Centrica plc 2023 Preliminary results
15 February 2024

Transcript

Chris O'Shea, Centrica
Good morning, everybody. Thank you very much for coming. It's super to see so many of you here. It's very nice to say hello to those of you that are online using the hybrid format that we've got. I'm joined today by our Chairman, Scott Wheway, our CFO, Russell O'Brien, and the rest of the leadership team are also here, so there will be the opportunity to catch up with them over refreshments after the Q&A session.

Let me start by briefly reminding you of our strategy laid out last July. As we've said before, Centrica is a uniquely integrated energy company, where each element of our portfolio complements, de-risks, and adds value to the others. There is significant value in the balanced nature of our business model. The way the energy system is changing plays to our strengths. The deliberately integrated nature of our portfolio means that we'll benefit from growing electricity demand and system complexity. In addition to providing customers with energy tariffs and services and solutions that work for them, our retail businesses will increasingly help customers flex their energy use towards lower price periods. Our infrastructure businesses are investing in assets to generate more green electrons for our customers and to help to improve energy resilience. Our optimisation capabilities and positions mean that we are able to procure commodity for customers effectively whilst also monetising our own and third-party assets, all whilst helping to balance the grid. These capabilities and trends underpin the green-focused growth and investment strategy that we announced.

Our strong cash generation provides us with choices as to how we deploy our capital, with investments made because they are strategically aligned and they generate attractive financial returns across the group, in addition to helping us maintain balance in our portfolio and to deliver net zero for our customers and for our company. We believe that this strategy creates significant value and represents a highly attractive investment proposition.

Now, when you look at 2023, we made very good progress. We've transformed our operations. We've transformed our colleague engagement over the past couple of years, and that's resulting in improved customer satisfaction in the retail businesses, and this will underpin our long-term profitability. We reported another strong financial result. Adjusted operating profit and earnings remained at elevated levels, while strong free cash flow once again demonstrates the highly cash-generative nature of our portfolio. This strong performance underpins our confidence in delivering compelling cash returns. In total, we returned £800m to shareholders in 2023 through the progressive dividend and our ongoing share buyback programme, and we're building a pipeline of projects, having commenced delivery of our green-focused growth and investment strategy.

I'm really pleased with how most things have gone in 2023. I'll come back in a bit to provide some more colour on our operational and our strategic progress, but first, let me hand over to Russell, who's going to cover the financials in more detail.

Russell O'Brien, Centrica
Great. Thank you, Chris, and good morning everybody. Let me first remind you of our refreshed financial framework, which underpins long-term value creation for Centrica. Namely, sustainable earnings with £800m of operating profit from Retail and Optimisation over the medium term and earnings from Infrastructure on top. Maintaining a strong balance sheet, progressive dividends moving to 2x cover over time, investing for value, and our clear philosophy on the return of surplus capital. Although this is the long-term financial framework for the group, our performance in 2023 against all aspects has been good.

Excluding the impact of Spirit Energy Norway disposal in 2022, adjusted operating profit and earnings per share were broadly flat as the impacts of high and volatile commodity prices across '21 and '22 continued to provide tailwinds into '23. The highly cash-generative nature of our business model was again demonstrated with free cash flow of £2.2bn. This includes an increase in capex to just over £400m as our green-focused investment plan starts to build momentum.

We close the year with £2.7bn of net cash, up from £1.2bn at the start of the year. As Chris has said, we returned a total of £800m to the shareholders in the year, and our strong financial position means we have the confidence to increase the full-year dividend per share by 33% to 4p, consistent with our progressive dividend policy.

I've shown on the slide here the operating profit split between Retail, Optimisation, and Infrastructure. The business unit split is in an appendix of the pack which we've laid out today, and there's more commentary on the performance in this morning's RNS announcement, but let me cover the headlines.

Starting with Retail then, we generated £799m of profit, over £700m higher than in '22. We saw an improved result in British Gas Services & Solutions, which returned to profit off the back of operational improvements, helping to underpin revenue growth and providing a good platform as we move into '24. Bord Gáis made a small profit, having been loss-making in the first half, with significantly improved financial performance in the second half as challenging market conditions for energy supply eased, providing strong foundations to drive an improved result into '24. But the increase was largely in British Gas Energy, where operating profit was up materially. I'll cover this in a little bit more detail in a minute.

Next, Optimisation, where profit was £878m. Centrica Energy, our new name for Energy Marketing & Trading, had another good year, although profit nearly halved compared to the very favourable environment we experienced in '22. Lower prices and market volatility naturally impacted gas and power trading profit. However, we saw the benefit of our diverse portfolio with both the LNG and route-to-market businesses delivering higher profit, in part due to tailwinds from '22. We also saw increased energy supply profit in Centrica Business Solutions, with a 14% increase in volume sold to medium-sized businesses and margin supported by effective risk management and optimisation.

Finally, Infrastructure, where profit was down by a little over £200m year-on-year to £1.1bn. Within this, Rough profit was very slightly down year-on-year, with a strong first half reflecting high seasonal gas price spreads last winter, followed by a much reduced second-half profit against a backdrop of lower spreads. Volumes in each of Spirit Energy and Nuclear were down by around 15% year-on-year, reflecting a natural decline in the upstream portfolio, and in Nuclear, higher planned outages, as well as the closure of Hinkley Point B in '22.

Now, these impacts were more than offset by higher achieved prices despite lower market commodity curves underpinned by our rateable hedging strategy. Just to remind you, in our infrastructure businesses, we start hedging 24-30 months ahead, so profits are, to a large extent, sheltered from moves in commodity prices in the short term. In Nuclear, the newly enacted electricity generator levy also impacted operating profit by £326m.

Before I move on to cash flow, let me provide some context on the strong British Gas Energy operating profit of £751m. There were a number of drivers of this result, including, as flagged at the half year, the industry-wide one-off recovery of wholesale costs from prior periods through the domestic price cap. This was worth around £500m to us. In addition, we delivered effective risk management and optimisation, particularly during the first half, while higher commodity prices naturally drove higher unit margins. These positives were partially offset by the impacts of reduced underlying customer consumption and an increase in our cost per customer. We incurred dual running IT costs, with good progress on the continuation of our platform migration, and we chose to ramp up investment in customer service. We committed a further £84m of direct voluntary support for customers in the year.

We also saw our bad debt charge increase by £244m to £541m across the residential and small business customer base. There are allowances for the residential element under the price cap, but it is something we will continue to closely monitor and manage as we move through '24. It is important to remember that the structure of the residential supply model in the UK is such that you should expect to see some degree of volatility between reporting periods. In any given period, the Ofgem price cap does not always allow suppliers to perfectly match revenues to costs. Earnings will also be impacted by the other risks we face, such as the weather or wholesale market pricing dynamics.

Looking at the result over time, you can see on the right here the multi-year British Gas Energy residential margin since the SVT price cap was implemented in 2019. On average, we have been profitable, achieving a margin of slightly above 2%, which is broadly in line with the margin allowed under the price cap. It is this performance against what has been a challenging regulatory and economic backdrop that gives us confidence in our medium-term sustainable profit guidance of £150-250m for UK residential energy supply.

Moving now to cash flow. As we've demonstrated over the past few years, Centrica is a highly cash-generative business. In 2023, EBITDA of £3.1bn was supplemented by £220m of dividends from our nuclear investments. We paid over £1.1bn of tax when including the payments related to the electricity generator levy. We saw a working capital inflow of £244m, including around £600m of inflow in Centrica Energy, as high profits from 2022 translated into cash flow as positions closed. This was partially balanced by an outflow in British Gas Energy, largely related to the impact of falling commodity prices. As I said earlier, capital expenditure was up to £415m, with just over half of this on flexible and renewable power assets in the UK and Ireland as we start to build towards our £600-800m per annum green-focused investment plan. All of this led to strong free cash flow of £2.2bn.

