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Centrica plc

Preliminary Financial Results 2019

Thursday, 13th February 2020

Iain Conn, Chief Executive

Good morning ladies and gentlemen, and welcome to Centrica's 2019 Preliminary Results Presentation. First a word on safety. There are no planned fire alarms today, and any building evacuation will be announced by security. Emergency exits are marked at the front and rear of the auditorium, and UBS events staff will accompany you to the muster point, which is located in Finsbury Square.

For today's presentation and Q&A I'm joined by Chris O'Shea, the Chief Financial Officer, Sarwjit Sambhi, the CEO of Centrica Consumer and Richard Hookway, CEO of Centrica Business. We also have other members of the executive team present, and following yesterday's announcement about the Chairman taking a leave of absence due to an unanticipated medical condition, Scott Wheway, our Interim Chairman, is also in the audience in the front here. The Board wishes Charles well and expects him to return to his duties shortly.

In the first part of the presentation today I'll provide some key headlines and briefly summarise our 2019 performance, and the strategic progress that we've made since our strategic update last July. Chris will then provide a more detailed review of our 2019 financial performance and the outlook for 2020. I'll then come back to provide some more detail on our strategic implementation at the Group level, including our role in enabling the transition to a lower carbon future and specific updates for both the Consumer and Business divisions.

Let me start with the key messages from today's announcement. First, our operating profit was stable year-on-year on an underlying basis. Excluding the impact of external factors, and before inflation, the customer-facing divisions' adjusted operating profit contribution was up materially relative to 2018, but this was offset by the Upstream division whose underlying performance was down by a slightly higher amount. The underlying year-on-year improvement in the customer-facing division is encouraging. Chris will show you this in more detail shortly.

However, our reported financial performance was materially below 2018, significantly due to the impact of falling commodity prices and the UK energy supply default tariff cap, including a one-off impact of an additional £70m which we have successfully challenged through the courts.

Reflecting these circumstances and the impact on our near-term cash flows, and considering our pension obligations and the requirement for strong investment grade credit ratings for the future customer-facing company, we also had to take the difficult decision in July to reduce the dividend to 5 pence per share. Adjusted operating cash flow and net debt were both within the 2019 target ranges we set out last February. Importantly, as predicted, second half earnings performance was significantly improved, compared to the first half.

We delivered material customer account growth in Consumer, the first full year of growth in my time with Centrica, with total accounts at the end of 2019 above the level of two years ago, and we are beginning to see indicators of stabilisation in UK energy supply. This growth has been enabled in part by new propositions and improvements in customer experience, which have been reflected in higher net promotor scores and better customer retention.

Our services and solutions activities are all demonstrating improvement in adjusted operating profit. We are seeing this in both Consumer and Business divisions and across an expanding set of services and solutions we now have in-market. As well as fuelling future growth, this also means we are increasingly well positioned to help our customers transition to a lower-carbon future. I'll return to this in the second part of the presentation.

We continue to deliver significant cost efficiencies across the Group, and having over-delivered on our updated 2019 target, we have significant momentum as we enter 2020.

We are progressing the portfolio conclusions we announced in our Strategic Update in July, including our planned exit from Exploration and Production, the refocusing of Centrica Home Solutions and the rebasing of UK Home.

Turning to 2020, in addition to pursuing the planned divestments, our focus will be on growing customer relationships, delivering further efficiency, continuing to build our customer facing propositions and capabilities, and, very importantly, maintaining financial discipline.

Finally, in terms of outlook for this year, we expect to deliver underlying earnings momentum from the customer-facing divisions, but recent commodity prices are weak and if they remain at current levels this will impact the Upstream division.

In trying to judge the net impact, we expect adjusted operating cash flow in 2020 to be in the £1.6bn to £1.8bn range, based on the prices at the end of December 2019, and for sources and uses of cash flow to remain broadly balanced.

Moving now onto our 2019 performance headlines.

As already referenced, the challenging operating environment impacted financial performance in 2019. EBITDA of £2.1bn was down 13% and gross margin of £3.9bn was down 9%.

Adjusted operating profit was down 35% to £901m, and adjusted earnings per share was also down 35% to 7.3 pence. After correcting for the impact of the UK default tariff cap implementation and other external factors, including inflation, underlying operating profit was down year-on-year by £15m, or 2%.

The core customer-facing divisions were up £258m relative to 2018, but this was offset by the Upstream division whose underlying performance was £273m down, primarily due to lower volumes in both Exploration & Production and Nuclear, and higher non-cash charges. This underlying growth in our core divisions is encouraging and within this, in total across the Group, adjusted operating profit from our services and solutions activities was up £80 million year-on-year to £120 million, and we're targeting a similar year-on-year improvement in 2020.

Adjusted operating cash flow of £1.83bn was within our 2019 targeted range of £1.8bn to £2bn. Closing net debt of £3.18bn was also in the 2019 targeted range of £3.0bn to £3.5bn. Chris will cover our 2019 financial performance in more detail shortly.

Consumer accounts increased by 722,000, and by 451,000 in the UK, with further growth in services and solutions relationships. We also saw account growth in North America, and a further stabilisation of account losses in UK energy supply in the second half of the year. This reflects increased sales of energy and services bundles and a more competitive cost base due to our strong focus on cost efficiency. We recognise there's more to do in improving customer journeys and NPS, and in becoming the most competitive provider, but we continued to show improvement in 2019.

Across the Group, we again delivered significant efficiencies, with £315m of like-for-like cost savings in 2019. This is in excess of the increased target of £300m, providing significant momentum into 2020.

Looking now at the drivers of earnings momentum in 2020 relative to last year we expect to see continued earnings momentum from the core activities of the customer divisions. This is from gross margin expansion in services and solutions, continued consumer account growth, expanded unit gross margins in UK energy supply with the absence of the one-off price cap impact from Q1 2019, and continued cost efficiency momentum as we target being the most competitive provider.

As Chris will outline in a moment, we will have a negative impact from the remaining legacy gas contract from the 1980s which we expect to be loss-making until expiry in 2025.

In the Upstream, the latest REMIT announcements indicate higher Nuclear volumes this year and we expect stable Spirit Energy volumes, but lower volumes in Centrica Storage. The big uncertainty is what is going to happen to commodity prices. This is naturally impossible to predict precisely.

If we apply the commodity price curves prevailing earlier this week, we would expect the earnings impact from the non-core Upstream portfolio and the legacy gas contract to broadly offset the continuing year-on-year earnings momentum from the customer divisions.

Let me now turn to strategic progress.

At our Strategic Update in July we reiterated our purpose and strategy. Our purpose remains to satisfy the changing needs of our customers, but we have increased our emphasis on enabling the transition to a lower carbon future.

Our focus is on two things: our distinctive strengths of energy supply and its optimisation, and services and solutions centred around energy. This includes us beginning to capitalise on the growing opportunities in Home Energy Management, mobility solutions with electric vehicles and the interface with them, and system optimisation, including leveraging our competitive advantage in demand response. I'll share a few examples later in the presentation.

This focus is reflected in our new climate change ambitions and targets we set out last February. I'll provide a progress update later, but I am pleased that Centrica regained the coveted CDP "A" rating in early 2020, and we continue to engage constructively with the Climate Action 100+ group who have recently published a case study on Centrica.

Our shift back towards the customer began in 2015, and having concluded that Centrica had built sufficient capability in the customer-facing businesses to complete this shift, we are progressing the announced divestments of both Spirit Energy and Nuclear. Chris will provide an update on divestments in his section.

