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Centrica Preliminary Results for year end December 2009

Presentation Transcript – 25 February 2010

Roger Carr - Chairman

Good morning ladies and gentlemen and welcome to the Centrica Preliminary Results Presentation.

This morning I will provide a brief overview, before handing over to Nick for his review of the numbers. Sam will then set out the progress we have made, with 2009 marking the successful culmination of a three year programme to deliver our strategic priorities. And as we turn to the next phase in our development, we have established four new strategic priorities which will shape the future direction of the Group. Sam will expand on these in his presentation.

Centrica has performed well in 2009. This was achieved in a year when wholesale commodity prices declined sharply and global economic conditions continued to deteriorate. While lower wholesale gas prices led to a substantial reduction in operating profit for our Upstream UK business, our UK downstream business, British Gas performed strongly. We have continued to improve our operational efficiency and have delivered a marked improvement in customer service levels. As a result our competitive market position is much improved and you will have seen our recent price reduction which made us the cheapest major supplier of gas and power to the residential market.

In North America we are well positioned in key deregulated markets and we will consider opportunities to build a more integrated business model over the medium term.

In this low price environment, we also took the opportunity to address our UK energy hedge position. The acquisitions of Venture Production and a 20% stake in British Energy have transformed our upstream activities in the UK, creating a growth business in its own right. We are confident that these long-term transactions will stand us in good stead for the future, enabling us to maintain a balanced business, well placed to target investment in areas of greatest return.

The industry as a whole is entering a significant investment phase as the UK moves towards a lower carbon future, whilst maintaining security of supply. The Government has a vital role to play in providing the stable investment climate, planning regime and appropriate market support mechanisms that will be required to enable these investments to be made.

2009 has been a transformational year for Centrica and much has been achieved. We have established a robust, competitively aligned and integrated model and under

Sam's leadership, we are well placed to build on our capabilities to deliver strong growth and superior financial returns for our shareholders.

With that I will now hand over to Nick.

Nick Luff - Group Finance Director

Thank you Roger. Good morning everybody. As usual, let me start with some commodity price context. Obviously 2009 was a year of low gas and power prices, without the recovery we have seen in oil prices. Clearly that is good for our downstream business, but less positive for the upstream. Those low prices did come off the back of a period of high prices in 2008 of course and the effect of those high prices was still being felt through 2009 because of the hedging.

If you look into 2010, the forward curve implies continued low gas and power prices for much of the year, albeit with some contango in the curve implying high prices for next winter. And then we have the lower chart, where low gas prices did translate into reasonably good spark spreads, obviously good for our CCGT's. The forward curve does imply lower spark spreads for 2010 albeit they are better than dark spreads, even through next winter.

So with that backdrop, here are the key financials for the Group. Revenue was up some 5% to almost £22 billion, helped by some FX movements, but also driven by good growth in business energy sales on both sides of the Atlantic and by growth in the UK residential services businesses. Total operating profit was down to £1.85 billion. I will give you a breakdown of that in a second. But that reduction was more than offset by the lower tax rate as profits shifted away from the heavily taxed upstream. And the net result was a healthy 22% increase in earnings which enabled us to maintain earnings per share at 21.7 pence, despite the higher number of shares outstanding following the Rights Issue. The dividend we set at 12.8 pence per share, an increase of 5%, maintaining our record of delivering real growth each year.

So here is the divisional breakdown of the results and you can see immediately the shift of profit from the upstream to the downstream as commodity prices fell. I will start with the UK downstream and British Gas recorded profits of over a billion pounds for the first time, an increase of over 40%. I will give you the detail now.

All three of the businesses within British Gas contributed to the increase. Starting with residential, here the profits recovered from the squeezed margins we had in 2008. We came in this year with margins of 7.6% on revenue that was largely unchanged, which drove the profit of almost £600 million. You will remember the cold weather in December just gone, and this time a year ago in February it was quite cold as well. And for the year as a whole 2009 was in slightly colder in fact than 2008. Despite that you might have seen average consumption per customer for gas was actually down by 7%. But that lower volume was offset by higher average retail prices, hence the unchanged revenue. Despite the low spot prices, unit commodity costs for gas were slightly up in 2009 over 2008 with the effect of hedging but they were down for electricity. The net effect of those commodity price movements and our retail price movements led to overall higher gross margins which were sufficient to absorb higher energy efficiency obligations, higher bad debt costs, and to allow us to restore the net margins.

Moving across to the top right. Residential services performed very well in difficult economic conditions, profit up over 20% to over £233 million. Product holdings increased by 5% with good growth in plumbing and drains and in home electrical. Good cost control, helped by the integration of the services and British Gas integration, meant we were able to expand the services margin again, coming in at over 16%.

And the bottom right, business energy supply performed equally strongly, increasing both revenue and margins, giving profit of £183 million, up over 25%. We have higher average customers in the numbers in that business, following the E4B and BizzEnergy deals at the back end of 2008, and higher average selling prices, and that more than offset lower average consumption, higher unit commodity costs and higher bad debt costs.

And for British Gas as a whole, we are on track to deliver the £100 million of operating cost savings that we are looking for from the integration. Indeed we expect to go beyond that, albeit we plan to reinvest the excess in strengthening the brand and establishing the platforms to develop growth areas further.

Moving to the upstream, profit there down to £525 million, reflecting the lower wholesale gas price. Here is the detail on that. You can see gas production profits were down substantially to £444 million, despite the inclusion of four months of results from the Venture acquisition. Gas production volumes were actually down 30% as we shut Morecambe in for large parts of the year when it was more economic to buy it from the wholesale market rather than producing our own reserves. That does in fact hurt reported profits, but it does preserve long-term value. We did produce more oil, courtesy of the Venture assets, but unit selling prices of both gas and oil were down, albeit not down as much as the market was down, again the effect of hedging. Of course the upstream is heavily taxed so operating profit fall was not that significant when you get to the bottom line.