As you unpick the cash movements in Centrica, you should and do see a degree of volatility between periods. Our business environment can be complex and is constantly evolving, although the portfolio is set up to thrive against that backdrop. This does mean though that we do see movements in working capital between periods, but its deployment helps underpin our sustainable earnings. Again, it is useful to look over multiple years, and over the past four years, you can see we have delivered nearly £7bn of free cash flow.

Closing net cash of £2.7bn was £1.5bn higher than a year ago, and after the £800m of cash returns to shareholders we referred to earlier. Our balance sheet remains strong, even after including a technical pension deficit of around £900m, broadly unchanged over 2023, and pre-tax decommissioning liabilities of £1.5bn. As we've seen in the recent past, margin cash can move around materially. In 2023, we saw an unwind of the significant amount that was deployed at the end of '22, with more than half a billion pounds of inflow resulting in £240m posted at the end of the year.

We need to maintain balance sheet flexibility and adequate liquidity at all times. This supports our strong investment grade credit rating, and that allows us to secure energy in advance for our large customer base and capture opportunities to add value across the group, including in Centrica Energy. Our position against our credit metrics is very strong, even though the agencies require us to hold more material buffers than many of our peers. For example, 50% FFO to net debt with S&P for our BBB rating.

As we set out last July, we currently consider the right level of medium-term leverage to support our credit ratings has been up to 1x net debt to EBITDA. This is a level I believe provides enough buffer to manage the inherent volatility in the markets we operate, provides the flexibility to continue to invest for the future, and importantly, allows us to grow shareholder distributions in line with our progressive dividend policy.

Moving on to our investment plans, and we're continuing to deploy capital across the group in a disciplined manner, creating value while seeking to maintain balance across the portfolio. In 2024, we expect to spend more than the £415m we spent in 2023 as we ramp up this capital investment. In addition, to spend on power assets, we've started to deploy capital into our meter asset provider, or MAP business. This offers an attractive and rateable return, with the capital almost immediately productive. We installed our first British Gas smart meter in late 2023 and expect to build this investment gradually to £100m a year.

Chris will update you on the early stage progress on building the pipeline of power assets shortly, but before he does, I'll remind you of the framework against which we assess these potential investments. We set the bar high for new projects and maintain a disciplined and cautious approach against the changing macro environment. All projects have to meet our return thresholds as we target average post-tax unlevered portfolio returns of at least 7-10%. For all our investments, we target additional group portfolio benefits of around 2%, including from Optimisation. When we make an investment, we aim to make three returns: an infrastructure return, an optimisation return, and a retail return. Now, we have a lot of potential projects, but I won't let us waver from our return thresholds. I chair Centrica's investment committee, and there are plenty of potential investments we turn down because they don't have the right financial profile or they don't provide additional portfolio benefits.

Finally, let me cover the outlook. As you would expect, we are not changing the medium-term profit expectations we provided for our business units last July. Obviously, in any given year, the actual results by business unit will fluctuate, and so the guidance should be seen as an average over time, but as Chris outlined, one of the benefits of our balanced portfolio is that our businesses de-risk each other and our 2023 performance has reinforced our confidence in delivering these profit projections. Let me share how I see some key trends playing out over 2024 and how that might flow through to the results.

As is normal at this stage in the year, there are a wide range of uncertainties. The most material of which is the weather. The wider competitive backdrop and the impacts of a weak economy and bad debts and customer demand are also something we will continue to monitor closely. Therefore, there are a range of possible outcomes. We know that there won't be a repeat of the one-off cost recovery seen in British Gas Energy in 2023. While there are various moving parts, from what I can see, the medium-term expectation of £150-250m is also a good yardstick for 2024. In addition, the recent strong performances of British Gas Services & Solutions and Bord Gáis provide strong foundations to drive an improved result in both these businesses in 2024. In addition, while lower commodity prices and reduced volatility relative to 2023 will naturally reduce optimisation opportunities in Centrica Energy, Spirit Energy and Nuclear are largely protected from further moves in 2024 by our rateable hedging strategy. We've shown our hedging positions at the end of 2023 on an appendix slide.

Thank you, and I'll now hand back to Chris.

Chris O'Shea, Centrica
Thanks, Russell. As I said earlier on, I'm really pleased with our financial performance in 2023 because it does demonstrate just how cash-generative our portfolio is. You're going to hear over the next few minutes I'm also very pleased with the progress we've made in delivering better operational performance and improved customer outcomes.

What underpins our retail strategy in the UK and Ireland is very, very simple. We're investing in our colleagues, we're investing in our brands and communities, and we're investing in our customers. As I said before, if we take care of our colleagues, they will take care of our customers, and the resulting performance will take care of the shareholders. That's why improving colleague engagement is such an important foundation. I was super pleased to see this approach in top quartile across 2023. It's a significant improvement from where it was less than three years ago. A number of our businesses are already top quartile. This is resulting in materially improved customer satisfaction and sentiment as you can see by the fact that British Gas now has a four-star Trustpilot score. I believe it's called deep green now, so we're very happy.

We know times are tough for many of our customers right now, given the cost of living crisis and the uncertain economic outlook, and you've heard how this has translated into higher customer bad debt, but we're doing what we can to help our customers. We've now committed £140m in direct voluntary support for customers struggling with their bills in the UK and Ireland since the start of 2022. That includes contributions to the British Gas Energy Trust. This £140m, which is completely voluntary, can be up to £2,000 per customer, which makes a huge difference for those of our customers that are struggling most.

In British Gas Energy, we're making excellent progress in migrating customers onto our new technology platform. This is modernising our operations, and it's allowing us to broaden the product offering, including our innovative PeakSave range. We've now got well over 5m customers on the new platform, and we aim to have all customers migrated by 2025. This system migration is improving customer service, and it will ultimately lower our cost per customer. Although, as it's fully expensed through the P&L, it will continue to add cost in the immediate term as we have dual running of our systems.

As you can see, we also experienced almost 1m extra customer contacts in 2023 when you compare it to 2022, but it's about 5m more when you compare it to 2021. In the current economic environment, more people want to call us more frequently, and they want to speak for a longer time. We want to make sure that we're there for them. We've therefore continued to invest in customer service, including hiring 700 additional contact centre colleagues in areas where we know that they're needed. This resulted in a 40% decrease in our average speed to answer despite the increase in customer contact volumes. As you would expect, this is having a positive impact on customer satisfaction, with higher NPS scores and stable customer numbers. Of course, we will continue to operate as efficiently as we can, but not at the expense of being unable to offer our customers the product range or the service levels that they both demand and deserve. This will underpin customer retention and growth and long-term sustainable profits.

We move now to British Gas Services & Solutions. As we said last July, the growth opportunities here are truly huge. British Gas, in combination, serves around 30% of UK households, but the Services business serves around 10% of UK households. What's critical for the future health and growth prospects of this business is embedding the operational improvements we've delivered over the past couple of years. The performance over the past year has been strong, with reschedules greatly improved, more customers left satisfied, and engineer NPS increasing. This strong performance has started to flow through into commercial performance, with improvements in customer retention resulting in a stable customer base in the second half of the year.

In line with the strategy, we've also seen a significant increase in the number of jobs we've undertaken for customers who do not have a contract with us. We can do that because of the extra capacity created from both improved productivity and our recent recruitment drive, which will continue. Importantly, we're seeing improved revenue per customer, which, given the fixed nature of a large portion of the cost base, will be critical as we continue our journey to get this business back to the range of £100-200m of operating profit over the medium term.

