centrica

Interim Results
Presentation Transcript – 30 July 2015

Iain Conn – Chief Executive
Good morning everyone, welcome to Centrica's 2015 Interim Results presentation. Today we are also presenting the outcome of our wide-ranging strategic review, the headlines of both are contained in the RNS that we issued earlier this morning.

In our presentations and subsequent Q&A on both the Interim Results and the conclusions of the strategic review, we are intending to provide you with clarity on our performance, strategic intent and priorities along with key parameters which shape Centrica as an investment.

I am joined today on stage by Jeff Bell, who yesterday we confirmed as CFO going forward. Jeff is deeply knowledgeable about Centrica's business, performance and strategy. I am also joined by our Divisional Heads, Mark Hodges who took over as Head of British Gas in June, Mark Hanafin, Head of Centrica Energy and Badar Khan, Head of Direct Energy. And in the front row here we have our Chairman, Rick Haythornthwaite, Grant Dawson, Group General Council, Jill Shedden, Group HR Director, Nick Baird, Head of Corporate Affairs, and Ian Peters, Head of Customer Facing Strategy. Those of us on the stage yesterday asked if we could have a bigger table because it was a bit cramped and we ended up with smaller chairs, that is one way to deal with it.

Before we begin just a word on safety, there are no planned fire alarms today, any building evacuation will be announced by tanoy and emergency exits are marked in green at the rear and front of the auditorium, and Deutsche bank staff will direct you to the muster point by Drapers Hall at the bottom of Throgmorton Street so let's hope we don't have any interruptions.

Let me now turn to the agenda for today. We are going to take just over 30 to 35 minutes presenting the first half results, leaving nearly half an hour for questions. We will then come back after a short break for an in-depth presentation on the outcomes of the strategic review, leaving adequate time for questions on our strategy and direction. A buffet lunch will be available after the session and the team will all be available for further discussion should you wish to stay.

I have only been with Centrica for 7 months and since the beginning of the year I have obviously been meeting the team. I have also been able to deepen my understanding of our operations, our people and our capabilities. I am very pleased with where we have got to strategically and believe Centrica has all the components necessary to deliver a powerful proposition. Although we have had a very difficult time in the last year, and have had to take some tough decisions, I am confident we have built a strong platform from which we can be a leading energy and services company. We have the right capabilities and strengths with which to do this. I am therefore excited about this next phase and look forward to describing later on how we plan to pursue that future and deliver long-term shareholder value.

So let's move to the results part of the morning. Jeff will go through the details of the results in a few minutes. I will then come back after Jeff has finished just to cover the current context and operational performance and milestones we have delivered for the first half and along with Jeff, Mark, Mark and Badar we will then take your questions.

A lot has happened in the external environment since January. Jeff will cover wholesale gas, oil and power prices which remain depressed. In addition we have had the UK General Election in May and the Competition and Markets Authority investigation which is ongoing. I will return to these subjects and particularly the CMA investigation after Jeff has been through our financial results in detail.

Let me just briefly cover the headlines. So earnings in the first half of the year were £611 million, up 15% with corresponding earnings per share of 12.3 pence. Post-tax adjusted operating cash flow was £1.1 billion. We have made good progress in strengthening the balance sheet and improving our financial metrics with sources of cash exceeding uses in the first half reflecting the actions we took at the start of the year to cut capital investment and rebase the dividend. With capital discipline we remain on track to constrain investment levels to just over a £1 billion in 2015. Our full year outlook remains broadly unchanged, but uncertainties include low wholesale commodity prices, a competitive environment for our customer-facing businesses and the ongoing resolution of the billing issues in British Gas Business which we will cover in more detail later. As a result, given the colder than normal weather we have seen, we expect earnings to be weighted towards the first half of the year.

We have made changes to the senior management. In addition to appointing Jeff as CFO, we have welcomed Mark Hodges to the team as Managing Director of British Gas. Mark is a veteran of the UK insurance industry and is already making a significant contribution both to performance and strategy.

Our strategic review is complete. A significant amount of management time has been dedicated to the review and it has been a thorough and rigorous analysis of the Group’s prospects, capabilities and performance. We have concluded that Centrica is an energy and services company. Our purpose is to provide energy and services to satisfy the changing needs of our customers. In future our focus in everything we do will be to enable us to be excellent in serving those customers. Serving customers is what we are known for, what we are good at and where we already have distinctive positions. The strategy has therefore been developed around that as we look to deliver long-term shareholder value through returns and growth. And I look forward to coming back in the second session to describe the conclusions of this strategic review in some depth.

I am now going to hand you over to Jeff to take you through the first half Financial Results and the outlook for the rest of the year, Jeff.

Jeff Bell – Chief Financial Officer

Thank you Iain and good morning everyone. I would like to start with the financial headlines of our Interim Results this morning and then review the business unit results as well as cash flow and the balance sheet.