In contrast power generation did very well. The low gas price led to good spark spreads and that helps our CCGT's. We also had a good contribution from the new wind farms and that gave us profit overall of almost £150 million. That figure does include one month of our 20% share of British Energy of course.

The I&C losses were much reduced, coming in at less than £100 million, and our volumes in that business were half what they were in 2008, partly due to us terminating a contract earlier in the year, but also because our customers took less when they could buy more cheaply from the wholesale market. The loss did come in even lower than we had been forecasting. We had been expecting to be hit by some costs to a flexible procurement contract connected to the Sean field. However we gave notice to terminate that contract as a result of the onerous contract written against it which removes the ongoing charge from our results. That did come with an exceptional cost and I will show you that later.

Just coming back to the British Energy and Venture transactions, we have completed the provisional fair value accounting exercise for each of them. As you know, that does result in an uplift to the fixed asset values in both cases, almost £1.3 billion as far as our share of British Energy is concerned, £650 million for Venture. And that of course increases depreciation going forwards. That is all non cash of course and therefore we will be focusing on the results before that incremental depreciation. If you want to adjust for it, the ongoing after tax impact is just under £100 million which works out at 1.9 pence per share.

The other important assessment we have made is reserves recognition, following the Venture acquisition. The Audit we have had done has confirmed that the reserves and contingent resources that we assumed in our investment case are indeed there. However we are taking a somewhat more prudent approach than Venture did, in as far as what we recognise as a proven or probable reserve, a 2P reserve. And as a result of that, there is a net reduction in overall reserves of some 60 million barrels of oil equivalent and that gives us combined reserves, including the cushioned gas in Rough, of some 400 million barrels.

Coming back to the results, Storage had another good year, operating profit of £168 million. That was down on 2008 which of course includes some cushion gas sales, but average achieved SBU prices were slightly up and operationally the asset itself performed extremely well. In North America, Direct Energy had a challenging year, profit coming in at £153 million despite some help from FX rates. Here is the detail on that. You will recall that we had an additional bad debt charge of £45 million in the first half. That did cause us to review the balance sheet very closely and we have made some further adjustments to both revenue recognition and cost accruals totaling £16 million. So a one-off hit in total of £61 million this year, without which Direct Energy as a whole would have been flat year-on-year.

Before those one-off charges, the residential energy business increased profits to £155 million, benefiting from the low commodity prices and expanding margins to close to 6%. Business energy also performed strongly in what was the first full year after the acquisition and integration of Strategic Energy. Services was also ahead but as you would expect upstream and wholesale suffered from the lower gas price and gas production profits in particular were well down.

Turning to cashflow, we had another strong year. EBITDA we maintained at over £2.5 billion. We also reduced the working capital requirements of the business, largely as a result of the reduction in retail prices. Interest costs were up of course, but that was more than offset by a reduction in the cash tax that we paid. So all that produced a very strong operating cash inflow which we invested, together with the proceeds of the Rights Issue at the back end of ’08, and invested that in the business. And you can see the Capex was over £4 billion. That left us with closing net debt of £3.1 billion, or £2.5 billion if you adjust for the margin cash out position that we had at the year end.

Coming back to the Capex, obviously in 2009 that was dominated by the acquisitions. You can see there at the bottom, a net of close to £3.2 billion. That includes what we spent on Venture, what we spent on the 20% stake in British Energy. But it is net of the proceeds from the SPE disposal. Organic Capex was around £900 million as you can see, the largest component of which was the spend on upstream gas in the UK. That includes spend on the Grove, Chiswick and Seven Seas projects. UK Power includes stage payments on Langage as the construction for that new CCGT continued and also the initial costs for the Lincs Windfarm.

We give you some guidance there for 2010 Capex. Again we expect UK gas development to be the largest component. Projects for this year include York and Cygnus, as well as more on Chiswick. For UK Power, we have the final payments on Langage as that comes into service and our 50% of the share on Lincs. Lincs is of course now in joint venture structure with Dong and Siemens and that has reduced our capital commitment to that project.

We are showing storage here at £150 million although that does very much depend on the timing of investments for Baird in particular, so we might see some of that slip back into 2011.

Overall organic Capex guidance we are giving at £1.2 billion, that is down from our previous estimates because of the reduced commitments to Lincs. To that you will of course need to add acquisitions including the $380 million we are spending in Trinidad on the LNG project there which we announced just this morning.

Turning to the Balance Sheet, we have a strong position. The business now has over £9 billion of capital employed in it, but only around a third of that is funded by debt. That debt level of £3.1 billion represents around one and a quarter times EBITDA. You do have to adjust for pensions and leases to get the full picture, but we do have headroom given the further investment, given the cash generation in the business.

The pension deficit as you can see, as measured by IAS19, is up quite significantly. That reflects the fall in corporate bond yields, finishing the year at £565 million, and that is despite the fact that we have put in close to £300 million of deficit payments during 2009. We have agreed a funding plan to address the deficit with the Trustees, based on 31 March '09 valuation. And that funding plan calls for another £200 million of deficit payments in 2010 and £100 million in 2011.

As you have now seen from the results, we did have a fair number of exceptional items in 2009. I will give you detail on those. The first two you have seen before were included in the first half results. So let me just comment quickly on each of the others. The UK restructuring costs of £75 million is of course mainly the integration costs for British Gas, something we flagged with the November IMS. It also includes £20 million for the Venture integration. The £49 million credit you see there is the profit we realised on the disposal of 50% of Inner Dowsing, Lynn and Glens of Foudland wind farms. You then have the onerous contract related to Sean, which is £199 million. And we did take £150 million, or close to it, of impairments in 2009, reflecting the low commodity prices and how they impacted on asset values. A number of items within that, including Canadian Gas assets and some North Sea gas assets and also some write downs on two of our older UK power stations. And finally in these exceptionals, you have got the £273 million credit within discontinued. That is mainly of course the profit on disposal of SPE. All those together with the IAS39 mark to market movement, which actually was quite small this year at £71 million, all of those get added together and reported in the middle column.