Let me move now to cover the progress we've made in the early stages of building our pipeline of power assets. In addition to around 600MW of operational assets in the UK and Ireland, we've got around 450MW of capacity under construction right now and another 300MW megawatts in the detailed planning stage. This increase includes the addition of new solar and battery projects since July, which are expected to deliver returns consistent with the investment framework that Russell reminded you of earlier. There will be group portfolio benefits on top of that. We're also now evaluating around 2.5GW of early-phase projects for a range of potential options. The assets that we're investing in will deliver high-quality long-term returns for Centrica, and they'll play an important role in the changing energy system in our core markets for decades to come.

But it's not all about these new projects. As you know, we've got some very, very valuable existing assets which can play the dual role of reinforcing the country's resilience and adding value for Centrica shareholders. The assets have finite lives, but we're delighted that we've been able to extend the majority of our assets over the past year, and progress to longer-term net zero options at a number of these assets.

Firstly, if you look at Nuclear, we've already extended the lives of Heysham 1 and Hartlepool so that they will remain operational until March 2026, two years later than previously forecast, and the possibility of further life extensions for the entire fleet is currently being looked at. There are three more reactors in addition to those two. We've also said before that we could consider investing in new nuclear, although I want to reiterate that we will only invest if the risk and the reward balance are right for us as a shareholder.

Then, when you look at Rough, we've doubled the storage capacity, meaning that this now provides enough gas to heat around 10% of UK homes throughout the winter. We've got exclusive use of this asset until 2030. We own 100% of the field, the pipeline, and the terminal, and we have exclusive use until 2030. It's a hugely valuable asset. We stand ready to repurpose this asset into becoming the world's biggest combined methane and hydrogen storage facility, which would bolster the UK's energy security and help to deliver a net zero electricity system. But again, to do this, we've got to see the right regulatory support framework, which would unlock around £2bn of investment and create thousands of UK jobs.

Spirit Energy remains important for the UK. Last year, it produced enough gas to heat a further 10% of UK homes. Although we won't be investing in any new exploration from Spirit, production for the Morecambe Bay gas field is now expected to last into the next decade. Following the granting of the carbon storage licence, Morecambe Bay also has the potential to be one of the UK's biggest carbon hubs, creating thousands of additional jobs in the North of England.

Now, we talk about Morecambe Bay, and we talk about Rough, but it's also worth remembering that we own two of the UK's largest gas processing plants at Easington on the east coast and Barrow on the west coast. Combined, these two plants can process half of the UK's total daily gas demand. Not half of what homes demand, but half of what the UK uses in gas. Gas remains an important part of the UK's energy mix, and these assets, in our view, will continue to play a vital role for years to come. They should be part of a hydrogen future. To that end, we've built nascent production in technologies that could play a key role in helping the transition to net zero in our markets. That includes three hydrogen joint ventures in the UK and in Ireland. At the same time, we're reviewing the potential for Europe's first-ever ammonia-fired power station at the Bord Gáis Energy Whitegate site in Ireland following the announcement in November that we've signed an MOU with Mitsubishi Power Europe to explore this development.

We see a number of these larger projects as potentially in addition to the £600-800m per year capex range as set out as part of our green-focused investment strategy, but we will be disciplined with our balance sheet, and we will not bite off more than we can chew. These projects provide further evidence of just how well-placed Centrica is to create value from the energy transition.

In summary, 2023 was another strong year for Centrica. Our progress has reinforced my confidence that we will deliver against the strategy and the investment case we laid out last July. We're focused on what's important. We're focused on colleagues, we're focused on customers, we're focused on cash. We've got an organisation that is confident but is not complacent. We have a well-balanced portfolio. In short, we're confident of and we're focused on delivering.

That's the end of our presentation. Russell and I will be delighted to take your questions. There are microphones in your seats. Please, if you can take them out and press the button because those online will be able to hear you then. We're going to start in the room. Once we've gone through the room, then we'll go to any questions that we've got online.

We'll go first, Ajay, and then we'll come to Jenny, and then we'll come to you. Hopefully, all the difficult questions are for Russell, or the Chairman, or the leadership team that are here.

<u>Question 1</u>

Ajay Patel, Goldman Sachs
Thanks for the presentation. My one question is around capital allocation. You finished the year '23 with £2.7bn of net cash. Clearly, it looks like the business is set up for further cash generation over '24. If you think about working capital, inventory in gas stores, bills coming down, it should seem that working capital continues to be an inflow over '24 as it stands on the current forward curves. That does point to a lot of cash as a proportion of market cap and relative to the 1x net debt to EBITDA target. How do you think about that? As in, is there going to be an assessment of that? When could we hear about that? Is the steering more towards maybe acquiring to add to your pipeline, or accelerate your investment path, or is it more around capital returns? Just wanting to understand where the weightings lie.

Russell O'Brien, Centrica
Maybe it's good just to stand back and just reflect on the balance sheet in general, the moving parts in Centrica, and the way that I think about it, and certainly the way that we laid it out last summer. The need for the investment grade credit rating is paramount for Centrica. The liquidity draws in this business are massive if things move around. We want to have the liquidity in those moments to be ready to pounce. It's good for the downstream business, good for the optimisation business, and good for the upstream business. As you saw in 2022, when the markets were particularly volatile, we had margin cash out of the business of some £2bn, so those numbers are quite material. We

also want to make sure we've got the capacity to invest in the long term, and we've laid out our plans for that.

As you look at it, we do have a strong balance sheet, and when we have situations where we have surplus capital, we will look at that and judge that some of that can come back to our shareholders. We've got a track record. In '22, we started a share buyback programme that continues through to now. It will be a total of £1bn. We don't have any more updates on that today, but the philosophy is pretty clear. The balance sheet is strong, we've got options, and that's I think the way that we're looking at it today.

Chris O'Shea, Centrica
If I could maybe add to that, I would say that if you cast your mind back to when Scott became the Chair, and then they asked me to be the Chief Exec, we didn't really have any options. We had a balance sheet that was under real pressure, operations that were not in a good state, and so we had to sell stuff. Thankfully, I think we sold well, but that was quite defining for me, which is we want to have options. You talk about would we consider acquisitions to add to the portfolio. I don't mind whether something's an acquisition or whether it's organic; we have exactly the same requirements in terms of the returns that we want to see. There are different risks with organic, there are different risks with acquisition, but what we want to do is to take our time and make sure that we invest this money wisely. It's not burning a hole in our pockets. The team here will tell you they've come recently with investments that we've said no to. We have enough money to fund all of the ideas the team has got, but if they don't meet our return criteria, they're absolutely not going to be invested.

You've seen the liquidation of our asset position over several years because they're naturally declining businesses, whether it's gas production, whether it's nuclear power generation. As we've turned those assets into cash, what we didn't want to do is to get ahead of ourselves and start to invest too quickly. We wanted to stabilise the operations. We wanted to make sure the customer service got in the right place. We wanted to make sure that we could start to grow the business. Once we got to that, then we could turn our eyes towards where do we invest this additional money.

The way I think about it is we had these assets on the balance sheet three or four years ago, which were worth more than they are today, although we've taken steps, I think, to increase the value. We've turned some of that stuff, we're warehousing the cash, and then we'll look where to invest, but if we can't get the right returns, we will not invest. As Russell said, it was very important that we restarted the dividend. It's very important we've increased it. We also really wanted to show that we understand this is shareholders' money that we manage, which is why we've got these capital returns going on. I say, bear with us, give us time, but I think we've got a good use for the money, but if not, then it belongs to the shareholders who will get it back.