In July we also announced some specific decisions relating to a number of our business units. We've made progress in all of these areas. We are pursuing the fundamental rebasing of UK Home as we "re-imagine British Gas", continuing to drive structural changes in customer journeys, internal processes, digitalisation and the cost base. Also within UK Home, we saw significant growth in home services in 2019, and further revenue and order book growth in Business Solutions.

Centrica Home Solutions, formerly Connected Home, continued to demonstrate revenue and customer growth and has been refocused on the UK and Ireland following our decision to exit North America and Italy, with new propositions centred around Home Energy Management and Remote Diagnostics.

We delivered improved returns in North America Business, up to 9% in 2019, having made structural interventions to reduce costs, improve underlying margin quality and optimise capital employed.

Finally, we are targeting £350m of cost efficiency in 2020, which is already significantly underpinned. This would take our total annualised cost efficiency delivery since 2015 to £1.6bn. Our like-for-like controllable cost base in 2020 will be materially below that of 2015 in nominal terms, even after funding our growth investments, fulfilling a five year target we set out in 2015.

Let me hand over to Chris to take you through our 2019 financial performance and the 2020 outlook in more detail.

Chris O'Shea, Group Chief Financial Officer

Thanks, Iain. Good morning everyone.

Let me start with the current commodity price environment. The Group continues to be heavily exposed to commodity prices and this will remain the case until we complete the disposals of Spirit Energy and Nuclear.

Market prices for Brent oil, NBP gas and UK baseload power were all materially lower in 2019 than in 2018, and forward prices indicate they will be significantly lower again in 2020. The fall in the UK gas price has been particularly dramatic, with the average 2020 calendar year price now one third below that seen in 2019, and well under half that seen in 2018.

Hedging protects us from these low prices to some degree, and as usual we've hedged around two-thirds of our 2020 Spirit Energy post-tax exposure, at an average price of 51 pence per therm for gas and £45 per barrel for liquids. However, overall, the current commodity price environment is expected to have a negative impact on cash flows and earnings in 2020 relative to last year, as you heard from Iain.

As usual we've provided an indicative "rule of thumb" which you can find in the appendix that shows the impact on Upstream earnings and adjusted operating cash flow of any further movements in gas, oil and power prices. And it is worth noting these rules also apply to any increases in prices, however remote that may feel right now.

Moving on to the financials now.

Revenue was down 2% to £26.8bn, which reflects the lower commodity price environment and the impact of the introduction of the UK default tariff price cap.

Adjusted operating profit fell by 35% to just over £900m, reflecting the impact of the price cap and lower commodity prices.

With a reduced tax rate reflecting a lower proportion of profits coming from the more highly taxed E&P businesses, adjusted earnings fell by 34% to £419m and adjusted basic earnings per share reduced to 7.3 pence.

The proposed full year dividend is 5 pence per share, in line with the announcement we made in July. As you know we have cancelled the scrip dividend alternative, and therefore this will be paid fully in cash.

EBITDA fell by £328m, less than the reduction in adjusted operating profit due to increases in DD&A following price related write backs to E&P assets at the end of 2018 and the impact of increased IT capital spend in 2018.

Adjusted operating cash flow reduced by 18% to £1.83 billion, in the bottom half of our 2019 targeted range as we indicated would be the case in July.

Group net investment was significantly lower than 2018, reflecting proceeds from the Clockwork disposal and lower capital expenditure as we increased focus on financial discipline.

Closing net debt was £3.2bn, within our targeted 2019 range of £3bn to £3.5bn, and this includes the non-cash impact of adopting IFRS 16 on 1st of January 2019.

Let me now cover exceptional items and certain accounting re-measurements, both of which had a significant impact on statutory earnings in 2019. We separately identify exceptional items and certain re-measurements on the face of the income statement to make our underlying performance easier to understand.

In 2019, we recognised £934m of total impairments, largely in E&P and Nuclear due to lower forward market commodity prices. We also incurred £356m of restructuring costs.

Our net pension credit includes a £108m charge related to pension strains associated with our redundancy programme, which was more than offset by a £260m past service credit following an amendment to how future pensioners take their benefits from our UK pension schemes. Finally, we recognised a net gain on disposals under our non-core asset divestment programme of £35m.

And we also have substantial risk management activities, hedging a large proportion of purchases of gas and electricity to meet the future needs of our customers, principally where we sell fixed price energy. We separately identify those non-cash mark-to-market movements and against the backdrop of falling gas and power prices, this generated a post-tax expense of £544m in 2019.

The combination of the exceptionals and non-cash mark-to-market movements led to a statutory loss for the year of 17.8 pence per share.

We'll move on now and cover adjusted operating profit in some more detail.

The UK default tariff price cap impacted profit by £300m, while other external factors, including commodity, FX, weather and inflation reduced profit by a further £176m. Excluding these impacts, operating profit fell by 2%, with significant efficiencies and improved underlying

Centrica Business performance largely offsetting declines in both Consumer and Upstream. I'll now cover each of the divisions in turn to provide some more colour on our results.

Starting with Centrica Consumer, adjusted operating profit was down 33% to £505m. Again, here you can see the £300m related to the UK default tariff price cap, which includes a one-off, non-recurring impact of £70m related to wholesale energy costs. As you know, we won a judicial review on this matter, although it is as yet unclear how and when we will recover any of the £70m. The net effect of other external factors was £104m, however as we saw no repeat of the service challenges which arose from the 'Beast from the East' in 2018, and with colder weather on average in 2019 versus a warmer than normal 2018, we had a positive movement in profits of £55m due to weather.

The underlying margin bar reflects the lower average number of energy accounts in the UK, changes in product mix and the non-recurrence of a bad debt provision release in 2018, partially offset by the recognition of a one-off benefit of about £30m from the renegotiation of one of our smart metering contracts. Partially offsetting this was another year of improved profits in both North America Home and at Bord Gáis Energy in Ireland.

The decline in underlying margins in the Consumer division as a whole was more than offset by cost savings from the Group's efficiency programme, with £229m of savings delivered in 2019.

Moving on now to Centrica Business, which delivered a much improved result in 2019 with all businesses delivering year-on-year growth in profit. Please note, this segment no longer includes our Nuclear business.

External factors had a small negative impact on the result. However, our one remaining legacy gas contract made a small profit in the year, compared to a loss in 2018.

The improvement in underlying margin includes a recovery in North America business power margins as expected, while we also delivered strong trading and optimisation performance in Europe including in our route-to-market services. In addition, we saw a strong performance in delivering cost savings through the Group's efficiency programme.

I think it's worth providing you with a bit more detail now on our Energy Marketing & Trading track record, and our legacy gas contracts, to ensure you have a good understanding of the underlying activities in, and the quality of, this business.

The chart on the left shows the historic financial results of the underlying EM&T business. Iain will provide some more detail on its activities later in his section. From 2015 to 2019 we have delivered compound annual growth of 20% in pre-tax profits. The chart on the right shows the material swings in profitability from the legacy gas contracts over the last few years, and the outlook moving forward.

We now have one remaining contract relating to the Sole Pit gas field, which at current prices is out of the money. This contract was originally signed in 1988, well before Centrica came into existence, and it runs until 2025.

In 2019 we were able to make a small profit due to favourable oil hedges and reducing the volumes taken under the contract. However, we currently expect to be required to take significantly higher volumes in 2020, and as a result expect the contract to make a pre-tax loss of a little under £100 million in 2020; this translates to EPS of a little over one pence.