So in summary then, 2009, a strong performance given the low commodity price environment. The UK downstream business was particularly strong, not just in residential energy, but in business energy and in services as well. Upstream we did suffer from the low wholesale gas price and North America was impacted by the one-off issues that I talked about. Nevertheless overall earnings were up over 20% and that enabled us to maintain EPS as I said earlier.

2010 has started strongly. The cold weather in the UK has increased consumption levels in our residential business quite significantly of course. We have passed back much of the benefit of that to consumers through the lower retail prices, the price reduction we announced a couple of weeks ago. But that has put the business in a very strong position competitively and we do continue to see good growth in the other parts of British Gas Services and Business Energy.

To go to the forward curve, we are expecting to see continued low gas and power prices at least through to next winter. And unlike 2009, that does come off a period of low prices, so we will see the full effect of those flowing through, less cushioning from hedging. That will of course impact our upstream earnings both in the UK and North America, but we will benefit from reduced losses in the I&C business and of course this will be the first full year of contributions from Venture and our share of British Energy.

Overall we are comfortable with where forecasts are right now, although it is early in the year of course. So we will see how commodity prices and the weather turn out from here.

And with that I will hand you over to Sam.

Chief Executive's Review
Sam Laidlaw - Chief Executive

Thank you very much Nick. Well good morning everyone. 2009 was a big year for Centrica. As we have just heard from Nick, the financial results for the year were strong against the background of declining wholesale commodity prices and of course the continuing weakness in the global economy. These market conditions did however allow us to address our upstream hedge, through the acquisitions of Venture and the stake in British Energy. Combined with our continued focus on efficiency and service across the Group, we have now delivered on each of the strategic priorities that we set out three years ago.

To transform British Gas;
To sharpen the organisation and reduce costs;
To reduce risk through increased integration, and;
To build on our growth platforms.

In British Gas the first stage of the transformation is complete. Our service levels and operational efficiency have improved dramatically. This has been reflected in a number of recent surveys which confirm that our service levels have improved considerably - from having the lowest customer satisfaction among the major suppliers just two years ago, we now have the most satisfied customers, a truly transformational achievement.

The significant improvement in service is also clear in our own operating statistics. The number of calls received from customers has fallen by about 40%. The average speed to answer is now consistently below 60 seconds. The overall number of complaints has fallen by 70% and is now well below our market share.

The number of online transactions has also doubled in the last year alone with the increasing number of customers choosing to submit meter reads and book annual service visits online.

Our first time fix rate in services has also improved materially. And we have achieved higher levels of employee engagement. As a result, our net promoter score shows an encouraging upward trend in both energy and services. In addition, our new advertising campaign has successfully contributed to the strength of the brand. The combination of very competitive pricing, demonstrated by our market leading price reductions for both gas and electricity, and higher service levels, has lead to customer account growth of some 550,000 customer accounts over 2009.

We have reduced our cost base in residential energy by over £200 million over the period and we are on track to achieve further cost savings across British Gas in excess, as Nick mentioned, of the previously announced target of £100 million. This will allow us to reinvest in the business, building on the strength of the British Gas brand, and establish platforms for further growth.

Under the leadership of Phil Bentley, we are now running British Gas as a single business, focused on meeting the current and future energy and service requirements of our customers. A combined management team is now in place and support functions have been fully integrated. This enables the business to offer a wide range of low carbon technologies and energy efficiency advice and expertise for our customers.

We also now have FSA approval to offer insurance based products to our customers, presenting greater flexibility in the range of energy related products we can provide. The combined British Gas business is well positioned for growth as a result of the increased competitiveness of our products, but also from cross selling and bundling. During the year we increased the number of joint product households, those customers that use both services and energy, by 164,000 to over 2 million. And that was helped by the launch of our first bundled energy and services product, Energy Extra, and 58,000 customers have chosen to take this product by the end of the year. We will continue to target growth in joint product households, deepening the customer relationship and increasing retention.

So, in summary, I am very pleased at the transformation of British Gas leaving the business well placed for continued growth.

Now let’s turn to the upstream and I will go over reducing risk through greater integration. As this chart shows, three years ago only 20% of the energy we supplied to our retail tariff book came from our own sources. Following the acquisitions of Venture and our stake in British Energy, we have dramatically improved the level of vertical integration in the UK business to over 60%. This makes our earnings less volatile and our energy hedge position more closely aligned with our competitors. Having addressed this, we now have a pipeline of opportunities in power and gas and the flexibility to target those projects with the highest return.

The acquisition of Venture Production has materially increased the scale and capability of our upstream gas business. We are pleased we have retained the majority of the skilled Venture team who have helped to deliver the new strategic direction of the business. The integration of Venture with our own existing business provides us with a sustainable and a flexible portfolio of assets with valuable development opportunities going forward. The combined business is now structured around five core regions to maximise the benefits and focus on assets and the infrastructure performance, regional geology and of course business development opportunities.

Our LNG business has also developed quickly. During 2009 we bought 15 LNG cargoes into the UK, and we already have a further 7 contracted for 2010. We have utilised our capacity at the Isle of Grain and bought gas on both the delivered and an FOB basis. LNG will be an increasingly important source of gas for the UK as domestic production declines. And in this respect the announcement today regarding our acquisition of upstream LNG reserves in Trinidad, both current production and over 1tcf of contingent resources, is significant.

Turning to upstream power. Our power generation segment has also made significant progress in 2009. The acquisition of a stake in British Energy from EDF establishes our position in nuclear power and the right to participate in EDF's new nuclear build programme in the UK. Considerable progress has been made across the power generation portfolio. Our new CCGT power station at Langage in Devon is now operational. And we have further strengthened our leadership position in offshore wind. In October we gave final investment approval for our 270 megawatt Lincs offshore wind development. And we are pleased to have been awarded exclusive rights over the Irish Sea zone in the Crown Estates Round three offshore wind process last month.