<u>Question 2</u>

Jenny Ping, Citi
Two questions, please. Firstly, just following on from Ajay's cash flow question, I was hoping you would help us with the net cash position and how we should think about it through '24. Obviously, we've had a volatile couple of months, but presumably, collateral is unwinding there, and that would give you a decent headroom on the net cash to start off with just based on the two months trading today. Any help there?

Then, just on Sizewell, where are you now in any discussions you're having with government? If you can elaborate on some of your comments that would be great.

Chris O'Shea, Centrica
Let me take the Sizewell question first, and then I'd love to hear the answer because I'm continually asking Russell where the cash is going to end up. Where we are at the moment, there's an ongoing process with Sizewell. We're involved in that process. I can't really say much more than that, other than if the returns are in the right place and they compensate for the risk, then we will certainly consider that as a board. If they're not, then we don't feel the need to be involved in it. If it works, we'd like to be, but if not, there are plenty of other investment opportunities out there. We're looking at lots of things to bring green electrons to our customers. That's what our customers want, we hear that that's what our shareholders want as well, but not at any price. Time will tell. We'll see how that goes. Russell, how much money are we going to have at the end of the year?

Russell O'Brien, Centrica
Nice try. A couple of things as we look at 2024 and think about cash. The margin cash at the end of the year posted was £200m. The end of the previous year was £800m, so that was a £600m benefit in '23, but quite frankly, where that number goes really depends on so many factors – the positions we take, the movements in the markets. I wouldn't want to guide you on the margin cash number in particular. Working capital more generally, though, in a lowering price environment, yes, that should be some release to the company. It's a little bit volatile in the retail business as you look at the payable balances between periods, but if you stand back from that over time, that should be a help. On the other hand, we are committed to ramping up our green-focused investment plan. That was £415m in the year 2023. You should expect to see that growing in 2024. I think that's probably the main moving parts. The rest of it, the cash generation, I've guided to earlier in terms of core performance.

<u>Question 3</u>

Anna Webb, UBS
Two questions from me. Firstly, on the provisions, which were up significantly, you discussed the bad debt charge, which has almost doubled. Can you talk a little bit more

about what you're seeing on debt deterioration? It would be great to hear your thoughts on that.

Then, secondly, on Energy Marketing & Trading, or Centrica Energy as it is now, I appreciate that it's difficult to give guidance in this division given the volatility, but as part of your mid-term guidance, you gave that £250-350m range, and I believe you said that applied in all market conditions. Do you expect 2024 to be already achieving that range, or can you give us any indications there? That would be really helpful.

Chris O'Shea, Centrica
Maybe let me touch on the Centrica Energy one. I think what we said was we expect that in more normalised market conditions. The range is good across the piece, but to be clear, we saw elevated commodity prices in 2022 and very high volatility. I think Cassim, who's sitting here, has the same view. If we saw those same circumstances through a future year, we would expect to make £1.4bn or a bit more. We'd expect to make what we made in 2022. I think we've seen quite a substantial reduction in gas prices in the last two or three months. I think volatility is quite low just now. Storage across Europe looks like it's quite full. We have a rule roughly since the Russian invasion of Ukraine if you exit the winter with 50% storage capacity being full, then you're probably okay for the following winter. If you exit it with less than 25%, you've probably got a problem based on what gas we can import into Europe. I think we're about 70% or something full at the moment, so unless we have an incredibly cold February and March, we think next winter looks okay. We think that the prices will probably remain a bit depressed, and we think volatility should remain low as well because there's an abundance of gas. We wouldn't want to give a profit forecast, but we've obviously gone through our budget-setting cycle for this year, and without disclosing too much, I'd be very disappointed if we weren't in that range, but we've really got to see how the market transpires. You've got three parts to that business, and they're not all completely correlated. You've got some compensation there in the LNG business, the gas and power trading, and the renewable energy trading business.

The second one, Russell, bad debts, how are people going to pay us? When are they going to pay us, sorry?

Russell O'Brien, Centrica
Thanks for asking the question about bad debts because that is a big movement through the year. £584m was the provision in total across all of the businesses in the year, up from £342m, so that's a big move up. A lot of that we saw when we did the interims as well. Interesting, if you look at it as a percentage of revenue, that's gone from 2.6% for British Gas Energy up to 3.9% in the year, so there are multiple different factors there. You've got a challenging cost of living crisis, high bills and, of course, in the second half of the year for a lot of our customers we didn't have the government support scheme help as well so that also was a bit of a drag in the second half. But as you look into 2024, of course, bills are coming down naturally with the pricing

environment, and that should be a help. As we sit today, we're hoping for our customers and for the business that we do see a bit of an improvement in the bad debt charge, but it's very early in 2024 to give anything more than that, but that's the general trends.

<u>Question 4</u>

Ahmed Farman, Jefferies
A few questions from my side. Firstly, on slide 17, it seems like you're migrating customers to a new platform that's going through very well, but when can we start to see the benefit of that in terms of cost per residential energy customer? Could this already start to come through in 2024? Then, how should we think about that in the context of the margin?

Secondly, you talked about how gas prices and power prices have come down a lot, and this will bring down the energy bill over time, but what does that mean for the underlying competitive dynamics and customer churn in the business?

Then, finally, just taking the same thing to the £800m medium-term guidance, which you are obviously reaffirming today, I'm just wondering whether the commodity price background, the volatility, are there any moving parts around it, or is it the case that the guidance was actually quite conservatively structured in the first place?

Chris O'Shea, Centrica
Let me have a go at that, and then Russell will probably come in when I get my numbers wrong. The guidance that we gave – remember, we've got a balanced portfolio and that guidance excludes infrastructure, so that's for the core retail and optimisation businesses. There will be ups and downs and puts and takes in that, but we think the guidance still holds quite well.

In terms of what would be the impact of lower gas and power prices on competitive dynamics and churn. I think everybody assumes that when prices come down, churn is going to go up, and there will be lots more price competition. I don't really think that's the case because, if you think about it, you have got more profit, marginally more, but if you're on a margin of 2-2.4%, the number that Ofgem allows us, if you've got a £2,000 energy bill, you've got more profit to play with than if you've got a £1,000 energy bill, so arguably, you've got more prospect of price competition at the higher levels than you have at the lower levels.

What we had over the last three or four years was a complete illusion of competition. We had people that came into our market, they paid £420 to get a licence, they didn't have to demonstrate any financial resilience, and they got a free bet. If you had this very, very odd situation, which we did, which is the market was effectively in contango, showing higher prices out, but the curve shifted, so the within-day prices were always quite low. If you didn't hedge, you could make decent money, and you could afford to have all this price competition, but then when actually the curve stopped shifting out, and we started travelling along the curve, all of a sudden, I think as Warren Buffett said, when the tide goes out you find out who's been swimming with no shorts on, and we found out 30 energy companies had no financial resilience at all.

We have seen a little bit of an increase in customer churn, and we have launched a fantastic product last week. If you're not on it, you should be. Price Promise. £1,699 for the average UK home. Guaranteed to be lower than the upcoming price cap announcement, and it's fixed for a year. No penalties if you transfer to another British Gas tariff. Catherine's sitting here, she can get you signed up people outside. But we did that because we saw in the market an opportunity. Cassim's team are in the market always looking to see how can we buy energy well, and they go out and see we've got an opportunity to buy a big chunk of gas and electricity, they're talking to Catherine's team every day and saying, do you think you can get a product there? It's a multi-bi-directional conversation. That's what we're trying to do for our customers.

But if you look at the investment we're making in customer service, I think, actually, we will see probably less of the price competition that we saw in previous years, which is just these irresponsible people in the market. If we see that again, Ofgem are completely failing in their job. What we will see is more competition for companies. How well do you buy energy? We buy energy very well. I think we've got probably the best energy procurement function in the entire market. That means that we should be able to provide our customers with better prices.