Let me start with revenue which decreased 2% compared to the first half of 2014, primarily driven by lower realised unit prices for oil and gas in Centrica Energy and fewer customer accounts and lower unit retail prices in Direct Energy. Adjusted operating profit fell 3% to £1 billion, while our customer-facing businesses, British Gas, Bord Gáis and Direct Energy reported higher profit, this was more than offset by a lower profit in Centrica Energy. The adjusted effective of tax rate was 29%, 8 percentage points lower than in the first half of 2014 reflecting this shift in the Group’s profit mix away from the higher taxed E&P business. As a result adjusted earnings increased to £611 million, 15% higher than in the first half last year and equivalent to

12.3 pence per share. As indicated at the Preliminary Results, the interim dividend per share is down in line with the 30% reduction in last year's final dividend to 3.57 pence per share. And finally net debt fell from £5.2 billion at the end of 2014 to £4.9 billion as a result of positive net cash flow. As a backdrop to the more detailed business unit results I would first like to touch on commodity prices and weather in the first half.

From a commodity price perspective, prices traded in a much more stable range than the dramatic changes experienced in the last half of 2014. After reaching a low point in January, Brent oil prices rose to trade for most of the first half in the $55 to $65 dollar per barrel range. NBP gas prices also fell in January and remained below 50 pence per therm for the remainder of the period, while in the US Henry Hub gas prices traded generally in the $2.50 to $3 dollar per mmbtu range or around 20 pence per therm equivalent. AECO prices for our Alberto production traded at a further discount to Henry Hub.

UK power prices also remained low and spark spreads were just above zero for much of the period. This created a challenging environment for Centrica Energy.

For the energy supply businesses, weather again was a key factor in understanding first half results, although for very different reasons which I will outline shortly. As you can see from the left hand side of the slide, average UK temperatures were generally colder than normal, represented by the blue areas compared to the orange areas which represent warmer than normal temperatures. In contrast the first half of 2014 was exceptionally warm and as a result average residential gas consumption for households in the UK was up 11%. In North America, average temperatures in the US North East were significantly colder than normal through the winter months as you can see from the chart on the right. Temperatures were also extremely cold in the same period in 2014, but as Alberta experienced much warmer temperatures than the previous year, overall residential gas consumption fell by 6% for Direct Energy.

Now moving on to the different components of our operating results, you can see the breakdown by different business units and their relative contribution to first half operating profits.

In British Gas profits increased to £656 million up 44%. Residential Energy profit increased to £528 million reflecting the higher average gas consumption from the colder weather mentioned earlier as well as lower ECO costs due to the phasing of spend between the two years. Post-tax margins increased to 9%. However taking into account our two gas price reductions and assuming normal weather in the second half of the year, we would expect full year margins to be broadly in line with recent years.

Residential services operating profit was down 3% to £125 million. A 2% reduction in product holdings since the start of the year was largely offset by a one off benefit relating to a change in the employee pension scheme.

In British Gas Business, operating profit fell significantly to just above break even, due primarily to issues related to the transition to a new billing and Customer Relationship Management system. This resulted in higher bad debt charges and increased cost as additional resources were deployed in response. The business also faced competitive pressures on both margins and accounts. We expect to have resolved the system issues for customers by the end of this year and the impact to be primarily affecting the current year only.

In Direct Energy, operating profit increased significantly. Unlike the first half of 2014, similar periods of cold weather this year did not result in significant additional Polar

Vortex related costs to the business as a combination of more stable, physical infrastructure, market redesign and management action, led to a significantly improved outcome for the energy supply businesses.

In Direct Energy Business, underlying profit increased as the higher unit margins from sales contracts written over the last 18 months were reflected in operating profit outturn. Furthermore the cold weather in the first quarter enabled the business to deliver a strong optimisation performance from its pipeline of storage capacity contracts. The business also benefited from the roll-off of amortisation charges relating to the Hess acquisition.

In Direct Energy Residential, excluding the impact of additional cost of the associated Polar Vortex in 2014, underlying operating profit fell, predominantly driven by the continued decline in the Ontario customer base, and a competitive operating environment in the US North East. However unit margins remained broadly unchanged and we are starting to see organic customer growth in Texas. In Direct Energy Services, the business reported an operating loss reflecting the sale of the Ontario Home Services business in the second half of 2014, and our accelerated investment this year in solar installation capacity to drive future growth.

In the Republic of Ireland, Bord Gáis Energy reported an operating profit of £23 million in the first half of the year reflecting higher than expected gas consumption as a result of the colder than normal weather. Whitegate, the gas-fired power station, performed well with strong availability and reliability.

Turning to Centrica Energy, operating profit in gas was down significantly to £48 million, predominantly reflecting the impact of the lower wholesale price environment. The reduced operating profit also reflects an operating loss from our midstream gas business, which was impacted by losses on historical flexible gas contracts and lower trading profits. And as we indicated in February, these flexible contracts were optimised for value during 2014 with a consequential impact on 2015. Reflecting this, the gas business reported a loss after tax of £23 million. The midstream business is expected to return to profitability in the second half.

In E&P, European realised gas prices were down 13% from 56 pence per therm to just under 49 pence, and realised oil and liquid prices were down 33% from £60 per barrel to £40. In the Americas the reduction in gas and oil prices was even more significant with realised prices for both down by over 40%.