We have also successfully developed new funding models for our offshore wind activities. Going forward it will continue to be important to ensure that we put in place efficient financing structures for all our investments.

In Storage, the Rough facility once again demonstrated exceptional operating performance. In 2009 overall reliability was in excess of 98%. Storage utilisation was very high during early 2009 as a result of the Ukrainian crisis, together with record rates of injection which followed the successful completion of compression upgrades. The importance of gas storage and Rough in particular was demonstrated just last month with the field supplying around 10% of the UK's gas demand on each of the three days when National Grid issued gas balancing alerts. As the UK's independence on gas imports increases, storage will play an increasingly important role in maintaining the country's security of supply. And therefore work continues on our three new potential storage projects, Caythorpe, Baird and Bains, which together would add around 85bcf of storage capacity.

In North America the economic climate and the low commodity price in 2009 remained challenging. This clearly impacted our upstream business. Whilst downstream, Business energy performed well, the residential business was however severely impacted by some of the one-off accounting charges which were clearly disappointing. However towards the end of the year, the macroeconomic environment had begun to show signs of recovery and the business is performing well.

We have a strong downstream position in key deregulated markets. In Texas, a market larger than the UK, we are the third biggest residential power supplier. And we have grown our customer base in the US North East by over 150,000 customers to over half a million customers.

The scale and profitability of the business energy division has also grown following the acquisition of Strategic Energy in June 2008, with revenues and electricity volumes more than doubled. That makes us the third largest C&I supplier of power in North America.

Upstream we have increased our gas and oil reserves through small-scale acquisitions to around 400 bcf equivalent. And in power generation, we have improved the reliability of our CCGT fleet in Texas, resulting in increased availability and reduced outages. With a new management team appointed under Chris Weston, we will now look to further develop the integrated energy model by investing for incremental growth and value as well as improving the returns from the existing business.

So we have made good progress across the Group in the last three years through greatly improved operational performance, including particularly our safety performance, but also through significant changes in our business model. And we are now ready to move on to the next stage.

Our vision remains unchanged. It is to be the leading integrated energy company in our chosen markets. Building on the capabilities we have developed over the past three years, we have set out four new strategic priorities, which will enable the business to move forward and deliver growth.

First, to grow British Gas, leading the transition to low carbon homes and businesses.

Second, to deliver value from our growing upstream business, securing sustainable energy for our customers. And by sustainable here, we mean both a growth business in its own right, and a business with a low carbon focus.

Third, building an integrated North American business with leading positions in deregulated markets.

And finally, and most importantly, driving superior financial returns, through operating performance and our investment choices.

We therefore have four new clear strategic priorities and priorities for each of the businesses with a clear financial context to deliver growth across the Group. Let's start with British Gas. Here you can see we have a number of distinctive capabilities. We serve 12 million homes, amounting to half the households in the UK. We have an unmatched services businesses that has unmatched scale. We have a strong recognised brand, and our existing position as a leader in energy efficiency and green technologies. And it is a business with low capital requirements.

Our strategy for growth within British Gas builds on these capabilities. We identify three aspects within the strategy. First, to optimise the business, to drive further efficiencies and continue to deliver best in class service. Second, to take the lead through innovation and existing growth areas, including enhanced service propositions, for example through insulation, which we announced this morning, insurance based offerings and product bundling with energy. And third, to capture new markets by embracing new technologies, for example smart metering and microgeneration. And by entering new or adjacent markets, for example the local authority sector. In this way we will continue to grow the business, building on our existing capabilities and leading the transition to low carbon homes and businesses of the future.

Our second strategic priority is to deliver value from our growing upstream business, to secure our customers energy needs. Here we have a number of distinctive capabilities. We have transformed our scale and capability in upstream gas. We are the only UK supply business producing both gas and power, giving us a unique dual fuel hedge. And we have a low carbon intensive generation fleet. And we are leaders in UK offshore wind and gas storage. Given these distinctive capabilities our strategy for the upstream UK business, under the leadership of Mark Hanafin, has two key elements. Delivering value from our existing investments, and developing our pipeline of low carbon investment choices, with access to a strong range of investment opportunities, including offshore wind, new nuclear, gas development and gas storage projects. We can target those opportunities with the strongest returns, with each project competing for capital across the Group. While the prospects for growth from future investments are attractive, we will also remain very focused on optimising the returns from our existing portfolio. This remains a vital component of our commitment to ensure sound financial stewardship.

In North America, our objective is to build a more integrated business. The market continues to offer attractive opportunities in large profit pools, as we look to grow our leadership positions in competitive, deregulated markets. We currently have strong downstream positions in multi-state deregulated markets for both residential and business customers, with gas and power assets to support these positions, and the unique services capability. Under Chris Weston's leadership, our strategy here is to improve the returns from our existing business, to grow our leadership positions to become the number one or two player in competitive deregulated markets, to leverage our services capability with bundled offerings and low carbon solutions, and to build on our upstream asset base to grow the structural hedge.

Our fourth priority provides the Group wide context of strong financial stewardship. Maintaining a strong balance sheet is a clear priority. We will target our investment to opportunities offering appropriate double digit levels of return, taking into account the risks inherent in each project. We will also phase our investment to achieve consistent and superior earnings growth. Effective competition for capital therefore provides a healthy environment for challenge within the business, enabling us to make appropriate choices from the options available.

Alongside financial discipline, a strong health and safety culture, best in class service levels and leading technology systems and processes are also key enablers of performance. As of course is the continuous development of our people and organisational capability. Our focus on costs and efficiencies will remain relentless.

In conclusion, 2009 marks the successful culmination of a three year programme during which we have made significant progress. We have now delivered against our existing strategic priorities and Centrica is well positioned to move forward to the next chapter in our development.