But the big thing that customers are really looking for is a service. That's why we've invested quite a substantial amount of money in service. You see that our average speed to answer is down a minute over a two-year period, despite customer contacts being up by more than 5m, which is really quite a testament to the work that the team are doing to drive the operational improvements. The Trustpilot score is important. It's gone to four. We want to get that higher. Our customer service is not the best in the market. It's mid-table, maybe second quartile. We want to be number one in the market, so we have got a long way to go on the customer service. If you get all of that right, then you'll find your cost per customer will be one of the leading costs per customer.

Now, what we've seen is that with inflation – what we don't know the result just now is inflation going through the general economy is what is the most competitive cost per customer. We don't know that at the moment. Ofgem's recent decision to require every energy company that has got more than 50,000 customers to do the consolidated segmental statement means that they've all got to disclose all of the information that we disclose, so we will be able to do proper benchmarking across different companies. What we want to make sure is we want to be the best. It's going to take us some time to get there. We want to be the best in customer service. We want to be the best in cost per customer. We want to have a bigger market share. That means that we grow our profits, which means our customers will save more money.

The cost per customer is down, I think, if you look just now, excluding the dual run cost. We strip out bad debts because that moves up and down. It can be quite substantial depending on the economy. It's down from 97 in 2019 to 80 in 2023. Now, what we won't do is chase blindly a cost per customer number because that can then damage your customer service. I think that's what we were doing in the past. I think we were focused purely on cost. We're focusing on margin. What margin can we make from our customers? There are many different parts to that. How well can Cassim buy the energy? How well can Catherine run the energy business? How well can the commercial director grow the customer numbers so that you've got this brilliant thing of buying energy better, running the operations more efficiently, more customers coming in, spread your fixed cost base, and then offer your customers discounts, but we're focused more on the margin rather than just blindly chasing a cost number.

Hopefully, that answers that question. I don't know, Russell, if I got any of the numbers wrong if you could help me on that.

Russell O'Brien, Centrica
No, that's right. In 2024, specifically, you should continue to see some investment in the dual running costs and in the customers. That will continue for a bit longer. That's a spend that we're happy to do. I have to say, underneath that, there's no shortage of cost discipline in this business. This is a margin game. Every day, we are trying to chase down efficiencies across the portfolio. The trend here really is just investing in ensuring the longer-term growth of the business.

Then, you referenced the £800m guidance – the medium-term guidance. I wouldn't say that was conservative guidance. I would say that's appropriate guidance, but as Chris said, that's a number at more normal market situations that we guide to.

<u>Question 5</u>

Dominic Nash, Barclays
A couple of questions from me. The first one is that we are likely entering an election year, maybe the end of this year, who knows? But this is the time when I suspect that energy policy will start to crystallise in the manifestos and in the Labour Party. I'll be keen to hear your point of view on what you would like to see coming up in the debate with the speed of the net zero targets, i.e., the gas boilers versus heat pumps, security of supply, and the GB Energy and the £28bn. Overall, your view on the current Labour policies and where you think they should evolve to.

The second question is going back to Retail. Can you just quickly remind me again on the latest on the market stabilisation methodology and whether that's going to be impacting on your churn rate? Is that being extended?

Finally, on your bad debts, can you remind me again what the level allowed is, and if there's a structural increase, how does it work for remuneration over the whole industry?

Chris O'Shea, Centrica
I'll leave the election one to the end because that's probably the most difficult one. Bad debts, I can't remember the exact amount, but I know we've got an extra £16 per customer coming in for most of 2024. Not all of it, I think, but ultimately, there's a bit of a lag working through, so if everybody sees heightened bad debts in 2024, then you'd expect to recover some of that in 2025. I don't know if you know the exact rate, Russell, but it moves about.

Russell O'Brien, Centrica
No, but we expect, yeah.

Chris O'Shea, Centrica
I think the market stabilisation charge ends at the end of March. It's not really in effect. I think at the moment, if you were taking customers, you wouldn't be paying it because you've got to have like a certain price drop mechanism. We don't think it will be extended. I think Ofgem have been quite clear it won't be extended. They're to be applauded for bringing it in, and I'm sure if we saw the same market conditions in the future, they will consider bringing that in, but we don't think it will be extended. We don't think it's going to be needed.

Look, on the election, what we would like more than ever, what we look for is stability. Stability in policy and no real surprises. We look for partnership with whoever is the government of the day. There will always be a lot of speculation, I think, about energy policy, but it probably doesn't help for us to add to any of that speculation. We just want to have a constructive dialogue with the government of the day. We want to be able to make the case for our customers and then work with the government and the regulator to go on. But we definitely will have an election by early January at the latest next year.

Dominic Nash, Barclays
Can I just pin you down on one area then on that one, which is a non-answer, but the debate over heat pumps versus gas boilers, for example, clearly impacts your business. What's your view on whether the heat pumps will be coming and gas boilers will be phased out?

Chris O'Shea, Centrica
You could look at this and say we're a boiler business and therefore heat pumps are a threat. Actually, we installed I think 5% – we've got 5% of the UK's heat pump markets. We did about 3,300 last year. The majority of them were in the social housing space or in the not-able-to-pay market we do through our ECO obligation. The way I look at this business is we are the biggest installer and service of heating systems in the UK. 85% of

homes in the UK are on the gas grid, and they use gas boilers. The majority of the rest of them are off like my house is off the gas grid, but I've got a gas boiler; it's just an LPG boiler. We've always said that the pace of the energy transition is we will do well no matter what the pace is. If it really heats up and everybody is installing a heat pump, we have the largest workforce in the UK on this, where they are the best workforce, they're the most productive, they're the safest workforce. We were looking at the stats for that this week. I would expect us to grab a large part of that market. We have a new business unit under Dan, who's sitting here, net zero, looking specifically at that. Heat pumps, EV charge points, etc. If that goes quick, I would expect that we would be in there. If it doesn't, we will continue to install and service boilers.

The great unknown is whether hydrogen will actually be in the energy mix as we go forward – sorry, it will definitely be in the energy mix, will it just be as a store for electricity, or will it be to heat people's homes? I don't know. We want what's best for our customers. If all of our customers going to heat pumps is what's best, then we'll make sure all of our people can install and service heat pumps and that will be our business going forward. We actually think a mix of technologies are required, so I think that what should be there is a huge increase in heat pumps and a huge increase in hydrogen boilers, and then you'll get decarbonisation. But we want what's right for our customers.

There's a lot more heat than light in this debate if you'll excuse the pun. There's a lot of very, very entrenched views. People will say, you can't use a heat pump in the north of Scotland because it's very cold, and somebody will say, well, Scandinavia, they've all got heat pumps, so how does that work? They all happen to have wood-burning stoves as well to get the boost of heat that's required. But we don't really get involved in that debate. What we say is, look, what level of insulation? What's the cost to run the thing? What's the cost to install the thing? Is there a nuisance value, and then how do we work with that?

What we have found is that the bit that people are massively underestimating is the attitude of consumers. Everybody is trying to figure out how to do this to consumers, and what we're trying to figure out is how to do this with consumers. We know, for example, when our heating sales advisors go to a house, we say, look, actually, we can do a heat pump, we can do a boiler, and we just tell them what we think is the right thing for them. A lot of people are put off by the fabric disruption that's required to install a heat pump. Obviously, we have to overcome that at some point, but there are too many people telling consumers what's good for them.