In terms of volumes, production was broadly flat compared to the first half last year, at just over 40 million barrels of oil equivalent. In Europe, gas production decreased by 7% reflecting the natural decline of our assets in the UK and the Netherlands, partly offset by an increase from Norway as a result of the Valemon field coming on-stream at the start of the year, and strong production from the Kvitebjørn and Statfjord fields. Oil and liquids production was flat. In the Americas, gas production increased by 8% and oil and liquids by 25%, as new wells and assets acquired from Shell in 2014 produced ahead of expectations.

Total unit lifting cost and other production costs were broadly flat in comparison to the first half of 2014 with a 7% increase in Europe reflecting reduced production, broadly offset by a reduction in the Americas from lower royalty payments in Alberta. Our programme to deliver £100 million reduction in cash production costs by 2016 is on-track and already realising benefits.

In Power, operating profit increased 11% to £68 million. Gas-fired generation volumes decreased by 20%, reflecting an outage at Langage earlier in the year, but lowered depreciation charges as a result of previous year impairments resulted in a reduced operating loss for the gas-fired fleet.

Nuclear output was only slightly down at 6.1 Terawatt hours, despite four reactors at Heysham 1 and Hartlepool operating at reduced power generation levels following the discovery of a boiler spine issue at Heysham 1 in 2014. The reduced output, lower power prices and inflationary cost increases all contributed to the decrease in operating profit to £108 million.

Renewables profitability was £18 million compared to a loss in 2014, with the prior period reflecting a £40 million write-off of cost relating to the Round 3 Celtic Array offshore wind project, partly offset by lower generation volumes. Midstream profit fell in comparison to a strong prior period.

And lastly, Centrica Storage, where seasonal spreads remain at low levels. However, operating profit in the first half of 2015 was slightly higher than in the same period in 2014 due to higher space sales in the 2014/15 storage year, and lower fuel gas costs due to a later start to the injection season. We discovered a potential technical issue at the Rough asset during a routine inspection in March of this year which resulted in us deciding to limit the maximum operating profit of the Rough wells. It is anticipated that the limitation will remain in place until the testing and verification works are completed between September and December 2016. This will negatively impact second half profitability, although this impact will be broadly offset by the sale of cushion gas, with Centrica Storage receiving consent from the Oil and Gas Authority in July to increase the reservoir size of Rough.

I would like now to move on to net investment. Organic capital expenditure was just over £200 million lower than in the first half of 2014. In E&P capital expenditure was slightly over £400 million, down 24% compared to the first half last year, and remains on track for full year expenditure of approximately £800 million. British Gas capital expenditure reduced by nearly 50%, reflecting the completion of systems projects towards the end of 2014.

The Group realised disposal proceeds of £180 million in the first half related to the sale of our portion of the Lincs wind farm project financing debt, partially offset by the acquisition of AlertMe earlier in the year.

Turning now to cash flow. As you can see on the slide, in the first half of 2015, the Group had £357 million of cash inflow, in comparison to a £59 million cash outflow in the same period of 2014. This reflected actions we took earlier in the year to restore balance to our sources and uses of cash.

EBITDA fell 4% to just over £1.4 billion, primarily driven by lower cash generation in E&P from falling commodity prices. We saw negative working capital movement compared to a positive movement in 2014, mainly due to the billing issues in BGB and cold weather. We would expect this to largely reduce in the second half assuming normal weather patterns. This was broadly offset by a reduction of taxes paid of nearly £300 million reflecting the significantly lower profits in the higher taxed E&P business. Adjusted operating cash flow was £1.1 billion, slightly lower than last year.

However at a net cash flow level we saw a much more favourable year-on-year comparison, primarily from lower dividends paid, reflecting our decision to rebase the

2014 final dividend by 30%, and a first time take-up of our scrip dividend alternative of over 40% and no share buyback activity.

Taking into account non-cash movements, Group net debt therefore fell by £300 million in the first half of the year to £4.9 billion. This excludes a margin cash balance of £465 million, around £300 million lower than at the start of the year.

Although not visible in these numbers, during the first half we concluded the issuance of €750 million Euros and £450 million pounds of hybrid securities, helping underpin the Group's financial metrics and improving the Group's liquidity. We continue to retain strong investment grade credit ratings with Moody's at Baa1 (stable), downgraded from A3 negative outlook in March, and with A– (with negative outlook) with S&P.

So let me summarise before handing back to Iain. 2015 first half earnings were up 15% with improved earnings from the customer-facing businesses more than offsetting lower earnings from the upstream gas business. Although operating cash flow fell to £1.1 billion. However, the actions we took in February to more structurally balance the Group's sources and uses of cash have been effective, and as a result we have made good progress on reducing net debt.

Looking forward to the full year, earnings will be weighted to the first half. Full year outlook remains broadly unchanged from February but uncertainties include lower wholesale commodity prices, a competitive environment for our customer-facing businesses and the ongoing resolution of the BGB system issues.

With that, I will hand back to Iain.

Iain Conn – Chief Executive
Thanks Jeff. I would now like to cover the recent context for the Group and our operational performance in a little bit more detail.