There is some flexibility in the contract regarding the timing of delivery, and our traders will continue to focus on trading around, and optimising, the contract for value. However, if the current environment remains it's likely to result in an annual loss of between £50m and £100m each year until the contract ends in 2025.

Moving now to Upstream, where adjusted operating profit fell by almost 70% to £179m. The combined negative impact of commodity prices and FX moves was £115m, with a lower achieved gas price only partly mitigated by slightly higher achieved oil and power prices and capacity market income relating to 2018.

Nuclear volumes were 14% lower, reflecting the outages at Hunterston and Dungeness, which combined with higher costs negatively impacted profit by £96m. Please remember that the nuclear power plants have very high fixed costs so when you lose volumes the profit impact can be disproportionately large.

In Spirit Energy, the impact of slightly lower production and higher depreciation following price related asset write-backs at the end of 2018 negatively impacted profit by £103m.

Volumes from Rough were lower as expected due both to natural field decline and the decision to produce only in the winter, with underlying profit down £73m as a result.

There was £47m of additional field specific and exploration write-off costs in Spirit, including at Warwick in the West of Shetland, although we also delivered £46m of cost efficiencies across the E&P businesses.

If we look at Upstream in a little more detail now. Our share of Nuclear generation was down 1.6TWh to 10.2TWh. This reflects the outages due to cracks in the steam pipes at Dungeness, which resulted in the reactors being offline for the whole year, and a higher rate of cracks than expected in the graphite reactor cores of the Hunterston reactors which significantly limited availability. It is worth noting that the other six sites saw increased output compared to 2018.

Overall E&P production was in line with our expectations in 2019. In Spirit Energy improved availability at Morecambe helped offset lower production from Norwegian assets, and we expect Spirit production to remain broadly flat in 2020. Continuing our seasonal production profile, we expect Rough to produce between three and five million barrels of oil equivalent this year.

Touching briefly on projects. During 2019 the Oda field was brought on stream while projects to develop further reserves are ongoing at Nova, Chiswick and [Maria].

The reserves replacement ratio at Spirit was 140 per cent, an excellent performance, which means we end 2019 with more reserves than we had at the start even after producing almost 50 million barrels of oil equivalent. New reserves recognised include the effects of a 10 year field life extension at Statfjord and positive revisions at Kvitebjorn, Cygnus and South Morecambe.

As planned, three wells were drilled in the Greater Warwick Area in 2019. The first well at Warwick Deep discovered oil but it did not flow at commercial rates. The second well at Lincoln Crestal, confirmed the presence of Light Oil which can be produced at commercial rates. The third well at Warwick West confirmed the presence of light oil, however further technical analysis is required. We will of course keep you informed of updates as we finalise and execute the 2020 work programme.

We turn now to cash flow. You can see on the left the reduction in EBITDA I referred to earlier.

We saw a relatively small increase in cash tax payments, although not to the scale that I indicated a year ago and that's largely due the impact of falling commodity prices on E&P profit and some success with various tax authorities which resulted in tax refunds to Centrica. The Nuclear dividend was down as you would expect, the working capital movement was a slight negative, as £250m of structural working capital benefit delivered in the year but was largely offset by timing effects between years, including the impact of both the capacity market suspension in 2018 and its reinstatement late in 2019.

As you can see on the right, despite adjusted operating cash flow falling by £415m, our free cash flow fell by less than £50m as we took steps to restrict capex, cut back on acquisitions, and execute our non-core asset disposal programme.

And I've made this point a few times, but I really do want to stress the flexibility in our cash flows – our capital expenditure programme is made up of a large number of relatively small projects and we can adjust these to suit our conditions – the same also applies to the restructuring programme.

Net interest outflows were lower due to the reduction in gross debt and a £139m outflow in 2018 relating to our debt repurchase programme.

Dividends paid to Centrica shareholders of £471m were lower than last year, reflecting a lower interim dividend paid in November 2019, following the rebasing we announced in July, while we paid our first dividend to Spirit Energy's minority shareholders. Spirit's dividends depend on its cash flows and currently we do not expect Spirit to pay a dividend relating to 2019.

Our pension deficit payments also increased compared to last year under the new payment scheme agreed with the Pension Trustees as part of the 2018 triennial valuation. This included a one-off payment of £50m and therefore when you model 2020, you should assume pension deficit payments of around £175m.

Moving on now to our efficiency programme which delivered a further £315m of savings in 2019, once again more than offsetting the impact of inflation and foreign exchange movements. In addition, we reduced our total IT cash spend, including capex, by a further £56m.

We delivered savings through continued functional activity review and transformation, further procurement and supply chain efficiencies, and a focus on overhead cost and management structures in all businesses and functions. We also announced the closure of a number of office locations during the year.

Even after accounting for £100m of 'other' cost increases, which principally comprises of costs associated with growth in Centrica Business and the non-cash write-offs I mentioned earlier in Spirit, like-for-like controllable costs reduced by £74m.

We have now delivered £1.25bn of our cost efficiencies since 2015 and despite the impact in inflation and foreign exchange movements, and around £100m of additional operating costs in Home Solutions and Business Solutions, nominal costs have reduced by £400m over the period.

Over the same period we have seen around 12 and a half thousand colleagues leave the business and this is something that we deeply regret. However, it has unfortunately been necessary as we adapt to the changing environment and look to put the Group on a more stable and competitive footing.

Having delivered in excess of our target in 2019, we are expecting to see a slight acceleration in the delivery of efficiencies and we now expect around £350m of in-year savings in 2020, which is £50m higher than we expected at the time of our Strategic Review in July last year. Around two-thirds of these 2020 efficiencies are underpinned by the annualisation of 2019 efficiencies, and we expect to be in a similar position at the end of this year, meaning that the majority of our restructuring efforts should be completed in 2020.

Touching on the balance sheet now and the pension deficit. We continue to target strong investment grade credit ratings and we're currently rated Baa1, with a negative outlook, by Moody's; and BBB, with a stable outlook, by S&P. We've worked closely with the agencies to discuss our strategic plans and we understand the impact that the planned asset disposals will have to the credit rating thresholds.

It's important to note that we're disposing of our asset based businesses in order to deliver our strategy of focusing on the customer and simplify the group. We are not disposing of these businesses to strengthen our balance sheet.

We have a long-dated bond portfolio with maturities out to 2045 and an average interest rate of 4.8%. Furthermore, in February 2019 we renewed £4.2bn of Committed Revolving Credit Facilities with 21 banks, which had an initial maturity of 2024 with two separate one-year extension options. Our IAS 19 net deficit is £163m which is a little higher than last year.

The technical provisions deficit as agreed with the Trustees as part of our 2018 triennial review at 31 March 2018 was £1.4bn. Based on assumptions as at 31 December 2019, this technical provisions deficit is estimated to have increased to around £1.6bn.

The main difference between the IAS 19 and the technical provisions deficit is the discount rate – IAS 19 uses high quality corporate credit discount rates whilst the technical provisions discount rate is based on GILTS.

In the short-term the increase in the technical provisions deficit won't impact the £175m annual contributions which we have agreed to make, with the next triennial review due to be based on a March 2021 valuation date.

We continue to take actions to reduce both the level and volatility of the pension liabilities and during 2019 we agreed with those UK-based employees in the defined benefit pension schemes to reduce benefit accrual rates, and make lower company contributions going forward.