We'll work with the government of the day. We maintain good relations with the government and with the opposition. We feed into them what we think. They listen. Do they always act? Well, no, because lots of people are feeding in what they think. I'm not worried about this pace of change at all. We install about 100,000 heating systems a year. We service 2.9m customers. 2.8m customers on contract. I would like us to be installing more than 100,000 heating systems, I would like us to have millions more customers on contract, and I'd like us to grow materially our on-demand business. Heat pumps or boilers, it really doesn't matter to us. It just matters what's right for the customer.

<u>Question 6</u>

Pavan Mahbubani, J.P. Morgan
Thank you for the presentation and for taking my questions. Firstly, on LNG, you've given in the past on the Sabine Pass volumes that you were sold forward on average at a profit for the next couple of years. Can you remind us if that's still the case or what the latest position is? Any colour on that, please?

Secondly, on the Services business, can you give a bit more detail on what drove the improvements year-on-year in terms of underlying or growth in on-demand? What we should expect to see driving the further improvements in 2024. What I'm getting at is, are we past the low-hanging fruit, or do you have strong visibility on what's going to drive the improvements this year and then into your medium-term guide?

My last question is, how much of your net cash balance relates to customer advances or the prepayments in the British Gas Energy segment, please?

Chris O'Shea, Centrica
I promise you, if you were sitting next to Jana and you mentioned about the low-hanging fruit, she'd probably have your guts for garters. Look, on Services, it's been an immense job over the past couple of years to get – there is more operational control in that business than I've seen in my time in Centrica and probably for quite a bit of time before that. It has been this systematic programme of fixing things, which has meant that sometimes there are some things – I'm naturally impatient. I want everything to happen yesterday. I want us to have 50% market share yesterday, but you have to take your time and make sure you fix these things in order. There's been a really huge focus on that. We've seen that continue into the early part of 2024.

Across all the businesses, the operational improvements are there. What that's meant, in the same way that with the assets we focused on fixing the business, we were liquidating assets and building up cash. We focused on getting the operational foundations right so that we can grow. This year should be a year of growth. Now, how do you see the improvements coming through? A large part of that cost base is fixed, but not all of it. Even the labour force is semi-fixed. We've got some contractors who do some peak shaving, but it's semi-fixed, and one of the debates we have is, do you recruit ahead of demand, or do you get the demand ahead of recruitment? I think you probably have to recruit ahead of demand, but what that does is it introduces a risk, which is that you have a bit of a dip in your profits. I don't think the growth in this business will necessarily be linear. But what we've done is to reestablish the fact that we're there when our customers need us.

We're trialling something just now, which is what we call a customer promise. If you call us by 11:00 in the day, we'll be there same day. If you've got no heating or hot water, we'll be there same day. We're achieving that in about 90% of cases. It gives you an idea of how we're running this business differently. In the past, we would have gone out and announced that without any idea how we could do it and then customers would be upset. What we've done is we're trialling it ourselves over winter to see whether we can do it. Now, we think we probably can. I think if you think about how this business grows. What happens is we see that we can do it, so we go out to customers and say, we'll give you this in 90% of cases. Then, maybe what we do is we also demonstrate just how long you have to wait for a standard plumber if you don't have a contract. We think if we do that and we satisfy our customers, then we'll attract more customers to our contract portfolio. We'll need to recruit more engineers, so we'll have more capacity that we can use for on-demand. The more we get on-demand, the more we recruit, and so you get this virtuous circle. I think the growth is in on-demand and in the contract customers.

I don't think there was low-hanging fruit, to be honest; I think it's been a real bit of heavy lifting. If you think about the fact we only supply 10% of UK homes with Services. We used to talk about having a 55% market share, and we do. 8m homes in the UK buy this contract product. We've got just under 40% market share in terms of the number of people that buy it, but a lot of them are people paying 250 through some other utility company to not get very much cover. Ours pay for a full-fat product. By value, we have just north of 50% of the market where people buy contract services. For years, we told ourselves that was really good. We couldn't figure out why, with 55% of that market, we only installed about 8% of the UK's boilers. But when you break it down, we only service about 10% of UK homes. We only really sell boilers to our own customers. It's all dead obvious. When you flip it on your head and say to the team, how do you feel when you've got a 10% market share in a market that is completely and utterly fragmented? There is only one other national player, and we think we are far better than them, so the opportunities there are absolutely massive.

Then, your last point on LNG, we have sold forward some of this stuff. We have sold it forward at a profit. I don't think we give that guidance anymore. I'm not sure. But I don't know exactly everything we've got in the results. Do we give any of that guidance out?

Russell O'Brien, Centrica
No, but just to report what we said before, we try and hedge two to three years out, so certainly, as you look at '24 and '25, a lot of that's hedged, and part of 2026. We traded 260 cargoes last year, so a solid performance on the physical side. When you add in financial cargoes, 326 was the number there. The reason I'm saying that is the LNG business is not just about Sabine; there are lots of other moving parts there that drive the profitability. You also asked about customer deposits. At the end of the year, that

was approximately £1bn held by us. You've got to see that in the round, though. That's effectively accelerated payments for energy that we will provide in the future. We've also got money owed to us by customers as well, so you have to look at that number in the context of the overall working capital position, but that's the number.

<u>Question 7</u>

Harrison Williams, Morgan Stanley
Two from me. Firstly, just on the Rough investment to potentially convert that to hydrogen. This is something you've been talking about for a little while, and I realise it is a longer-term investment, but can you remind us of the potential timeline here to first hear about when that capital could be deployed?

Secondly, in terms of your flex or green investments that you're making, in light of the recent power price move, can you talk about has the order of preference within technologies or geographies shifted a little bit there? I know you've made some recent investments into Europe into new geographies, so I'm just interested in your commentary there.

Chris O'Shea, Centrica
Rough, probably from getting the right regulatory framework in place, we're probably, I would say, three to four years from having the thing up and running. Could do it quicker, but the concept that we've got is what we'll do is build a brand new platform, a brand new pipeline, and probably, to a great extent, a new terminal. We've bought land so that we've got the ability to do that. We just have to have the right framework. I would point out we like owning 100% of this asset. We like having control of this asset. We don't feel the need to invest the full £2bn of our own money. We'll have the option to do that, but we won't have the requirement. That is eminently fundable whether we look to bring in a joint venture partner to the infrastructure ownership or whether we look to bring in some project finance. When we talk about the £2bn, we don't automatically assume it's our own money. We want to make sure we have far more investment opportunities than we have cashed it to invest. But it just will take a little bit of time to get the right framework.

In terms of the green investments, when you say order of preference, do you mean which countries we go into? Is that the question?

Harrison Williams, Morgan Stanley
Yeah, the countries, and maybe if anything on technology as well.

Chris O'Shea, Centrica
We're technology agnostic. What we want is the right technology. We're looking at some innovative battery technology. We're looking at standard battery technology. We're looking at ammonia-fired power stations. We're looking at green hydrogen, blue hydrogen. Although it sounds like there's a lot of stuff we're doing, we're quite focused

on making sure that we get the right technology for the right place. We're building a battery in Belgium because we are already Belgium's biggest battery optimiser. We optimise more batteries in the Belgian grid than anybody else. The team that writes our battery software is based in Antwerp, so we thought it makes sense for us to put our capital there if we want.

We looked at some stuff in Scandinavia as well because a big part of Cassim's team is based in Denmark, so we know the Scandi power market incredibly well. What we're not looking to do is to just pick random countries. We will invest in places that we already have a presence and a deep understanding. I would look at the thing in Belgium as being – we don't look at France or Germany and think, how do we get in there? We look and say we've got a really good position if we've got the option to deploy our own capital. The UK is still a strong place for us to invest. Ireland is a strong place for us to invest. But it doesn't matter what country we're in, we're always measuring the risks that we're taking, and we're looking at the returns that we're getting. If we get a better risk-return balance in one country over another and we feel that we can actually do business in that country, then we'll do that, but I wouldn't want to get back to the point where we've got power assets in 15 different countries. It just gives you hassle that you just don't need. I imagine that to be quite concentrated, I think.