Our new strategic priorities will enable the business to move forward and deliver growth for a low carbon world, with new propositions and services for our customers backed up by new sources of energy in our integrated model. We will deliver value to shareholders both from our existing asset base and distinctive capabilities as well as through carefully targeted investment.

So with that, I would now like to turn it over to questions. Thank you very much.

Roger Carr

Thanks Sam. Questions please. If as always if you could say who you are and where you are from, and press the button in front so the mic becomes live. So if you would like to start.

Questions and Answers

Q1. Mark Freshney – Credit Suisse

Hi, it's Mark Freshney from Credit Suisse. Just three quick questions. Firstly you talk about leverage flexibility. Would you be potentially able to quantify what kind of leverage flexibility you have? Secondly a bit more colour, I guess, on the US hedge ratios. I know in the past in the UK you spoke about what your hedge ratio was and you had a target to get it to around about 50%. Perhaps just give a bit of colour there, and maybe also colour as to whether that's hedges in gas or electricity upstream? And I guess thirdly on the pensions, do you think that given that pensions are things generally done in arrears, that potentially putting in an extra, I think it is £300 million, into the pension plans is aggressive, and risks stranding an asset in the event that we do see an upturn in asset valuations?

Answer: Sam Laidlaw

Let me take the one on leverage flexibility and the US hedge and I will let Nick take the one on pensions. Leverage flexibility is perhaps an unfortunate terminology in that what we mean here is using the flexibility that we have in our investment portfolio. We have closed the structural hedge so now we have multiple options in gas storage, in gas production, in wind and in renewables. And we have the opportunity of making some choices. So it is really around taking advantage of the choices rather than implying leverage in the financial sense of the word. And I think that is important.

The second part of your question was round the structural hedge in North America. Currently if we look at the equivalent retail and tariff book, equivalent to the way we have looked at the UK, our structural hedge position again is around the 20% level. And you know over time, over a period and in the same way that this took us time in the UK, we would aim to move that up to 35%-40%. So you know, and this will be a gradual process of finding assets and opportunities that we think will clearly deliver high returns. They have to compete with the returns in the UK and you know it will be generating assets or it could be gas production. And Pensions?

Answer: Nick Luff

Pensions. I look forward to the day when having a surplus in the pension scheme is a problem. But we have agreed with the Trustees that we, if there is out performance of the asset base and we are relatively high proportion of equity investment, that we would use that to effectively de-risk the scheme and better match the assets and liabilities. So it is more, if there is a surplus asset out-performance to what our expectations are, we will use that to reduce risk rather than finding ourselves stranded with too much capital in the schemes.

Q2. Iain Turner - RBS

There is so much going on in the UK that is interesting and attractive, why are you persisting with the US when it is only 10% of your operating profit?

Answer: Sam Laidlaw
Why are we persisting with the US? We do think that the US has got considerable growth potential. We do think that in the same way, you know three years ago, people would say, well actually it is very hard for us to build the integrated model in the UK. I think we have demonstrated that can be done and I think you know on a much smaller scale, in terms of the relative size of the business, we have the opportunity of reinforcing and building the business. We can see very considerable growth opportunity. Markets are deregulating. And this is not just an acquisition driven growth opportunity in the US. We are actually seeing growth opportunities as markets open up. If you look at something like the Pennsylvania market, which opened the beginning of this year, we have already added 30,000 customers there organically. And so we can see a lot of opportunity there, ultimately within the UK, in the downstream market, our business will clearly be constrained for growth. And having made the decision, I think quite correctly, not to continue to compete in Europe, we actually need the geographic growth beyond these shores.

Answer: Nick Luff
It is not an opportunity cost either. I mean we are developing both and well.

Answer: Sam Laidlaw
And we will only do it if the returns are there, let's be quite clear about that.

Q3. John Musk - Nomura
Morning, it's John Musk from Nomura. A question on next year, or this year's, 2010 upstream oil and gas EBIT. Can you just, I think you are guiding, my understanding is to a lower number this year on last year. And I just want to understand the mix in terms of price and volume in that, and also on the volume side what is going to be coming from the Venture assets versus your legacy assets let's call them? And then secondly, you are relatively confident that you are going to be able to maintain margins in the downstream. Can you just talk a little bit about any political pressure you may face with that, certainly around elections as well?

Answer: Nick Luff
Yes I think at the moment our guidance would be for upstream profits broadly in line with 2009. And that really reflects the fact that although volumes should recover and of course as you say, we will have a full year of Venture and depending on how much we run Morecambe, volumes could be up 40% or more. But the average selling price of course will be down quite significantly because we were benefiting from hedges that we had coming into 2009 this year, sorry in last year's results, from the high prices in 2008. So you will see a much lower average selling price which nets out to about broadly neutral year-on-year position. The offset of course comes in the I&C losses which because of the low gas price does mean we are looking at only around £50 million in losses in I&C and then when you flow all that through in the reduced tax of course, because of the lower upstream profits, and higher downstream earnings, which is why we are comfortable overall with the figures.

Answer: Sam Laidlaw
And I think the supplementary on that, about 25-30% of production will come from Venture this year. In terms of the second part of your question which was around is there political pressure around margins? I think everybody understands that we need to make a return in this business and actually when you look at the 7.6%, last year was clearly a very low year because of the very volatile price and the rapidly rising commodity prices, the previous year was higher than that, 8.8%. I think at this level, which is consistent with our long-term guidance for this business now, I think that if

you contrast that with other businesses, and I would give you BT as an example at 15% or I give you even a business that has very different working capital requirements to this business, you know Marks and Spencer at 8½ %, I think that is the context that has to be seen in. I think the Ofgem Report which came out on Monday indicated profitability per home, that the number of £105, was seized on, but actually when you look at it, when you divide our actual results by the 10¼ million homes that we supply, you will see the number actually is, before tax, £58 per customer and £38 after tax. So that is the £3 a month per customer that we have been talking about. And I will certainly talk to you and people in Government about those numbers and I think they are comfortable with those numbers.