In addition, we have now substantially de-risked the pension fund asset portfolios, increasing inflation and interest rate hedges from around one-third to over two-thirds, thus reducing the volatility in the net deficit from interest rate movements.

I'd now like to give you an update on our divestment programme.

As a reminder, we plan to divest our 20% interest in the UK nuclear fleet and our 69% share in Spirit Energy, in line with our strategic shift towards the customer.

The operational issues we've experienced at Hunterston and Dungeness have impacted the nuclear disposal process. And as you know, there is a relatively small pool of potential buyers of nuclear power stations.

Whilst we are still pursuing the disposal of our share in this business in conjunction with our partner, it's unlikely we will dispose of all of our stake in a single transaction and as such, we now expect to still hold a share of the nuclear business at the end of 2020.

For Spirit Energy, there is a wider universe of buyers and a very active market. We kicked off the disposal process in the second half of 2019 and we expect initial bids around the end of the first quarter of this year.

In 2019 we announced our non-core asset disposal programme which was initially targeting £500m of proceeds. The sales of Clockwork and Kings Lynn, which we completed yesterday, plus some smaller E&P assets have generated roughly two-thirds of the £500m. However, when we took the decision to sell our overall interest in Spirit, we decided not to sell the remaining £150m of E&P assets originally earmarked for disposal and therefore we've concluded our non-core asset disposal programme.

The slide here shows what 2019 cash flow, EBITDA, adjusted operating profit and EPS look like, both for the current portfolio, and excluding Spirit Energy and Nuclear.

You can see on the left how sources and uses of cash are broadly balanced in both scenarios, despite around one third of the Group's adjusted operating cash flow coming from the two businesses we are looking to sell. This largely reflects the high capital re-investment requirements of Spirit Energy.

For 2020, we expect sources and uses of cash to again be broadly balanced both for the existing portfolio, and for the portfolio excluding Spirit and Nuclear. This applies to the current commodity price environment and as I mentioned earlier, we will proactively adjust our capital and restructuring programmes to reflect the operating cash generation of the business.

And as you can see from the table at the bottom of the slide, the earnings contribution of Spirit Energy and Nuclear was relatively small.

Before summarising I'd like to remind you of our refreshed financial framework. We continue to target growth in adjusted operating cash flow over the medium term.

The dividend is expected to grow from the rebased 2019 level over the medium term, in line with underlying growth in earnings and cash flow, and dividend cover from earnings is expected to be in the range of 1.5 – 2.0 times over the medium term.

We plan to deliver a further £1bn of cost efficiencies between 2019 and 2022 and delivered £315m of this in 2019.

Following the disposals of Spirit and Nuclear, capex is expected be around £500m per annum, although it will be lower in 2020 as we focus on delivering our restructuring programme. And as I've already said, we continue to target strong investment grade credit ratings.

Finally, our Group Return on Capital Employed target is at least 10 to 12%. We achieved 9% in 2019, which largely reflects the lower level of post-tax profit.

Finally, let me cover our outlook and 2020 targets.

We are expecting adjusted operating cash flow to be in the range of £1.6bn to £1.8bn in 2020, and that's based on the commodity price environment at 31 December 2019. If you fast forward to now, we have seen further commodity price falls, and if current prices persist, we would expect to be around, or even slightly below, the bottom of this range, despite the fact that we have already hedged around two thirds of our Upstream production in 2020.

As I have already covered, in the current commodity environment, we still expect sources and uses of cash to be broadly balanced as we proactively adjust our capital and restructuring programmes and you can expect us to continue to focus on this.

As indicated at the Interims in July, momentum from our customer-facing businesses in the second half of 2019 should benefit us at an earnings and cash flow level in 2020, including the absence of the one-off price cap impact; cost efficiency momentum; a full year of higher unit margins in North America Business; further growth in UK services; and growth in margins in the Solutions businesses.

However, as I mentioned earlier, we expect the remaining legacy gas contract to make a pre-tax operating loss of a little under £100m in 2020, or around 1 pence of EPS.

All in all though, we expect earnings growth in our core customer-facing businesses to more than offset the drag from the legacy gas contract.

As you've already heard, the current extremely low, and rather uncertain commodity price environment is likely to have a significant impact on Upstream adjusted operating cash flow. However, the earnings impact is likely to be much less material, due in part to lower depreciation in 2020 which reflects the impairments we have just taken at the end of 2019.

As a result, and as Iain indicated earlier, at a Group level we would expect the year-on-year positive earnings momentum from the customer facing divisions to be broadly offset by the negative earnings impact from the non-core Upstream portfolio and the legacy gas contract.

Finally, let me summarise our targets for 2020.

As just covered, we are targeting AOCF in a range of £1.6bn to £1.8bn based on 31 December 2019 commodity prices.

We are targeting a further £350m of cost efficiencies, and this would mean we have delivered two thirds of the £1bn 2019 to 2022 target by the end of this year. In addition, we are targeting an additional £50m reduction in our IT change capital expenditure.

Including this, cash capex is expected to be around £800m, including no more than £500m in Spirit Energy. Spirit Energy's £500m includes a one-off payment of around £100m relating to the decision not to proceed with the Hejre development in Denmark.

As mentioned previously, we expect sources and uses of cash to be broadly balanced in 2020.

Finally, we expect closing net debt to be in the range £3.2bn to £3.6bn, which excludes any impact of Spirit and Nuclear divestments, but includes a £200m non-cash increase in our debt due to the recognition under IFRS 16 of lease commitments for two new LNG tankers.

Ladies and Gentlemen, that concludes my comments and I'll pass you back to Iain.

Iain Conn

Thank you, Chris. I would now like to cover some of our operational and strategic progress in more detail. And I'm going to be covering three things. Firstly, an update on the changing energy landscape and a reminder of Centrica's purpose and strategy, including our role in addressing climate change and associated commitments.

I will then cover strategic progress in the Consumer division, including on customer account growth, energy supply dynamics in the UK and the objectives, plans and progress in the rebasing of UK Home. I will also cover growth in services in the UK, and finish the Consumer update by covering services and solutions more broadly, and specifically the refocusing of Home Solutions.

The third topic is strategic progress in the Business division and specifically, the growth and prospects for our Business Solutions activities, including specific case studies, the mix of activities of Energy Marketing & Trading, and the delivery of improved returns in North America Business. And I will close with a brief summary. So let me start with the changing energy landscape.

As we reiterated in July, the trends we identified in 2015 continue to play out. Specifically, the energy system is becoming more decentralised as advances in distributed technologies support decarbonisation. Choice, power and influence are moving to the customer. And digitalisation is improving customer interfaces, accelerating proposition development and delivering efficiencies. In addition, societal pressures to address climate change are intensifying.

In our focus area of energy supply and its optimisation, we have seen much greater regulatory focus and intervention in energy supply in recent years. In the UK, this includes the implementation of the default tariff cap, which as you've heard already from Chris, impacted our operating profit by £300m in 2019. £70m of this was related to the treatment of wholesale costs in the initial period of the cap in the first quarter of 2019, which we have successfully challenged in the courts.

This outcome underlines the importance of transparent and rigorous regulatory processes to ensure well-designed regulation that is in the interest of a well-functioning market, which in turn allows participants to operate with confidence and ultimately benefits all energy consumers. We will continue to engage with Ofgem to ensure a fair implementation of the ruling.