Question 8

Chris Moore, Carbon Tracker
Thank you for the presentation. I was interested in your comments before about heat pumps and hydrogen. I think you used to have a target for 28% reduction of scope 3 emissions by 2030 versus 2019. Can you just bring us up to date on how you're getting on with that target, especially in view of the volatility in markets we've seen in the last couple of years?

Chris O'Shea, Centrica
The scope 3 emissions, we've still got the target, but in reality, it requires action that we're not in control over. I would compare it to our target to electrify our fleet. I think I made a commitment a few years ago to say we wouldn't buy another internal combustion engine vehicle; we'd go all electric. We made the UK's two largest orders for electric vans, which felt good at the time. We've now got a lot of electric vans that we can't deploy because our engineers don't have driveways, and the rollout of a public charging network has been woefully slow.

We are committed to all of the targets that we've got, but our ability to deliver things like scope 3 emission reductions is quite limited. If you look at the moment, I think, on average, people that install heat pumps have been getting grants of up to £10,000, which would give us a £280bn bill to convert the entire UK housing stock to heat pumps. I just don't think that's going to happen. This is one of the reasons that we have been pushing hydrogen as a heating source – not because we don't own any of the gas infrastructure, but we think that's the best way to get to decarbonisation of the heating system.

But if you see a major slowdown, so if, for example, there's no support for heat pumps, they're not affordable, people don't want them, and there's no move to hydrogen heating homes, then I don't think there's any way that we're able to hit our scope 3 emission reduction targets. We do see demand destruction low single digits year-on-year and that's not just because the prices are elevated. That's happened over the last four or five years, but that in and of itself will not be enough to get us to that target. But what we don't want to do is to walk away from the target. We want to continue to press our case, to press our customers' case, to say what's needed in order to achieve the targets that we've set.

<u>Question 9</u>

Bartek Kubicki, Société Générale
Thank you for taking my questions. Maybe two topics to discuss. Firstly, your gas book in the context of what you said – lower volatility, lower prices, and from three perspectives. If you look at your gas production and your hedging levels at the end of last year and at the end of the first half of last year, there's only a small increase of volumes hedged. Question is whether you were more cautious, more bullish, or simply production will decrease significantly in '24 versus '23 in Spirit Energy.

Secondly, also low volatility, low prices, low spreads. How do you think the gas storage business will play out with your fixed costs and low spreads? Whether you can break even or it's not a good time to break even.

Also, on your gas book on LNG, if we look from a mid-term perspective behind your hedging profile, there will probably be a lot of LNG gas coming from Qatar. Question is whether you think LNG trading will be still profitable, or for some time simply will be too much gas on the market.

Consequently, also on the LNG, I would like to ask you what's your view on the difference between Henry Hub and European gas? Whether you think it could converge more, or the margins will remain, excluding regasification and transportation.

That's the first thing and second thing, if I may, on your…

Chris O'Shea, Centrica
That's the first question? My word, that's a long question!

Bartek Kubicki, Société Générale
It was the first topic, sorry. First topic, and now the second topic on the business energy. Do you think those profits and those margins you've made are sustainable? Is

there a case for a margin improvement, or there is no case for margin improvement, and they will decrease to levels we saw years ago?

Chris O'Shea, Centrica
Taking the last bit first, I think the margins are healthy in there. We've got to be careful that we're always focused on how do we give customers what they want at a price that they're willing to pay. I'd like to focus more on growing that business than necessarily on expanding the margins because if you expand the margins too much, you do one of two things – you attract competitors into the market, or you piss your customers off, and they go somewhere else. We've got to be very careful that we don't get lazy and simply look for margin expansion. I think growth is the engine that will drive all of our businesses.

On the gas, there are a number of questions in there. On the LNG mid-term, do we think it will be profitable? We do, but who knows? The spread between Henry Hub and European gas prices, you've got to think that will stay quite wide or widen more if Biden's ban on future LNG exports from the US sticks because what you'll have is this captive US market with, I don't know, the 30m tonnes or something they're exporting from the US just now. They could go up to 60, 70, 80m tonnes. If they decide not to, then you'll have this gas island, which will be priced under Henry Hub, and you'll have this European network, which will be priced off TTF and NDP. There are some big ifs in there, but the way that it looks right now, you'd expect that you'll probably see – I mean, maintenance of that margin. I don't think it will necessarily converge.

How much LNG Qatar bring on. You've also got to overlay. If you think about yourself. You are the Qataris with all of this gas. If you think the speed of the energy transition is actually going quicker, you've got an incentive to get your gas out of the ground because you might have a stranded asset. If you think the speed of the energy transition is going slower, you've got an incentive to maintain price discipline. Like anything to do with the global energy market, it's multi-dimensional. It's like a 10-dimensional chess game or something, and so you can't just look at two separate dimensions. I think that the Qataris will be making a judgement as to how quickly the pace of change is going. If I was in their shoes and I thought that electrification was not going to go as quickly, I wouldn't be trying to get my gas out of the ground as quickly as possible. If I thought it was all going to be electrified by 2040, I wouldn't care about price, I would just be trying to flood the market with gas. A, to monetise the asset that I've got, but B, lower prices could discourage electrification. There are so many things you've got to look at there.

The gas storage business – it costs us about £100m to operate the Rough field and facility. We're obviously always looking at ways to reduce that, but could you get to the point where the spreads are so low that it becomes not profitable? You could. But you've got to remember that it's not just looking and saying what's the spread forecast over the next 18 months? You change your nominations, I think, three times in a single day, so our team today will be looking. We might be injecting in the morning, doing nothing in the afternoon, and withdrawing at night. When you've got these short-term spikes in volatility, when you've got the UK's biggest gas storage facility – we're the only energy company with a big storeroom. If I think about it, if in Catherine's business we find we've bought too much, it's a bit warm, what do we do with the gas? Everyone else has to sell it on the market, and to follow the market, we can put it into our storeroom. This is the integrated nature of our business. It's the beauty. We can put it in, and we can sell it forward.

But the worry is if you see spreads on the market being very flat over the next 10, 15, 20 years, you find it very difficult to make an investment case to put £2bn into redeveloping this asset. Yet, if you know you're going to have this volatility, and the other question is, how do you value that option? That's why the conversations with the government take quite some time because they will maybe look and say, well, you're making money from it, just invest yourself. And we say any rational investor will not invest in a long-term storage project. When you're having that conversation between two commercial enterprises, that's difficult. When it's a commercial enterprise and the civil service, the order of difficulty increases substantially. We continue to have, I think, very constructive conversations, but it takes time on this.

With Rough having been closed before, I'd be really surprised if we saw it getting closed again because the public interest – when I told the team that runs it, almost every politician in the UK knows Rough is a gas – they have no idea what it is, but they know that it's a gas storage facility because there was a huge controversy over it closing. I think if we got to that situation, that might speed up the regulatory process.

Your last point on the hedging. Russell will be able to tell you the volumes, but remember, our production is declining. We have a rateable hedging strategy. We don't look and say, the market looks really good; let's hedge all of this volume. I think it's 75% – I don't know if we've changed that number – over 24 or 30 or 36 months, so we just put out 2.5% every month. We will look at that periodically and might make a change because we want to change the risk management but we don't want the management in Spirit to be deciding whether the gas price looks good or not. We want them to focus on producing as efficiently as they can. We use hedging to de-risk, but you would naturally see the absolute volumes dropping off because year-on-year, you're losing between 7-10% of your production.