As Jeff outlined, commodity prices remained low and we are responding to adjust to this new environment through attention to operational uptime and a focus on cost and capital discipline, particularly E&P. Colder than normal weather helped all of our customer-facing businesses, although competition is intense and excluding weather fluctuations, demand for energy per unit GDP continues to fall. Operations have been generally strong although we have had some issues which I will cover in a moment.

Two other external uncertainties the business has had to deal with over the first half of the year was of course the UK General Election and the Competition and Markets Authority investigation into the functioning of the UK energy market. We welcomed the certainty and continuity provided by the clear results of the UK Election and we look forward to working constructively with the new Conservative Government, indeed as we have started to.

The Competition and Markets Authority investigation into the UK energy market is ongoing, and they have published their provisional findings and notice of possible remedies earlier this month. We welcome this wide-ranging review, which recognises the realities and difficulties of implementing policy, pricing and regulation in what is a complex marketplace. The CMA have carried out a comprehensive and thorough assessment. We also welcome the possibility that this review will have a constructive and positive influence on competition in the energy market.

We agree with the conclusions that the CMA has reached in most areas. In particular their conclusions regarding the functioning of the wholesale markets, vertical integration and the fact that they have found the evidence does not suggest tacit co-ordination between suppliers.

We also agree with many of their conclusions regarding the impact of regulations on supplier ability to innovate and offer broader tariff choices. We do agree there is more which needs to be done regarding customer engagement and agree with the conclusion that smart meters will help significantly in eliminating customer frustration with estimated bills and improving insight. We are keen to work with the CMA on remedies designed to improve customer engagement still further.

Where we don't agree or have some questions about the practicality of some of the proposed remedies, we are in active discussions and have made proposals in our recent oral hearing. We do not agree with their conclusions on profitability and returns. However, our view is that profitability is an outcome of a competitive market, and our focus therefore is on helping the CMA with their remedies to improve the functioning of the market.

On remedies, we are generally supportive of many of the proposals, but believe that some of the possible remedies are not in the best interests of competition and the consumer. The potential introduction of a transitional safeguard tariff for domestic and micro-business customers who remain not engaged following other remedies will be difficult to implement and could actually decrease engagement. We believe that if the other remedies are designed well, such a default tariff would not be necessary.

We have had two constructive oral hearings with the CMA and look forward to engaging with them as we provide responses to the provisional findings and potential remedies in the coming weeks and months.

Let me know turn briefly to operational performance in the first half.

In our customer-facing businesses, we continue to focus on safety, compliance and improving customer service. Our safety performance is stable, but we are paying particular attention to the risk of customer injuries and driving safety. In customer service, net promoter scores improved in our residential businesses in the first half of the year, while we also announced we would be investing an additional £50 million in our UK residential energy call centres to improve service levels further.

In Residential Energy our market share remained broadly flat in the UK, as we responded to a competitive environment with a 5% price reduction in our residential standard gas tariff in February, and some competitive fixed price and collective switch offerings. On July 15th we announced a second 5% reduction in gas tariffs effective from the end of August. This combined 10% reduction will benefit our customers significantly in the coming Winter. We saw stable accounts in the Republic of Ireland, having reduced our residential prices during the first quarter.

The sales environment remains challenging for UK services, with accounts down 2% in the first half. Some of this was due to demand moving towards home emergency and on demand services. We are currently working on a new range of products to meet this change in demand. In North America services product holdings grew slightly.

The major operational challenges in the first half of the year were in relation to resolving issues following the implementation of a new billing system in British Gas Business. All customers are now on the new system, however we have been unable to bill some of our customers and service levels have fallen to unacceptably low levels. Jeff has already talked you through the impact on the first half results, and we are working hard to resolve the issues. The majority of customers (I am pleased to say) are now being served normally, the vast majority in fact, and although some uncertainty remains, actions are in place to resolve the issues for customers by the end of 2015.

In North America energy supply, the number of residential accounts fell slightly as we deliberately focus on the more valuable customer segments and the quality of our offerings and on sales margin discipline.

Turning to E&P and Power, safety is also a focus and we have again seen fairly stable performance but have been focusing on process safety and high potential incidents. In E&P, production was flat relative to 2014 and we remain on track to achieve production volumes of around 75 million barrels of oil equivalent in 2015, in line with previous expectations. This includes a first contribution from the Valemon field in the Norwegian North Sea, which came on-stream in January.

We continue to make progress with the Cygnus project with our partners Engie and Bayerngas, with first gas expected in the first half of 2016. In Power, nuclear operational performance was good, with volumes broadly flat despite four of the reactors running at reduced power during the first half of the year. However, gas-fired operating performance was impacted by an unplanned outage at Langage.

As well as delivering solid operational performance, we delivered on a number of important milestones during the first half. We have now installed more than 1.5 million residential smart meters in the UK, building on our market leading position. Smart meters are the enabler to help customers understand and control their energy use, and we believe will be a key driver in helping to improve trust in the sector. We are also pleased that the CMA reached a similar conclusion.