Q4. Lakis Athanasiou – Evolution.

Lakis Athanasiou of Evolution. Just three or four questions. On your UK gas Capex guidance, can you give a very rough split between development expenditure and exploration and appraisal? Also on Lincs, you know when you did the joint venture announcement, you did not say anything about debt and we have been hearing in the markets that you are out there looking for debt. Do you think you will be able to achieve non-recourse funding for the construction phase of Lincs? On British Energy, now you have had some chance in the Board Room, do you have any concerns that EDF may not put in the kind of maintenance expenditure, the expenditure on life-time extensions that you would want to see and maybe because of pressures elsewhere in the organisation, channel funds outside? And finally, if you can, any guidance on your hedge positions this year and next in residential acquisition costs and upstream gas and generation?

Answer: Sam Laidlaw

If I could deal with the last one first and that we don't give guidance on our hedge position. Let me move onto the first one which is how much of the £550m of upstream gas is going to be on exploration. I think approximately just over 20% will be on exploration and appraisal, 22%, not all of that of course will hopefully be written off. Hopefully we will have some success and therefore the P&L charge will be lower than that. I will let Nick speak to the financing of the Lincs project and perhaps Mark as he is on the Board of British Energy, talk to your question around, is there a risk that they are going to under invest in these facilities.

Answer: Nick Luff

On Lincs, as you say, we have put that into a joint venture with Dong and Siemens. We will, at some stage, put some gearing into that structure. We have some feel as to whether that is sensible to do that now or whether to leave it. As you say the issue is construction risk, clearly you can get project finance, we just did it for the existing wind farm, so we did that after they were built. You can cover off construction risk, it is a case of who is taking it, whether the banks are taking it or whether we, as the developers, are taking it. So it can be done, but we will see what terms are available and if they are sensible we will go ahead with it.

Further Question:

Would that be so called limited recourse if you are taking it onboard? So there are all kinds of tunes you can play?

Answer: Nick

Correct. It is an allocation of risk.

Answer: Mark Hanafin - Upstream UK Managing Director
On the EDF question. EDF are very focused on supporting British Energy with all of their resources, and you see that coming through in the very healthy production figures and liability figures. Absolutely no evidence of pressure to cut back.

Q5. Gus Hochschild - Mirabaud Securities
If I may, a rather anal question with regards to the double ROC regime for your wind projects. I am mindful of the rather more nebulous government or the renewables obligation amendment of this year, which appears to suggest that for a project quality, it hinges on whether a project is relevant. So whether the turbines, and I quote 'are relevant or not'. So therefore I would be very grateful for some form of guidance from you and perhaps by way of example some of your projects as to indeed what makes a project relevant or indeed unfortunately irrelevant?

Answer: Sam Laidlaw
Well in terms, and I will let Mark add to this, or Nick add to this. But you know, in terms of our Lincs project, there is no doubt that it qualifies. In terms of the next two projects that we have in Round Two, which is Docking Shoal and Race Bank, actually you know they will qualify, if they are developed within the critical time frame. And it is actually more a question of whether they meet the timeframe. And we expect that, we are preparing and moving ahead with Docking Shoal and we would expect that certainly that would conform with the timeframe if we can get all the engineering done in time.

Answer: Mark Hanafin
Well it is Race Bank that we are working on. Sam is absolutely right. It is not a question of the turbines we are using not being appropriate, it is just a question of timing and the window you need to have first power.

Further Question:
Just for clarity, sorry to take up time. So it has to be operational before? Sorry, it has to be operational before March 2014 to qualify?

Answer: Sam Laidlaw
Correct.

Q6. Nick Hyslop - RBC
I had a question. DECC are going to launch their feed-in tariff of sub-5 megawatt microgeneration. I think you mentioned 5 megawatt microgeneration as an opportunity for you. Some people might think that might be quite significant on a 1-2 year view. Are you gearing up for that?

Answer: Sam Laidlaw
Well the answer to your question is yes we are. I think that microgeneration in the home, and sort of our field, build on this, both the arrangements that we have with Ceres which has been through the Alpha testing, is now in the Beta testing. And we are going to be installing some of those boilers this year. The arrangement we have with Baxi too, where we have a microgeneration facility made and intend to capitalise on that. So Phil, anything you would like to add on microgeneration, because I think it is significant?

Answer: Phil Bentley - Downstream UK Managing Director
Yes, as you know, it does make the returns far more attractive now for investors, and on top of that for households to invest in it and on top of that, British Gas was the

only company that has got what is called pay-as-you-save funding from the Government as a pilot where you can recover that investment through the bill over an interest free credit period. So we think we are in quite a good position. And on top of that there we have been investing in some microgen technologies, for example, we are the largest installer of solar panels now through Solar Technologies. We have also got some pellet burners as well. So we think there is a big opportunity there, it is part of, Sam touched on, around the community opportunity, because hitherto we focused on the householder and the home owner. But actually a lot of this money is being spent now through councils and local authorities. And teaming up with them we think offers a big growth opportunity for British Gas.

Further Question

And one follow up question. Given your current leadership position on pricing in residential gas and electricity, could you give us perhaps an idea of how you are doing in terms of new customers at the moment?

Answer: Sam Laidlaw
Sales are very strong. I will let Phil speak to that, but there has been very good response to the price reduction.

Answer: Phil Bentley
We are doing well.

Further Question
Could you give us a number?

Answer: Sam Laidlaw
Not the number. But what I would say is that before the price reduction, in the month of January, we were growing customers. It is actually, we know sales are up very substantially. It will be a few months with the industry processes before we see what is actually happening to notifications and therefore you know how this translates into additional growth, but we expect it to.