Russell O'Brien, Centrica
Yeah, no real change in the philosophy on the Spirit hedging. So 443mmth for '24. 174p. You can see it on page 32. I think if you're thinking it was a change, the philosophy is broadly the same, and of course, we adjust it through time for various factors. Chris, there was another question about the margin improvement in retail.

Chris O'Shea, Centrica
Yeah, I think I said at the start we don't expect it to go out. Yeah, thank you.

Do we have any questions online? It's funny, one of the bits of feedback we get is our results presentation is too long, so we kept it really short, but the Q&A has gone on for quite a bit of time, hasn't it? Which is good. This is the good part.

Question 10

Harry Wyburd, BNP Paribas Exane
I'll keep these two questions very quick. Firstly, I wanted to ask on your net finance costs. If I've done my maths right, I think you had a very small net finance cost in the second half, but obviously, on a very high cash balance, so I wondered at what point would you expect your finance cost line to become finance income? I guess consensus has that other cost quite far out and that could be quite material as an upside to consensus if you were earning a good rate on your £2.7bn of cash.

The second one is on share buyback. Should we expect there is a chance that you might once again renew or add to your share buyback programme when we get to July this year, especially given how good your cash balance was at year end? On that, given that we're ahead of an election and the political landscape might make capital returns a little bit more problematic after the election, potentially, do you see July as potentially one of the last chances to launch something big in terms of shareholder returns?

Chris O'Shea, Centrica
Thank you very much. Let me take the last question first, and then I'm sure Russell will tell you about the net finance costs. I never thought actually we'd have a net finance income.

I was asked by an investor in the US, I think last year on a roadshow, were we worried about the prospect of a Labour government because of the prospect of windfall taxes. I said, well, since 1982, the UK has had seven windfall taxes – two under a Labour government and five under a Conservative government. Logically, if you looked at a change of government and said, who should you be worried about as a taxpayer? You should be worried about a Conservative government. The reason I share that is because we're led by the data and we're led by what actually happens rather than by people assuming that certain governments will do certain things.

We have seen, and everybody here probably has seen or heard of, there's been quite what people would call the charm offensive or something by Labour towards business. They've certainly been trying to engage and to emphasise that they are pro-business. The truth will be in the pudding as to whatever government is in power. I don't think that you've got a chance in July, and then you'll have no chance at all. I think any government that says shareholders can't get a return is hardly going to make this a welcome place for investment. I think that what every party realises is that we need foreign direct investment in the UK. I'm not sure that I would be that worried about it.

That said, on share buybacks, we're in the middle of a share buyback programme just now. As I said earlier on, very, very important for us to demonstrate to shareholders that we understand that we manage their money, and we manage it to get a return. I would say, give us time. Let us get to the end of the current share buyback programme. Let us progress the very exciting investment opportunities that we've got. Also, bear in mind the point that Russell often makes both publicly and to me privately, which is we've got to maintain quite a bit of liquidity to deal with volatility in the markets.

Again, if you think very early on, I mentioned when Scott became our chair, we had very limited room for manoeuvre. I think in August 2022, we saw £2-3bn go out in margin calls. Now, that was a bit of a pain in the neck, but it didn't really cause us to have to think about which parts of the family silver we were going to have to sell. Other companies did. Companies you would be very surprised at actually because we have trading relationships with a lot of them, and some of the phone calls we were getting actually would surprise you. But we took that in our stride because we made sure that we had the financial flexibility to be in control of our own destiny. I would just bear all of that in mind when you look at our cash position. I'm hopeful that we've got investment opportunities, but the key thing to take away is we are super focused on returns and the returns compensating for the risks. If we don't have projects that give us the right returns, we will not invest that money.

Russell, when are we going to have interest income? What rate are you getting at the bank?

Russell O'Brien, Centrica
It depends on a number of factors, Chris. Yeah, so it's a good question. At the end of the year, of course, we had £6.1bn worth of cash and £3.4bn worth of gross debt. The interest income, the average rate was 4.5%, but the interest cost on the debt was 8.38% because you've got to remember we've got quite a large debt stack and quite a lot of relatively expensive bonds in there. Then, of course, you're right, as you get to the end of the year, the interest cost of £286m was just slightly above the interest income of £267m. Depending on how rates play out, you could see interest net as an income. The other thing to bear in mind, though, is that the debt stack, the bond repayments, are 50% fixed, 50% floating, so it's not a direct read-through as the cash comes up straight through to that. We'll keep an eye on it, but that's the moving parts.

<u>Question 11</u>

Deepa Venkateswaran, Bernstein
I will take the last question. I wanted to understand in terms of your new investments, you are planning investments in peakers and batteries, and I noticed that you've done a small impairment as well. In the current market, with lower volatility, does that impact your view on the economics of these battery and flexible projects, or are they rather

driven by the volatility that comes from intermittent renewables and, therefore, kind of unrelated to low volatility in the power and gas markets?

Chris O'Shea, Centrica
Brilliant question. We've taken a long time to build a balanced portfolio, and you will get points where we have an abundance of wind and solar power, prices are low, volatility is low; therefore, our flexible assets will make less profit, but our retail business makes more profit, and the bad debt charge goes down because the costs go down, and the customers don't have such demand on their cash. We will have years where the assets don't do particularly well, but we would expect to do better in the portfolio. I think you see that if you look at the profit mix in '23 versus '22. The only thing I can guarantee you is the profit mix in '24 will be different to that we've seen. We've got, I think, a lot of compensation in the portfolio.

What I would say is that we invest in these things for the long term. I hate any form of impairment at all, but in this business, you'll see impairments one year, and you'll write them back the following year, so we're investing in the long term. I think what you might see as we go forward is, and what we've got, for example, in Ireland, for the peakers we're building is capacity market contracts. I think we will see more and more income for flexible generation storage assets coming from capacity markets because I think more and more we'll find, and even for very large scale thermal generation plants, more and more we'll find that these plants will be on standby, and therefore, unless you have very large capacity market payments, you simply will not keep these things on standby.

What we also have to see, and we'll see this, I think, with the new electricity system operator, is they have to change their merit order. At the moment, it's easier for them to call one coal-fired power plant and ask them to go on than it is to call 10 gas-fired plants. We have had some of our gas generation in the UK sitting idle when we've been burning coal. Now, that cannot continue. We have to get away from this old-fashioned pick up the phone from the control room, who do you call? Do you call 10 other Gregs, or do you call whoever it is that's running the coal plant? At the moment, they call the coal plant. I think there are other options there, but there will be volatile earnings there, but we look long term on this.

The way I think about it is our electricity markets cannot operate without backup thermal generation and without batteries. It's just not possible. The only way that these assets will not make a return is if we accept the fact that we'll have load shedding in the power markets. We'll be like South Africa. We'll have a few hours a day where maybe the lights don't go on. I just don't think that's feasible for a country like the UK, for a country like Ireland, a country like Belgium. I think we'll see good years and bad years in the asset business.

Closing remarks

Chris O'Shea, Centrica

Look, just to say thank you very much for coming. We look forward to seeing you all in July. The thing to take away is we are super focused on delivering. We are confident, and I think even more confident now in our ability to deliver the strategy that we laid out in July. You'll see that more and more if you see some of the tariff offerings that we've got, some of the service offerings that we've got. You should all have your Team GB and Paralympics GB bottles. Some of the things that we're doing to promote the brand more. These are all things that we have not been doing over the past several years because we haven't been confident enough in the offering that we've got as we fix the operational issues. We now are far more confident in what we've got, but we are not complacent. Hopefully, we'll see you in July with even better operational results and the financial results flowing through from that. Thank you.

END OF TRANSCRIPT