In North America, the New York Public Service Commission recently issued an order to stop competitive retailers pricing their variable tariffs at above local default utility rates. We have around 140,000 customers in New York, a relatively small proportion of our North America customer base, but this is another example of increased regulatory intervention.

Against this backdrop we must continue to focus on treating our customers fairly, improving their experience, reducing our costs to allow us to price as competitively as possible and providing customers with the products and services they demand. If we do this, we can maintain sustainable and profitable energy supply businesses.

At the same time, energy demand per unit GDP continues to decline in our core markets, and competition is intense. However, managing their energy is leading customers to demand greater optimisation, and services and solutions linked to their energy supply which is a developing source of growth and competitive advantage for Centrica.

There is rapidly increasing demand for lower carbon services and solutions centred around energy. This is true for both consumers and business customers, and digitalisation and software platforms are enabling more sophisticated customer relationships. The higher renewables load is leading to growth in route-to-market services, requirements for grid optimisation and flexibility services such as demand response and “virtual power plant”.

We have built skills and capabilities in all of these areas, and against this changing backdrop we believe we have the scale, positions and capabilities to leverage these growing needs.

Faced with these fundamentals, it reaffirms that Centrica must become an energy services and solutions company if we are to harness this growth in demand and we must increase the proportion of services and solutions in the portfolio relative to pure commodity energy supply.

Recognising this, in July 2019, we refreshed our purpose, and were ready to put addressing climate change explicitly at its heart. We are dedicated to satisfying the changing needs of our customers, enabling the transition to a lower carbon future. We are becoming a 21st Century Energy Services and Solutions company, focused on our distinctive strengths of energy supply and its optimisation, and services and solutions centred around energy.

We are completing the shift towards the customer, by exiting Exploration & Production and Nuclear. We are now equipped and committed to help our customers transition to a lower carbon future, with a range of skills and technologies which are increasingly in demand.

This has dramatically increased our ability to make a difference in addressing climate change and is reflected in our new climate change ambitions and goals we announced last February which reflect the Paris Accord.

We committed to own the obligation to reduce the emissions of our customers, our Scope 3 emissions, and as a company are committed to develop a plan to achieve net zero by 2050.

This has been recognised externally, and as I said earlier Centrica regained the coveted CDP “A” rating for environmental transparency and performance, which only 179 of over 8,400 disclosing companies achieved.

We have also now signed up to the Task Force on Climate-related Financial Disclosure - and continue to engage constructively with representatives of the Climate Action 100+ group of investors whose case study on Centrica I also mentioned.

So I would now like to spend a moment on our commitments to address Climate Change, our specific ambitions and progress against them.

We first showed this slide last February. Our strategy is now formulated to contribute to, and benefit from, the long-term structural changes required to address climate change as we complete the shift from a company unsuited to where the world of energy is going to one in tune with it.

We made commitments with clear targets in line with the Paris Accord built around 3 pillars: to help our customers reduce their emissions; to enable a decarbonised energy system; and to reduce our own emissions. We said at the time we would report our progress against this framework on an annual basis and you can see at the bottom of the slide a summary of how we did in in 2019.

At a headline level, we delivered an 3.9% reduction in customer emissions, largely driven by HIVE, smart meters, and the roll-out of more green tariffs in the UK, against a 2030 target of 3%. Excluding green tariffs, the other measures delivered a 1.4% saving.

We delivered 2.7GW of flexible, distributed and low-carbon capacity, on track with our targets. And we have reduced our own internal carbon footprint by 39% since 2015, well ahead of our 2025 target.

There will be more detail included in our Annual Report and Accounts, but in short, after one year we are ahead of our medium-term and long-term objectives. This is a long-term ambition and we will update on delivery and review targets annually.

Turning then to what we are focusing on to operationalise all of this in each of the customer divisions. Our strategy is translated into clear strategic pillars and these next two slides are as we shared in July, updated for recent progress.

In Centrica Consumer we have three strategic pillars: Energy Supply, In-Home Servicing and Home Solutions. These are all activities in which we have distinctive positions, strengths and capabilities.

And in Centrica Business, we are focused on Energy Supply, Energy Optimisation and Business Services & Solutions.

As we transition the mix of each division more towards providing services and solutions as well as energy supply, revenues, gross margin and unit margins are evolving. We have had to endure some big shocks from regulators, but despite this the overall picture remains relatively stable.

This is a slide we have shown for the last two years, now updated for 2019, showing revenue, gross margin and gross margin as a percentage of revenue for both the Consumer and Business divisions.

Consumer gross margin per account fell materially, as expected, to £90, which reflects the implementation of the UK default tariff cap. However, despite that step change, a gross margin of nearly 20% remains healthy overall, and with our focus on growth from higher margin non-energy propositions and further cost of goods savings, we are targeting an improvement in future years.

In Business, we saw a 7% increase in average gross margin per account as we saw further recovery in North America energy supply, and encouraging expansion of our services and solutions offerings. Customer accounts fell as we focused our attention on higher value customer segments. In terms of customer accounts, in the Consumer division, we're finally starting to see signs of growth.

As I've already mentioned, customer accounts grew by 722,000 in total in the year, and total accounts at 25.6 million ended the year above levels of two years ago. We saw net growth of 206,000 accounts in North America energy and services, as we gained some profitable aggregation energy customer books, and continued to compete well in home warranties and services for new-build homes, while accounts were broadly stable in Ireland.

In the UK, shown in the light blue horizontal bar, total customer accounts were up by 451,000, also to levels above those of two years ago. Growth in services and solutions more than offset a decline in energy. Ignoring Home Solutions for a moment, which grew by 373,000 accounts, the total of traditional energy supply and in-home servicing accounts in the UK grew by 78,000, as a result of our new bundled energy and services offering.

UK energy supply accounts were down by 286,000. This includes a reduction of 275,000 collective switch and white label accounts in the first half of the year as we exited the Sainsbury's relationship. While the number of customers on our British Gas branded tariffs was broadly stable, albeit with a change in mix, with the number of customers taking online tariffs increasing by 367,000, in line with our digitalisation strategy, and the number of customers on default tariffs declining.

This is a chart we showed in July which shows the relative stabilisation of UK energy customer accounts over recent periods, updated to the end of 2019. As you know, we saw a big step-down over 2017 and 2018 as we focused on margin quality and addressed loss-making channels.

Since then, as we've become more cost competitive, improved both service levels and customer journeys, and introduced energy and services bundled propositions, we're seeing the decline slow markedly, and accounts have been broadly stable since our trading update in November. There's still much to do, but the resilience of gross margin and trends in customer account numbers are encouraging. Nevertheless, the UK energy supply market remains very challenging, not least thanks to regulatory intervention.

2019 was the first year under the energy default tariff cap. Market switching rates have remained high, as shown on the top left, with total switching around 8% higher in 2019 than in 2018. This is in part due to the falling spot gas price over the year, which has resulted in an increase in the differentials between fixed term tariffs and the default tariff cap, which is calculated using lagging formula input costs to do with hedging.

However, with our more competitive cost base and our cheapest energy tariff, which is bundled with services, typically being priced very competitively compared to the market as you can see on the right, our rate of customer losses was much improved and we attracted many new to brand customers.

Faced with intense competition, the price cap, and difficulty meeting Ofgem's requirements, the number of suppliers in the market is also now falling. Fourteen domestic suppliers exited the market in 2019, and a number have been asking to pay their social, environmental and capacity market obligations late.