Our leading position in connected homes in the UK is another key differentiator for Centrica, and the acquisition of AlertMe in the first quarter gives us control over the technical platform that will underpin our connected homes activity, including the Hive Active Heating smart thermostat. We have now sold over 200,000 smart thermostats in the UK and have launched the next generation of Hive and a number of new devices. Hive has been sold into Ireland for the first time. We continue to develop a further range of products and will return to Connected Home in the second part of the morning.

In all of our markets we are focused on product innovation and increasing bundling of products and offerings. We believe Smart Meters and Connected Home are contributing to improved customer offers and reduced churn.

In North America we have accelerated our investment in solar installation capacity, and are looking to develop a proposition for Hive in the US.

In LNG, at the end of June, Cheniere made positive final investment decision on the fifth train at the Sabine Pass liquefaction facility in Louisiana. As a result, we expect to take the first commercial delivery under our 20 year US export contract with Cheniere by 2019. And in Power, as announced in February, we have progressed plans to rationalise out CCGT fleet with the closure of the Killingholme gas-fired power station in 2016. We also had intended to close the station at Brigg, but will now run it as a distributed generation asset.

So in summary, we delivered solid operational and financial performance in the first half of the year, and also made good progress on our shorter-term targets aimed at strengthening the balance sheet and balancing sources and uses of cash. We completed our strategic review and are clear on our purpose, direction and priorities for the next phase of Centrica. We will come back to that after the break.

So I would now like to open it up to questions. Can I ask at this stage that we keep the questions focused on the first half results, I know that will be difficult and pick up any questions on the strategy after the second presentation later this morning and when you are asking a question could you just identify yourself and we will take the next half an hour to cover the ground you would like on the results.

Thank you very much.

So with that, let's open it up to questions.

Questions and Answers

Q1. Martin Brough, Deutsche Bank
A couple of questions. One was, on British Gas, you have shown joint product households down 8% year-on-year, which is already a low proportion of the total households that you service, so could you just explain what is going on in terms of that decline as that seems to be a focus to increase going forward?

And the second question was on the scrip, so 40% of scrip take-up is quite a lot. Are you worried that you are sort of pricing in too much of the embedded option value there and if people do want to take cash out of Centrica aren't they being diluted quite a bit from the scrip so what is your policy going forward in looking at that?

Answer: Iain Conn
Great thank you very much for those. Mark Hodges will be able to talk into the first one and I will ask Jeff to talk to our views of scrip.

Answer: Mark Hodges
Okay if I talk about customer holdings. I think you can look at this in a number of different ways. If you look at residential energy broadly firstly, actually customer holdings in the first half are down by about 45,000 which is broadly stable. That is actually an improvement I think on the previous couple of years. We see that as reasonably positive and a function of the investment we are making in service, but also in terms of the pricing strategy. When you look at things like joint holdings, I think there are just some competitive forces within there; people are shopping around more, looking at the impact of switching sites. You look at whether that is dual fuel or fuel with services. Those are areas where we just see more intensity of competition. You look at British Gas Services actually our holdings are down 2% since the end of the year so that will have had an impact on that number. For me this is a reflection of the market environment we are in and that people have choice and we are going to have to work hard to make sure they choose us not just for one product but for multiple products.

Answer: Jeff Bell
With respect to the scrip dividend. I think we would consider the 40% for the first time as not representative of what we would expect to see going forward. Somewhat atypically it priced in just before the results of the Election which was clearly very positive for the share price, so not surprisingly it was quite financially attractive and we

would not expect that level on a normal basis going forward. But to your point, it was the first time we have offered a scrip alternative. I think, as we have said before, we would like to offer that to our shareholders and see what sort of interest and take-up there is. We are not unaware of the dilutive effects long-term and we will keep it under review, but we would like to see what sort of sustained take-up and interest there might be from our shareholders first.

Answer: Iain Conn
Thank you for that and also just on the first part, we will come back after the break to talk about prospectively what we think about attracting customers and clearly one of the questions which you all must be holding, is if the track record isn't to grow them, how do we do it going forward? If you can hold that, we will try and address that in the second part.

Q2. Deepa Venkateswaran, Bernstein
I have a couple of questions. On BGB, could you just help us understand what percentage of your customer base are your micro-customers which is covered under CMA and maybe what percentage of your normalised profits would be from these micro-customers?

And secondly on British Gas Services, so the product holdings are down there. Do you think with the CMA review and potentially some of the restrictions on cross selling, do you think that can help you increase your holdings in BGB in any way, or maybe this is a second half question?

Answer: Iain Conn
Well let me just touch on the second part of your question. We do think the CMA attention to regulatory framework and the ability for us to have more flexibility on tariffs and the offerings that we can make, will allow us to compete and differentiate in a more effective way. And we think it is a really important part of the changes the CMA is looking to implement. And we also believe with the capabilities we have got we will be able to play into that very effectively in a relative way and we will talk more about that after the break. On micro-business numbers, Mark?