Q7. Ajay Patel, UBS
Morning, Ajay Patel from UBS. My question is around the upstream. I was kind of thinking, clearly when the weak gas price environment, to what extent has that mainly affected contractual relationships with energy providers? Has that improved for you? Does that look attractive relative to acquiring upstream assets? Just a bit of colour there?

Answer: Sam Laidlaw
Yes, it is a very good question. In a softer gas environment, are upstream gas producers more inclined to talk to us? And I think the answer to that is yes. And therefore we continue the dialogue with a number of gas producers. Obviously they look, those that have LNG, you know, look at the relative attraction of the UK market relative to other markets around the world. Now one of the big phenomena is that with the advent of Shale gas, the US market which has previously been seen to be quite a significant import centre for gas, clearly is self sufficient now and therefore in a relative sense, the UK market becomes more attractive. But equally the Asian market is growing fast and prices in Asia are therefore still quite robust. So we have to offer a competitive proposition. And we, as I mentioned, we bought a lot of spot LNG last year. We are building relationships and over time we would hope that those relationships will turn into long term contracts. And it isn't really an either / or. We will have to have some contracted gas and some gas assets of our own, it will be a combination of the two.

Q8. Peter Atherton, Citigroup

It is Peter Atherton from Citigroup, a couple of questions please. Can I just pick up on the reserve adjustments on slide 11. If I have got this right, you have reduced the estimates of reserve by 60 million barrels of oil equivalent. From memory, Venture had 244?

Answer: Sam Laidlaw

240 million barrels yes.

Further Question

So it is a 25% reduction in the estimate reserves. Excuse my ignorance as a utilities, not an upstream, analyst but is that normal when you buy?

Answer: Sam Laidlaw

It is not abnormal actually because there is a wide range of different classification possibilities for reserves. Unless you go to the 1P SEC definition, internationally the SEC tolerates a wide range of different interpretation. We have historically booked all our reserves on a much more conservative methodology, essentially only booking reserves that we have a very high confidence are going to be developed in a very near term timetable, independent of volatility and the gas price. For a variety of fairly obvious reasons, they have a less conservative approach to booking their reserves. The critical point is, you know, was that a surprise to us relative to our investment case? And the answer to that is no. We actually, you know, haven't seen any downgrade relative to our investment case in their reserves. So we were never assuming if you like, that the 240 would be immediately developed.

Further question

Okay. And my second question, picking up on the Chairman's opening remarks. He alluded to your view of the various proposals for the wider power market that is under discussion at the moment. You are clearly, I think, expecting some significant changes to the structure of the market from what the Chairman said. Sort of using the five options as a base, were Centrica amongst those options?

Answer: Sam Laidlaw

Well I think the first point to make is that actually with the markets delivering and it is not broken at the moment. In the period, and this was I think illustrated by the Climate Change Committee's paper, in the period between 2020 and 2030, if we have a lot more intermittency on the grid, then a power market that was designed for low fixed cost, high variable cost generated power is going to have to be redesigned for a market that will have more intermittency and you know low variable cost, high fixed cost. But our view is very clear and that should be, you know, a gradual process. It is not an immediate problem. The only immediate problem I think is as sort of we have consistently been saying, along with EDF, that with the collapse of the carbon price there is going to need to be some sort of support mechanism for carbon or carbon related, to get new nuclear going, which is important if we are going to have security of supply in the second part of the next decade and you know every other form of low carbon technology has got a support mechanism so we need to level the playing field. So we would see that actually this is around sort of a one-off intervention, as the immediate issue is to ensure that full cost of pollution is played by the emitters rather than, you know, root and branch review with the electricity market which we don't think is necessary.

Further question:
Sorry another question. Just on the dividend. I think there is some market speculation around these results that you might announce an enhanced dividend policy. Where are we on dividend?

Answer: Nick Luff
Well we have maintained a dividend policy, which is to deliver real growth each year, and it is up again at 5% this year. And we believe we have got room to continue to deliver that. Recognising the stability of the earnings that is coming from becoming more integrated, yes, over time we might be able to push the payout ratio, but equally we have got a significant investment programme with significant opportunities to invest in the business, and if they are offering good returns then I think our shareholders will want us to invest in those. So we have to balance the two and I think we are comfortable with where the policy is at the moment.

Further Answer: Roger Carr
And that is exactly where the Board is, there is no view to change things. We are trying to build a business, use shareholder money effectively, return it when available, but move the movement on all the time in a positive way. And you will hear from us if we intend to change that.

Q9. Peter Bisztyga, Liberum Capital
Peter Bisztyga from Liberum Capital. Two questions from me. First of all, acquisitions like the Trinidad assets. Do you think those as counting towards your UK upstream hedge or your US upstream hedge or both? And then secondly, could you just give us a flavour for how customer churn rates differ between energy only customers and customers taking energy and services?

Answer: Sam Laidlaw
Let me take the first one and let Phil take the second one. In terms of the acquisitions in Trinidad, over time that is going to contribute, we would see it contribute. It has the option to do both, but more likely the UK market given where Shale is at the moment. But you know, it is well positioned as an asset where if gas prices are higher in America, and North America is importing gas, then clearly we have the option of taking the gas there or taking it to the UK. You know there are two pieces to this. That is, the existing production where we participate in 50% of the diversion rights, but the gas is actually marketed to a third party. We can always then buy it back. But the larger opportunity in terms of resource is actually the undeveloped gas fields which take time to develop, and it will depend on which market is more attractive at the time. But it does give us that optionality and we would see gas prices, actually, between the US and the UK have been starting to converge.

Further Answer: Phil Bentley
Well it is a great question because it goes to the heart of the strategy which is that the services piece, when bolted on with energy, makes a big difference to reducing churn. So we have seen churn in general in energy come down materially to pre-paying customers who used to churn at about 37% and now we are churning at probably about 17%. Our premium customers are churning less than 10% for energy. And we would expect with an overlay of services, probably to see churn reduce by another 40%. So it is absolutely critical to the strategy and it is one where we think we have a real competitive advantage versus everyone else out there, because at the end of the day you need a man with a van to get this stuff done. And all these new opportunities whether it is SMART meters, microgen, it is all part of cementing that relationship which we think we have a real opportunity to grow.

