece I don't understand?

Answer: Sam Laidlaw

We can put your mind at rest on that.

Answer: Mark Hanafin

I didn't mean that. What I meant was that if you have a good spread of earnings from your Upstream activities as well as your Downstream then you've got a more robust model. If you don't have those earnings outside of Downstream and your competitors are earning very healthy margins there they've got some options in terms of earning more money or competing in terms of margin downstream.

Further question

Right, but your competitors are in exactly the opposite position right now. They're downstream businesses make less money than you. Their Upstream businesses don't over-earn anymore, their coal plants are going to close, so effectively by doing this you will be in a more diversified and stronger position relative to the competition.

Answer: Mark Hanafin

That's what we're trying to do.

Right, we're going to have a 30 minute coffee break, is that right Andrew and then we go into...

Sam Laidlaw

The instructions from here get a little complicated. Hopefully everybody has got a tag which has got a colour on it. And Andrew will explain the musical chairs that you're now going to be asked to participate in.

Andrew Page

I'll make it as simple as possible. Step one we have a coffee break now that should be very straight forward. We have coffee just outside. We're going to start the next session at 11:00 o'clock in fact we have two sessions; we have a session which Jonathan will be leading on the Upstream and that takes place in this room. The people who have that first have the letter A on their lanyards. So if you have an A on the end you should come back here for 11 o'clock Upstream with Jonathan. If however you have a B on your lanyard then your session first will be on Power with Sarwjit and that'll be upstairs. It's actually up on the 7th floor. You can take the lifts up, they'll be plenty of people to show you the way there. As a further incentive there's also some coffee upstairs to guide you on the way. So either way 11 o'clock to start the next sessions.

Concluding comments - Sam Laidlaw

Well thank you all very much and also for those who have joined us by webcast thank you very much because I think you're leaving us at this point.