Answer: Mark Hodges
Yes I think in terms of the numbers, the numbers of customers will be the vast majority and if we think about how many, where the revenue will actually be weighted towards the I&C customers, but the customer numbers will be weighted towards the micro. I think one of the challenges we need to think about is how similar are the propositions and how similar are the services offerings we have for those micro customers in terms of comparing them to our residential customers.

In terms of the CMA it goes back to I think partially the point Iain has made, if we see a roll back of some of the RMR restrictions, if we are able to offer I think more innovative products, and that applies both to micro-customers and residential, we think that is good for competition, we think that could be good for us.

I don't think we disclose specific breakdown between micro, medium, I&C, I think that is something that is in the round in the numbers unless Jeff wants to correct me.

Q3. Mark Freshney, Credit Suisse
I have a question for Badar. Following the Polar Vortex, pricing discipline in B2B massively improved, you are seeing the benefit of that this year. Can I ask how much more of the benefit is there to flow through? You spoke about the gross margin improvement last year.

My second question is for you Mark. The CMA spoke about the Big Six potentially having overcharged by £50 per household and working through their maths and numbers, it seems what they are really saying is the cost to serve for the Big Six is about £150 and for some of the new entrants it is some way below £100. Is that analysis that you agree with?

Answer: Iain Conn
Can I just start on the CMA point and at a macro level which is, we don't agree with the CMA conclusion that the six large energy suppliers have been overcharging by £1.7 billion. I mean that is more than our entire profits and the implication is that we must therefore want to do this for free. Now I do think that as we admitted in February, our benchmark costs imply that despite our scale, we are not as efficient as we should be, or could be, to the benefit of our customers. And so clearly a part of the strategic review, I will come back to after the break is all about efficiency. We don't agree with lots of aspects of the CMA's analysis around profitability and we think that some of it has been based on some pretty theoretical models of competition, perfect competition where everyone is supposed to complete at cost of capital and generate no shareholder return. We just don't think that is feasible in a real market. So that is the general point. But Mark any specific points on the costs and deductions from the CMA and then ask Badar to cover it?

Answer: Mark Hodges
I think you have covered it. I don't think we want to get into a kind of a mathematical debate with the CMA as to how they get to cost per customer. I don't think in terms of the Big Six, we are obviously very focused on what we are doing. I think we are coming onto this after the break. Do I think we can serve our customers more effectively and more efficiently in terms of some of the trends that are out there, in terms of some of the ways we work? Absolutely. So I think you have covered it Iain.

Answer: Badar Khan
On North America our B2B contract lines are typically just over 18 months and we have been saying that for the last 18 months. We have been restoring margins through pricing risk more appropriate. So we are clearly seeing the benefit in this first half. But you will expect to see that continue into the second half. So you could take a look at our half two results last year and assume we will make a little bit more as a result of expanded margins.

Q4. Ashley Thomas, Societe Generale
Two questions. The first on ECO. You noted that ECO costs were down in H1. Can I confirm that you recognise ECO costs as expensed rather than accrued? And has your expectation for the cumulative costs for the total period changed at all? Has that come down?

The second question is on the dividend policy, the progressive dividend is now linked to growth in operating cash flow. Therefore on that basis will you review the treatment of the strategic investment fair value depreciation in your adjusted EPS calculation?

Answer: Iain Conn
Why doesn't Mark touch on the operational aspects of ECO and Jeff can talk to the accounting treatment and cover dividend policy items.

Answer: Mark Hodges
So I think in terms of the expectation of the full spend, no I don't think we are making any changes. And we are actually on track to deliver our ECO obligations by March

2017. I think in terms of the spend, I think it is more a case of spending more in half one 2014 to get ahead of the game. We had measures in place through the back end of 2013. I think this is a natural reaction for the business to have missed one of the earlier targets, we got very much ahead in that first half of 2014 and what you are seeing in the first half of 2015 is a return to normal levels of spend. That is how I would think about the difference. But in terms of the overall profile, no, we are still expecting it to be about the same.

Answer: Jeff Bell
On the accounting treatment, we will touch on it in the second half. What I would say is that we will be taking the output of the strategic review in the second half of this year, looking at both from detailed KPIs we would like to evaluate strategy on, but also with our change in focus on investment and areas of growth going forward we will also revisit our reporting segments and how we report the business. So we will look fairly completely across all of that including how we define different adjusted profit measures as well. It is on an expense basis as opposed to an accrual basis.

Q5. John Musk, RBC
Just a question on the E&P business or the upstream business. I am trying to get a handle on what we should expect in the second half. Can you just quantify the midstream loss that was in the first half, that you say will be returning to profitability in the second half, and give a bit of guidance on the phasing of the £100 million savings that we can figure out what it is going to look like and potentially what 2016 is going to look like if prices remain where they are?

Answer: Jeff Bell
So in terms of the midstream profitability, it does not form a large part of the overall E&P business so it was slightly loss making first half moving slowly to profitable in the second half. But would be reasonably small compared to the overall E&P business.