Ofgem is consulting on new licence conditions that are designed to reduce excessive risk taking by suppliers, including a requirement to put in place arrangements to protect a proportion of customer credit balances and the cost of government obligations. We support this, and any change in regulation that creates a more level playing field and ensures that the energy supply market remains robust for the benefit of customers.

Let me turn then to our ongoing response to such a competitive UK market as we set ourselves up to win for the future. We announced in July our plans for further improvement in the performance of our UK activities, and in the face of the price cap to fundamentally re-base UK Home. There are four objectives.

The first is to take us towards the cost base of the projected lowest cost supplier in the market for energy, and also reduce our costs of in-home servicing to market leading levels consistent with our brand and propositions.

The second is to innovate and improve our agility as we respond to the needs of our customers, to improve the customer experience, increase retention rates, and grow the number of product holdings per customer.

The third is to bring value adding propositions to market more quickly, to allow us to respond to an increasingly dynamic market place, and enable growth in market share for both energy and services.

And finally, we need to fundamentally change our organisation, culture and ways of working, to fully capitalise on the opportunities available.

This slide shows, and it's rather busy, apologies for that, on the left the plans we laid out in July to achieve these objectives, along with some of the progress we've made to date on the right. Let me pull out a few highlights.

Overall, we're transitioning to reorganise around customer end-to-end journeys, not traditional industry processes. This will also mean transforming our technology stack to be more flexible and lower cost.

We've been testing various technologies across the company in both customer facing divisions, and are currently in market with a proof of concept more agile offering based on our experiences in Ireland, and learning from our new digital proposition for UK business customers. I must stress this is not a massive five year IT capital programme, but rather a collaborative test and learn environment with key software partners with whom we are already in market.

At the same time, we're in the process of simplifying the organisation by removing around 800 non-customer facing roles in 2019 as part of our efficiency plans, with energy supply back office costs 15% lower in 2019 than in 2018. We continue to focus on improving our digital journeys and the customer experience. British Gas Brand NPS increased by 3 points over 2019 to +12, while energy supply digital transactions were up 10%, and call volumes were down 15%, or by 4.3 million calls. We increased the proportion of customer queries we resolved first time.

In in-home servicing, we are focused on improving our engineer effectiveness through the development of a new engineer fulfilment platform in partnership with Microsoft, which is on track to be fully operational in 2021. We're improving our parts supply chain, and we are increasingly preparing ourselves to benefit from new market opportunities, such as electric vehicle integration. In 2019 we up-skilled around 100 of our service engineers to install electric vehicle charge points. All of this is about transforming gross margin capture capability while driving cost competitiveness.

In July, we set out our ambition to reduce our cost per customer in UK energy supply, to become the most competitive supplier in the market. We said the plans already in place would deliver savings of around £20 per customer in real terms by 2022, taking us to around the level of the projected first quartile performer. We intend to deliver below this level, towards the cost base of the projected lowest cost supplier in the market.

We have changed our cost methodology slightly since the interims to calculate the cost per customer on a unique customer basis, rather than a dual fuel equivalent, and to include depreciation to capture the impact of any IT capex savings that we plan to deliver. The initial first quartile benchmark target of £85 remains the same.

In 2019, we saw a £5 per customer reduction in real terms, compared to the underlying 2018 level on a like-for-like basis. Our 2020 plans show we remain on track with the 2022 goals. In in-home servicing on the right, we're also focused on driving further improvements to competitiveness and service. In July, the measure of efficiency we used was cost per job. However, we believe that cost per customer is a more appropriate measure given that cost per job can be heavily influenced by the mix of products within the customer base. Our target is to achieve below £300 per customer by 2022, which we believe reflects our premium proposition and brand.

In 2019 we saw a reduction in cost per customer from £348 to £320 in real terms, largely in our cost of goods sold, which was the most significant driver of the improved year-on-year profit growth. In-home servicing in the UK is one of our unique capabilities, and other progress in 2019 has been encouraging.

We've been building on our nationwide scale as the largest provider of contract cover and installation of boilers, leading brand awareness, and high levels of customer trust. We continue to deliver high levels of customer service, with the proportion of customer visits delivered on time on the scheduled day already at high levels and improving, and with an engineer net promoter score consistently above +60. On the bottom left, we saw growth in customers and products per customer in 2019, and on the right delivered a much better financial result, with improvements in both gross margin and adjusted operating profit, largely due to cost of goods efficiencies.

We have strong momentum as we enter 2020, and we're targeting further account growth, including through the continued development of energy and services bundled propositions, joint propositions with Home Solutions, and further profit growth, with a significant proportion of the Group's cost efficiency programme expected to come from UK Home Services again in 2020. Services and solutions propositions centred around energy are key to our future growth.

We've been evolving dramatically in recent years. As a company we've had a strong track record of innovating for our customers, initially from the installation and maintenance of gas boilers, through to leading the smart rollout in the UK and the development of the Hive smart thermostat. More recently this innovation for customers has accelerated, with an increasing focus on energy and services bundles, the launch of other Hive propositions including the smart thermostatic radiator valve, the launch of green tariffs such as our Green Future offer, and electric vehicle charge point installations and tariffs. We also now have developed the technology and capabilities to offer consumers further low carbon propositions.

Taking two specific examples. In partnership with Mixergy, we are now able to offer customers the smart hot water tank system which learns the habits of users to reduce heat losses by up to 40%. And in partnership with Sonnen, we've installed a network of 100 domestic batteries to form the UK's most advanced residential demand response enabled virtual power plant, harnessing consumer actions to support National Grid's task of balancing the electricity system. These activities are small today, but as the energy transition accelerates, delivering these types of technologies to consumers will be increasingly important.

Our Home Solutions business now has 1.8 million customers and over 4 million cumulative products in market, and cumulative subscription customers have reached over 250,000.

We announced in July that our Home Solutions focus would now be on the UK and Ireland. Despite this refocusing, we delivered further revenue and gross margin growth in 2019, with our gross margin percentage improving to 22% from 19%, and average revenue per customer increasing by 11% compared to 2018. Subscriptions were also up 34%.

The refocus will result in significantly reduced cost and investment requirements moving forward. We reduced Home Solutions headcount by around 40% in the second half of 2019, and expect to deliver £15m of operating cost and £10m of capex savings in 2020.

Customer satisfaction rates remain high, with a Hive brand NPS of +39. And importantly, we continue to see a positive impact on our energy and services businesses, with the energy NPS for a Hive customer on average 20 points higher than for an energy only customer.

Looking ahead, there are further synergies to be delivered from closer integration of Centrica Home Solutions and UK Home, including continued leverage of our distinctive field force. In future, Home Solutions propositions will be centred around Home Energy Management and Remote Diagnostics and Monitoring, with a focus on further scaling subscription offers which are typically higher margin.

We've been developing the customer interface and integrating the Hive Honeycomb platform with demand response capabilities, and electric vehicle management, to engage our customers in broader Home Energy Management use cases such as with Mixergy and Sonnen which I mentioned earlier.

We continue to target EBITDA break-even by 2021, and revenue of around £150m-200m by 2022 in Home Solutions, although this will increasingly be integrated with our other Consumer activities in the UK.

That completes my review of the Consumer division. I hope you can see how the energy services and solutions strategy for the consumer is taking shape, enabling customer account growth and retention, and increasing stabilisation and growth of the business.

In my final section I'd like to cover strategic progress in the Business division, starting with Centrica Business Solutions.