Q10. Edmund Reid, Cazenove

Hi, its Edmund Reid from Cazenove. Three questions. The first one was on smart metering. I was just wondering if you could give us some details on the timetable for smart metering? The second one was the margin in the services business. I think historically you talked about a 15% margin, net operating margin, and it looks like you are doing 16.6% and you are obviously looking to grow that business. Are you still kind of thinking 15% or can you do better? And then the third one is a bit dull. It was on the working capital movement in 2009. Would you expect that to reverse in 2010 or was that reversal of a negative movement in 2008?

Answer: Sam Laidlaw

Why don't I take the first two and I will let Nick deal with the dull one. The smart metering, we are actually, I think, making good progress in the rollout of smart meters. Last year we installed 50,000, really largely in our B2B market. This year we expect to install just under 150,000 in the residential market and a further 150,000 in the B2B market. So we will have 300,000 by the end of the year. Now you know this is really a pilot if you like, in that only when we have the central comms system up and running, which will be about two years away, will we have the full functionality of these smart meters that enables everybody to take advantage of time of use pricing in the residential market. So you know, they won't have all the functionality this year that they will ultimately have because we have to build a central comms system. But the rollout has begun. And really the critical thing is getting that central comms system up and running as quickly as possible and we are engaged with Ofgem and DECC on that.

The second piece was around margins on the services business. We have got a wide range of different product offerings in there. I think our historical guidance of 15% really remains. Obviously it will depend on the products that we offer. The insurance based product is selling very well. We have now got a quarter of a million customers on the insurance based products and we will be switching more people over to that so hopefully that will give us a margin expansion as well.

Further Answer: Nick Luff

And on to the not so exciting question. If you exclude margin cash of course which will always move about with commodity prices, the big driver of working capital is the debtors within the downstream residential and business supply, energy supply. And that is dictated by where the retail prices are. And so you are absolutely right, the run up in retail prices in 2008 caused the working capital outflow which the fall in prices we have seen in 2009 has seen that reverse to a large extent. There is also an element of consumption in there. So falling consumption also helps working capital. So as we sit here today, I would guide to working capital being flat in 2010,,depending on what happens towards the end of the year in terms of retail price movements.

Q11. Jamie Tunicliffe, Redburn

Jamie Tunicliffe from Redburn. I just, you were pointing out that trade-off between some investment opportunities you see and the balance sheet having scope for that and then payout. Would you, just trying to understand that trade-off and how you manage it through time, are you, would you want to see, sort of, your leverage ratio decline much from here or is it really you see you are happy with the sort of debt to EBITDA of these level type ratio and you will look to maintain that balance sheet efficiency through time? Thanks.

Answer: Nick Luff

Yeah, as I said in my presentation, we're at about 1¼ times EBITDA at the moment for debt. There is some headroom in that and although we have stabilised the cashflows and earnings in business considerably with integration we don't have a regulated asset base, so we couldn't push it necessarily to the two times and beyond that some other big companies in the sector might be able to do. But certainly pushing up to one and a half times and perhaps further depending on the mix of profits is possible. And we will be able to do that if the right investments are there and the returns are there and we will use that headroom. The business is highly cash generative now and so we do have a lot of cash to potentially deploy and the opportunities we have talked about. But if the returns aren't there then the money goes back to shareholders.

Q12. Andrew Moulder, CreditSights

Andrew Moulder from CreditSights, could I just follow up on Jamie's question. I mean, what would stop you pushing out that ratio to two times, you know, net debt to EBITDA? Are you worried about the rating? Are you worried about access to the markets? What is the restraining factor here in the balance sheet strength?

Answer: Sam Laidlaw

I think ultimately, it comes down to do we want to keep the A rating? And the answer is yes we do because the sort of business that we are in, where we are entering into multi year, in some cases 20 year, gas contracts with producing countries, that is important. Not that we have any triggers if we have a lower rating, but actually it is just the ticket to the game. If you want to enter into a £20 billion gas contract, you have to have that A credit. So that is helpful for us.

Further Answer: Nick Luff

And I would add that the debt to EBITDA ratio only tells half the story. You do have to add on the pension deficit, you have to adjust for operating leases and we have assets in the business that are not on the balance sheet that we use and so they get capitalised. So it is not the whole story just looking at the debt to EBITDA ratio.

Q13. Ajay Patel, UBS

Ajay Patel from UBS again. My question is around capital in the upstream. So when we were at the analyst day there was a sizeable amount for the upstream, I think it was £2.1 billion if you took all the blocks and the chart for that. I was just wondering, if gas prices stay where they are at the moment, what proportion of that can actually be deployed and actually will a lot of that not make sense given the environment, and actually make sense later? Just trying to get a feel for what the trade off is like?

Answer: Sam Laidlaw

Well the good news is if you look at our portfolio and I think you are really talking about upstream gas rather than upstream power. If you look at upstream gas, both the organic portfolio that we had ourselves at Centrica and the portfolio that we acquired from Venture, a good chunk of that is reasonably robust at low gas prices even if we don't have any contango in the forward curve. And I would give you the York field which is in our plans for this year as a good case in point with very low capital and cash costs. There will be some at the margin and we are very focused on returns that, you know, clearly we will want to scrub and reduce the capital costs of, but I think the guidance that we are giving for this year, and think we are going to take one year at a time, you know we are spending £550 million on gas developments, is all projects that actually don't require any escalation in gas prices beyond the current level to deliver well in excess of our targeted returns.

Closing Comments: Roger Carr

Very good. Well thank you all very much indeed for coming this morning. Thank you.

End of Presentation