Answer: Mark Hanafin
Just to explain the issue there. We have three gas contracts that have a lot of flexibility in them and they have take-up provisions. We optimise those contracts for value rather than the P&L in the year so we took benefit in 2014, we get hit a little bit in 2015. The second thing is that the price of oil, a basket of oil index is with a lag so we hedged that. We accrual account for it and it means that with the drop in oil prices that has hit us first half, because we have hedged it and there is a lag, we get the benefit next year in terms of margin on it. So if we were marking it for market things would be pretty reasonable contracts. But we have got these lags and differences in hedging which is what you are seeing in the first half versus last year and also versus second half this year.

Q6. Fred Barasi, Goldman Sachs
Two questions from me please. Could you give an update on how your credit metrics look after the first half on the six months or rolling twelve month basis?

And secondly, BGR, very strong margin in the first half, 9% post-tax. Could you give any guidance for the full year margin please?

Answer: Iain Conn
One for Jeff and one for Mark Hodges respectively and I will come back on BGR in a second.

Answer: Jeff Bell

So in terms of the credit metrics, as you saw, a good reduction in net debt from £5.2 billion to £4.9 billion. We continue to project that we are strengthening our financial metrics and would expect to meet or exceed those currently set over the 2015/16 period. So we remain on track to do that.

Answer: Mark Hodges
In terms of BGR margins, 9% in the first half. I think we have explained some of the moving parts in terms of increasing consumption related to weather, it was colder than 2014. Actually the cold weather extended to April, May and June which benefited in terms of profitability. In terms of looking forward, we put the 5% price reduction in on 27 February and announced a couple of weeks ago a price reduction from the end of August going into this winter, so it is 10% reduction in price going into the winter. That will have a material impact in the second half of the year's profits. And I think the broad guidance we are giving is return to profitability kind of normalish levels that we have seen over the last few years in terms of margins, if you think about that 10% price impact feeding in through the October, November, December months.

Answer: Iain Conn
Just to add to that, I said this morning, our history has been £40 to £65 post-tax per customer margin out of £1,200 or so and we expect that for the year as a whole we will be back in that range. And one way to think about it is this 9% post-tax margin, if you strip out the one-off phasing issues that Mark touched on earlier, it was more like at the higher end of our normal range which we used to talk about 4 to 6% rather than some super normal profits. But clearly we have got into a lot of questions from the media over it this morning as you can imagine.

Q7. Bobby Chada, Morgan Stanley
Two questions. First on Storage. I think I may have missed or misheard what you said. But did you say that the issues with capacity and the reduced sales effectively from that will be offset in the second half by selling cushion gas so the two things net each other out?

And then the second question is, given the focus from the CMA on the differential procurement strategies across larger and smaller players and given expectation for changes in tariffs over time, are you changing your commodity procurement strategy yet or is it basically the same kind of system you have been using for the past few years?

Answer: Iain Conn
Bobby if I can take those. On the Storage issue first. Let me just explain what happened. We have been pressuring up and then depressuring that old reservoir for quite a long time. We have no imminent issue, but having been doing that for 30 odd years we decided that we should test the integrity of the wells and as a result of a recent inspection, a regular one that we decided to do this year. That reduces the maximum pressure that is available and therefore we can't put as much gas into the reservoir. So far that interrogation, we issued a recent REMIT notice on this, that interrogation is going well but we are not done with it yet. And until we are done with it, we can't raise the pressure. So the size of the reservoir has dropped. The Government has given us permission to reduce the lower end of the pressure range and therefore effectively it offsets about half of the lost volumetric capacity of Rough and it means we can sell that volume over the coming winter. And so that is what we are going to do. That volumetrically is about half, but obviously we will get some profit from selling the cushion gas and we have agreed the treatment of with the Government.

On the procurement strategy, I would just say in general terms, it is too early for us to make changes to that until we clearly know what the changes to the marketplace are. We think we have a very sensible procurement strategy. Clearly we procure largely against the standard variable tariff in its current form as well as our fixed tariffs and it really does depend on where the CMA ends up in terms of its determinations. But we are having really constructive conversation with them about how tariff structures, including the tariff choices we were talking about earlier, but also how tariff structures could ultimately improve the working of the market. Once that is clear obviously we will need to adapt our procurement strategy accordingly, but it is too early for us to know that outcome yet. So we are not changing it at this stage.

Further question: Bobby Chada, Morgan Stanley
Can I ask a follow-up on the CMA? It just feels from reading all the documents that the argument that you and the industry put forward that not everyone on the standard variable tariff should be viewed as disengaged, has basically fallen on deaf ears. Do you get a sense that there is any recognition of that argument when you have your meeting with them as it is clearly not clear in the papers I would say?

Answer: Iain Conn
No but there again don't believe everything you read in the papers. I think we have had some very good conversations with the CMA and this topic of course has come up. And some of the evidence we have submitted to them is some of our customers, quite a lot actually of our new customers each year choose the standard variable tariff and so they are recognising that. And the issue is two-fold really. Who is really disengaged versus those that have got a perfect choice to switch – 90% of the people say they are aware they can switch. The issue is some of them don't and so dividing the standard variable tariff customers into people who actively chose to go on it, people who were on it and quite happily on it and aren't switching and those who really are disengaged, is the essence of the conversation. And then the other part of it is all markets have certain percentage of customers who aren't fully engaged. Where do you draw the line there? What is satisfactory from a competitive point of view? That is the key issue. How do you then deal with the people, or should you, and who should deal with the people who remain? So clearly that is the dialogue, except they are very much listening. I don't think it is falling on deaf ears at all. But we will have to see where the outcome is. I think we have a question from Peter behind you.