This slide shows how the business has developed over the past four years. We formed the business unit back in 2016 by consolidating relevant capabilities across the Group, in particular relating to energy insight technology and energy efficiency. We have added further capabilities through targeted acquisitions, which now allows us to offer a wide range of products and propositions for customers, underpinning the revenue and profitability improvement we're now seeing.

We've built and are leveraging distinctive capabilities, integrating multiple technologies to deliver customer solutions. We're able to leverage our existing energy supply customer bases in the UK and North America to grow the business, with our focus increasingly on lower carbon solutions. The chart on the left shows the growth profile of Centrica Business Solutions since 2016 in terms of order intake or sales, the total order book, and importantly revenue, which was up 36% in 2019 to £285m.

The outlook remains positive for 2020 and beyond, with our order book supporting future revenue growth, and importantly 70% of the order book is recurring revenue from long-term contracts.

We're achieving healthy gross margins of around 20% on average across the portfolio, and we continue to target EBITDA break-even by 2021, and our goal remains to achieve £1bn of revenue by 2022. With recent growth rates and some small inorganic investment, this remains within our sights.

Let me cover a couple of real life customer examples. Through Direct Energy we've been supplying energy to the New York City Housing Authority, the largest housing authority in North America, since 2008. In recent years they've installed 186 natural gas back-up generators to improve the resilience of their energy system, but identified a need to improve automation and the efficiency of their monitoring and dispatch processes.

Utilising our capabilities and technologies, we were able to leverage our existing customer relationship to meet a range of customer needs, including saving them money, improving the operations and maintenance of the assets, providing additional peace of mind through improving resiliency, and a low cost automated and remote solution to optimise the portfolio of generators. In so doing, we also add multiple revenue streams for Centrica.

Another big opportunity is in the Healthcare sector of the UK. We already provide contracted services to around 90 UK hospitals, including the Royal Devon and Exeter NHS Foundation Trust. They identified a need to improve the efficiency of their operations, to ensure resilience, but also to reduce costs and carbon emissions. We were able to develop a combined solution factoring in LED lighting, Solar PV, HVAC improvements, combined heat and power units and new efficient boilers, which has resulted in significant savings for the Trust of £800,000 per annum, and 2,200 tonnes of CO_2 emissions. This is what Centrica is all about.

For Centrica, the partnership provides a 15 year income stream to cover design, construction, operations and maintenance, and like many other projects is an example to other public sector organisations of the benefits we can bring them.

Likewise in Energy Marketing & Trading, we are significantly focused on serving the customer, providing security of supply and increasingly optimisation services. EM&T is focused on four activities. The first, and the original reason for requiring a European trading function, is to manage the price risk on customer demand for our UK energy supply businesses, and provide a route to market for our Upstream businesses.

Secondly, part of our focus on the end customer, we've built a material route to market and related services business for third parties, and currently have 14GWs of largely renewable customer assets in Europe where we provide the route to market for the power generated. These volumes grew by 4% last year. We have high market shares, particularly in the Nordics, and this is a profitable revenue stream.

Third, we have more recently built an LNG business. We accessed the Isle of Grain, and entered into contracts with Qatar and Cheniere as a further way of securing gas supply for our downstream customers in the UK. However, we recognised in 2015 that Cheniere was potentially not an attractive position in the near-term, and we've now created a global portfolio with a web of asset positions to capitalise on value opportunities in the LNG market, and access customers in multiple regions from the Caribbean to Japan.

Finally, as one of the largest gas and power traders in Europe, it makes sense for us to use the insight from our hedging and route to market activities to generate further profits from proprietary trading. We offer a very strict risk management framework and deploy limited risk capital in these activities to add value to the Group where opportunities present themselves. The risk capital we employ in gas and power trading is just a bit less than 20% of the total, with the balance having connection to customers.

To conclude my Business division update, let me describe progress in North America Business. As you know, margins and returns in North America in 2017 and 2018 were disappointing due to a combination of both structural and internal factors. In early 2018 we laid out the actions we had taken to address this, and in July last year were explicit about putting returns first and our goal to deliver 10-12% economic ROACE as the top priority.

We're making improvements in the quality of underlying gross margin, focusing on higher value customer segments, and increasingly looking to leverage our Business Solutions technologies and propositions in what is the largest services and solutions market in the world.

The mix of the business allows for more balanced portfolio outcomes through time. As you can see on the left, natural gas supply to customers with infrastructure optionality has been a steady earner. Whereas power supply has recently been impacted by higher cost of sales, including capacity market charges. Optimisation of both gas and power books have consistently added material additional value, though where margin is captured varies year-to-year.

In addition to re-building gross margin, we're focused on delivering cost efficiencies and maintaining capital discipline through optimising the capital employed in the business, while maintaining the margin quality of the customer book.

We indicated that these actions, combined with the reversal of the commodity curve shaping effect and those capacity charges, were expected to lead to improved economic returns. And we achieved 9% return on average capital employed in 2019, in excess of the Group's cost of capital, and in line with our expectation for the year.

With improvement actions ongoing, we currently expect to achieve post-tax economic returns on capital employed in 2020 of at least 10-12%, in line with our medium-term average target. This is underpinned by the higher net margin under contract we've booked as we enter 2020, relative to a year ago, as shown on the right.

As always, returns in this business are subject to some commodity price and weather volatility. However, the actions we've taken have placed the business on a much firmer footing.

That covers the specific updates for the Consumer and Business divisions. I'd now like to summarise what I hope you've heard today.

Centrica's financial performance in 2019 was impacted by an extraordinary combination of external and regulatory factors. But underlying operating profit was stable, with material improvement in the core customer facing divisions, which is very encouraging.

Adjusted operating cash flow and net debt were within the 2019 target ranges we set out last February. Importantly, second half performance was significantly improved compared to the first half, demonstrating momentum as we enter 2020. We delivered material customer account growth in Consumer, and are seeing indicators of stabilisation in energy supply accounts in the UK. This growth has been in part enabled by new propositions and improved customer experience, which have also led to higher net promoter scores and better customer retention.

New services and solutions capabilities mean we're well positioned to meet our customers' increasing demands to transition to a lower carbon future, and to harness the growth associated with that demand.

We continue to deliver significant cost efficiency across the Group and, having over-delivered on our 2019 target, we have significant momentum as we enter 2020. This efficiency is crucial to enable us to compete to win and while we build new sources of gross margin.

We're continuing to progress the portfolio conclusions and divestments we announced last year. As we look towards 2020, our focus will be on growing customer relationships, further efficiency delivery, building customer facing capability and maintaining financial discipline, and a strong focus on cash flow.

And finally, in 2020 we expect the customer facing divisions to continue to deliver year-on-year earnings momentum, although recent weakness in commodity prices will impact E&P and Nuclear and could offset this growth. Based upon end 2019 commodity prices, we expect 2020 adjusted operating cash flow to be in the range of £1.6-1.8bn, and sources and uses of cash flow to remain broadly balanced.

After five years of repositioning this company away from investing in exploration and production and carbon production, and back towards the customer and energy services and solutions more tied to emissions reduction, we are starting to see performance stabilise and the competitive potential to be demonstrated.

Finally, let me take this moment to thank the Centrica team for their extraordinary commitment, effort and dedication as we have undergone this journey. It's not over yet, but we anticipate 2020 to be the last year of major restructuring, and without the commitment of my Centrica colleagues we could not have repositioned this company to face into a future in which we are now much more competitive and able to access new sources of opportunity and growth potential.

