

Iain Conn - Strategic Review

Group Overview

So this strategic review was a fundamental assessment of the company strategy and where we want to take the business. Why did we embark upon it? Well it isn't just because I arrived; it was actually because the circumstances at the beginning of the year were very difficult, following the fall in oil and gas prices, lower prospects from the capacity market in power and we really had to answer some questions about whether the strategy we had and the mix of businesses we had was still the right one going forward. We also had cut the dividend, having cut capital back in February and that was a further reason why we needed for our shareholders to make sure that we were able to say yes, here is the strategic direction for the next phase with some confidence and certainty.

Strategic Review Conclusions

At the highest level the outcome of the strategic review is as follows; we have concluded that that Centrica is a customer facing business and we are an energy and services company. That has been our role, since 1812, over 200 years and our purpose is to deliver energy and services to satisfy the changing need of our customers. Everything we do must focus on providing energy and services for that purpose. That includes: the securing of energy and the optimisation of it, but most importantly it means going to market in the right way with the right offerings to win over and maintain those customers. That is what we are all about; it is what we are good at, it's what we are known for, it is where we believe we can make the biggest difference.

Potential for Growth

The second thing that we have had to address is, can Centrica grow? And we believe that it is possible to grow this company. And by grow, I mean by operating cash flow over time so that we can fund things, including distributions to our shareholders. And we believe we can deliver returns and growth. Growth won't be easy, but we think it is absolutely possible and we have done a lot of work to underpin that.

Focus on Customer Facing Business

How are we going to that? Well, the third big conclusion is that we are going to focus more on the customer facing businesses and particularly 5 areas: Energy supply; energy services; distributed energy and power; the connected home; and energy marketing and trading. And we are going to divert 1.5 billion pounds of additional resources into these areas over the next 5 years.

Energy Supply, Services and Marketing

So first of all these 5 growth areas that we are talking about: 3 of them are known to everyone; energy supply is actually the anchor business that generates a lot of our cash flow. Starting from where we start in the UK, it is not going to be that easy to grow it, but we can grow other geographies and we have great plans for improving the offer and the efficiency of the way we go to

market so that we can offset decline and energy efficiency and so hold the business flat. The energy services business, where we have engineers and technicians going into people's homes. We believe that business can grow; we've got new sectors that we plan to go into, and we have got new offers that we are developing to play to play into all of our existing customers segments. And the energy marketing and trading business is one we have had for a long time, we optimise our own business but we are increasingly entering into new areas such as route to market services and risk management for our customers.

Distributed Energy

So what about these 2 new areas: distributed energy; and power and connected home. Firstly, distributed energy is a trend. There is a fundamental trend towards optimisation of energy and generation of energy behind the customer meter i.e. local generation at a business site and optimisation of their management system for their energy so that they can use less and when they use it they can use it at the cheapest times of the day. In a nutshell, that is what distributed energy and generation is all about and we are going to be establishing a new unit combining our existing power time with our existing distributed energy team to create international capability to pursue that growing market.

Connected home

In connected home, we have made a significant start already with some things that are more well known to people like the Hive thermostat that is remotely controlled. But we have also introduced a new range of products, including Hive 2.0 and new devices to help people control other aspects of their home environment. The internet of things is a trend also; it is a really big trend that is global. And we believe from the platform we have created, we can deliver new offers to bundle with our existing services and offers to our customers, as well as new ones, that could be new products in their own right generating new revenue streams for the company.

Reduced Scale Upstream

The 4th thing that we have concluded is that we are going to limit the scale and investment into and exploration and production and central power generation. That actually means limiting the scale of the E&P business and it means taking about £1.5 billion out of these businesses in terms of their plans over the next 5 years.

Cost Efficiencies & Financial Framework

Finally, 2 other things, we are going to drive a significant efficiency programme to make sure that Centrica is really leveraging its international scope and scale, so that we can win for those customers and we can win for our people and for our shareholders. That efficiency programme will be painful and it will take some time and it will have job implications. The last part of the conclusions is that we must operate the company within a disciplined, clear, financial framework which sets out the growth rate which we believe to be 3-5% per annum. It limits the amount of capital that we are going to invest in the business, initially to £1 billion per annum, we are going to deliver returns of 10-12% return on capital, and we are going to deliver a progressive dividend, linked to the cash flow

growth and finally we are going to maintain a strong investment grade credit rating which we need in order to support the mix of business that we want to pursue. So this has been wide-ranging, deep strategic review and I think it provides clear direction for Centrica in this next phase.

Impact on Jobs

In terms of the impact on headcount, clearly, major programmes where we are trying to leverage the scale of the company internationally will have an implication on headcount. When you are driving also for functional efficiency and recognising some of the trends in the market, such as smart meters, which are going to remove estimated bills, hopefully reducing call volumes. Over time that sort of thing has an impact on headcount. When you bring all this together, we have assessed that this programme over the next 5 years, will impact 6,000 jobs out of our current employee base. That's a large number. We believe about 3,000 of those roles can be reduced through turnover and natural attrition, but the other 3,000 will be in the form of redundancies. It is not clear yet where these redundancies will occur, but clearly my focus, despite the need to do this, to make Centrica competitive, is on treating people with dignity and respect and fairly and conducting a diligent process so that we get to the right answers and don't do the wrong thing.

The Future for Centrica

So in addition to the cost reductions, cost efficiency and the talk of headcount, we must remember why we are doing this. This is to create a 21st century energy company, one that is truly international, that leverages its scale, enabling it to win for its customers, for its employees and for its shareholders and to create options through that strength to further expand the group going forward. Although, there is short term stress and strain we will have to go through to get there. I fundamentally believe this is the right future for Centrica and one that will allow Centrica to win in the next phase of both the company, but also the energy industry in the next decade.