Q8. Peter Atherton, Jefferies
It is a question to Mark on the B2B billing problems. You are a newcomer to the industry but this industry seems utterly incapable of introducing a billing system without a catastrophic customer failure. Coming from outside the industry, is there anything specifically about this industry in the data flows and data management that you get that just makes it really hard to do and therefore we can expect these problems? Or is there something inherently rubbish about the way this industry actually manages the introduction of new systems?

Answer: Iain Conn
Mark could you also touch on what the problem is and what we are doing about it as well as answering the wider question of are we incompetent?

Answer: Mark Hodges
I may resist the temptation to describe the energy sector ability to move to these systems as incompetent. I think lots of industries struggle with big ERP type transfers. I think in terms of where we are, I think the first thing I would say is I do think the system when it works is better. There is always a danger that you look back and think that the old one was a panacea. In terms of as we move BGB onto this new billing and CRM

system that will be consistent with what we are doing in BGR and BGS, that gives us the ability to leverage if you like the platform across the businesses. It gives us extra functionality. We had no online capability in the world pre-migration. And we are already despite some of the issues, being able to convert people to online services and sell product online. So I think it increases our functionality. So I am convinced that it will be better and I am convinced that it is the right thing to do.

Obviously the transition has been painful. It arose towards the end of last year. It is a data migration issue and already this issue to work in a more constrained environment which is what the SAP system gives us. It is great, looking back with hindsight, you know hindsight is a wonderful thing. I am sure there are things we could have done differently. We will conduct a full review to make sure we get the learnings right now, the teams are focused on improving the billing accuracy, the timeliness and actually some of the areas of the business right now, we are back ahead of where we were. So this isn't a question of it not working, this will work. It is now a question of working through the rump of customers who have not had the service they deserve, make sure we get them back to normal and then as we move into 2016, exploiting the opportunity we have created. That would be my broad synopsis. And then how good is the sector? I think it is not easy moving the amount of data, it is especially not easy moving from quite old legacy systems into a new systems environment. As I say, my experience going back to the insurance world is that is hard in all sectors.

Further question: Peter Atherton, Jefferies
Is there a brewing reputational risk, you mention some customers are not getting billed. Are we going to hear about small business being driven out of business because they suddenly get hit with a 15-18 month bill from Centrica?

Answer: Mark Hodges
We are very cognisant of the representational risk. We have been contacting and in dialogue with customers as often as we can, keeping them updated so that they are aware of where we are. So to my knowledge there aren't those examples of us driving businesses out of business, but we are very thoughtful as we land bills that are catching up, that we think about the implications. What I would say is that the SME and we go back to the micro SME, because those are relatively more straightforward accounts, those are the ones that are now performing better than they were before migration.

Answer: Iain Conn
We have one more question over here and then what I would like to do is close and have a break and if we have time at the end when we do Q&A on strategic review to also pick up any questions that are overhanging from this morning on results if that is okay.

Q9. Iain Turner, Exane
It is on the B2B billing again actually. Just how much has it cost you in the first half in terms of extra cost and how much working capital have you got tied up unbilled?

Answer: Jeff Bell
So very much of the fall in profitability we would see sort of first half last year to first half this year would more or less encapsulate that cost. It is obviously spread across increased costs in terms of dealing with the issue, increased bad debt which we think we have gotten underneath of and the fact that we were unable to sign up new customers to the rate that we would have had last year and expected this year. Clearly as we move into the second half we think we have gotten underneath the bad debt

component of that. There will clearly be some additional costs in the second half as we finish resolving the issues. So you kind of want to think about it in that frame I think.

In terms of a working capital perspective, we have currently, the business itself carries a fair amount of working capital to begin with, we would see it being probably £100 to £200 million more than it would normally be at this stage.

Answer: Iain Conn

And just back to Peter's provocative question about competence. Needless to say, I have reviewed this situation quite a bit with the business heads, as Mark is all over it. And just to put it into perspective a little bit, in addition to Mark's point that these systems implementations are not always easy. We did test the system against the majority of customers and it showed up pretty well and most of the customers are effectively on it, especially the SME customers. The issue with hindsight, we did not do well enough, was around testing it for some of the most complex multi-site customers in the I&C sector and there we had a problem. And some of it was legacy and I am not sure we would have been able to resolve the issue easily, given some of the legacy data issues we had on some of the customers. So I don't want people to go away thinking this was complete incompetence about implementation, it wasn't. But clearly we could have done it better in hindsight and the system itself as Mark said, is functioning reasonably well and we are in a better state than we were probably at the end of 2013 before we implemented it. It has caused some real one-off issues for us that we are still trying to resolve. We have some customers that aren't too happy admittedly.

We will take a break and come back in about 15 minutes.

End of Presentation