Thank you. Let me now invite Sarwjit and Richard to join Chris and me on the stage to take your questions.

I did want to just make two points which I think are important to make. I know there's been a lot of focus on 2020 outlook and the guidance we've given today about earnings, and the potential that commodity prices would result, if today's curves stay, in offsetting the earnings momentum of the customer businesses, therefore that earnings in 2020 would be broadly flat with 2019. And I note the share price reaction to that.

One point I wanted to just make at the outset is, when we were putting our plans together for this year, we were comfortable with the outlook and consensus that the market had also reached a few months ago. It is the movement down in commodity prices, not any other changes to our activity set, which give rise to this outlook that we’ve just described today.

The second point I wanted to make was just around Nuclear. I saw a couple of people react when Chris said we may not sell the whole of nuclear this year. It is quite a large ticket size if we were to sell our interest plus the maximum amount that EDF is prepared to sell.

We don’t know yet the size of the first tranche that we would be able to sell, and the timing clearly is impacted by these outages. But as Chris can talk to in more detail, we’re relatively neutral in a cash flow sense and an earnings sense to whether we sell the whole tranche or a partial tranche. And we can touch on that in a moment.

So, who would like to go first?

Q&A session

Question 1

Mark Freshney, Credit Suisse

Just following on from that, presumably when you look to sell assets, any asset, you'd have a hold valuation, a valuation at which you wouldn't sell it. Is it plausible that this year you decide, or at what level would you decide not to sell?

And then also on the commodity hedging that you would have relating to UK Nuclear and Spirit, can you talk about whether you would be able to extract any cash from that on an asset sale and how that would fit in.

And just finally on the Upstream assets themselves, you alluded earlier to not needing to sell them, but would there be any impact on things like credit ratings if you were to keep them under a low commodity price scenario?

Chris O'Shea

There is a price at which we won't sell the assets, but just in case any of the buyers are watching, we wouldn't disclose that. We'd rather wait and see where the bids came in, but my view is always everything is for sale at the right price and nothing is for sale at the wrong price.

In terms of the hedges, the hedges for the Upstream assets are in the money right now. We have hedged forward, the market price has fallen, and so we have got hedges that are in the money. So, the net money you see in the income statement is the hedges for the downstream business and the hedges for the Upstream business. So, when we buy forward to sell fixed energy then that will go down in value so we'll have a mark-to-market loss. But we've sold forward at 51 pence a therm to further the production in 2020, and current price is 22, 23 pence a therm, so that looks quite good. So, it's not about extracting; there's value in there.

And then the last question about E&P, we were reflecting on this over the last few weeks, and the Spirit business is a nice business, 140% reserve replacement ratio last year is a really good place to be. We're also not like some other E&P businesses who are in the middle of a massive multi-billion dollar project. We spoke about whether we could say we had small capital projects or relatively small, they are relatively small because you might have something that is $100m or $200m. But we can turn them up and down and we could flex that to manage the cash flow, and the Spirit executive team are doing that just now.

Undoubtedly if we saw 20 pence gas for the next five years that's a problem. But at the moment having the assets gives us balance sheet strength, and I don't see any issue really in holding either the E&P or the nuclear business. It's all about price.

Question 2

Lakis Athanasiou, Agency Partners

Two questions. One on the New York PSC ruling. I thought that was something to do with disclosure on bills to compare against income in utility, so being a de facto price cap rather than a specific price cap. Could you comment on that please?

And second on nuclear Hunterston. I can't see why anyone wants to keep Hunterston going. Its average contribution has got to be fairly negligible. Why isn't the damned thing just being shut down rather than continuing incurring costs and not running? And what would be the barriers to just shutting Hunterston down full stop?

Sarwjit Sambhi

The New York PSC came out with the draft order in December. And put simply it was saying that the prices from the competitive suppliers can be no higher than the default utility, unless you could comply with compliant products. And largely they're products which can demonstrate added value, and in particular if they're green.

It was planned to be implemented in February; it's now been delayed until May. We're seeking some clarifications from the PSC in terms of the details, but we're also working towards seeing how we can make the portfolio compliant by buying green.

Iain Conn

And Sarwijit, the process has slipped, hasn't it? Just remind on the timeline?

Sarwjit Sambhi

Yeah, so it was February and implementation date now planned for May.

Iain Conn

And they're still consulting on it, is that right?

Sarwjit Sambhi

Yes, they're still seeking views. But in New York it's the regulator who decides. There is no legislation to be put in place, so we're just going to have to wait and see and give our views to the PSC.

Iain Conn

And Richard, should Hunterston keep going or should it be shut down?

Richard Hookway

Well, Lakis, as the saying goes there's life in the old asset yet I think. And just to remind you, Hunterston 4 did run for a period last year. And as Chris noted, there's significant leverage that if we get those assets back they can run for a couple more years, they can make a significant contribution over the remainder of their life.

Lakis Athanasiou

I don't get that with my numbers. I think when you look at the very low load factors the thing runs anyway, because of the boiler tube issues, when you compare that, the contribution to the average cost, I can't really see any profit in there. So, I still wonder why there's this effort to keep the thing going and at the moment not earning any revenue but just incurring costs continually.

Richard Hookway

The boiler tube issues are actually on Dungeness.

Lakis Athanasiou

No, it's the bifurcated boiler tube issues that keep Hunterston down at 70% load factor versus its capacity. That's the boiler tube issues I'm talking about.

Richard Hookway

But when it does run it does make a positive contribution to the fixed cost base. We believe that that asset will come back online. It is remitted to come back towards the end of April, as I think you're probably aware. And we think it could make a contribution in 2020 and 2021.

Iain Conn

I think on the nuclear fleet, for those of you who don't study it as closely, these advanced gas cooled reactors they're of different vintages, they therefore have different longevity. And clearly if you shut a site down you are then exposed to more of the overhead costs, including the process safety and technology costs, as well as the site costs, and you trigger entering into the decommissioning process, which the government basically covers for the nuclear island. But precipitating all of that overnight would be quite a big call.

So, I think it's a judgement, and obviously we want to get maximum value as a partnership out of it as possible.

<u>Question 3</u>

Sam Arie, UBS

I've got two questions, one for Chris and one I think for you, Iain.

Chris, can we just go back to that logic you set out last time we saw you at mid-year about the expected proceeds from the disposals and how you would use half of that to fund the restructuring and half then on the balance sheet to keep the credit ratings metrics where they need to be? Obviously you're talking now about doing a partial divestment on Nuclear, maybe a different valuation on E&P, you mentioned pension deficit going up as well. Where does that leave you then now versus that logic of six months ago and the credit metrics?

Chris O'Shea

I didn't mention about the value of E&P going down. I think people will look through the current low prices and take a medium price term. I don't know where the price will come out.

If we sell E&P and Nuclear our credit thresholds go up, and so therefore, everything else remaining equal, we have less debt capacity. So, we have to keep some cash on the balance sheet. We essentially convert an asset into cash. But we need to keep more cash on the balance sheet than we have in terms of value of assets. So, if we keep these businesses then the credit thresholds stay where they are, and it's actually easier to keep your rating at BBB flat or Baa1 with Moody's.

And we can flex up and down our restructuring programme. The cost of it, I was a bit worried at the start of the year that it might be a bit more expensive than 1.25 per pound; actually when you look at the rollover into 2020 it's come in a bit below that. So, we were quite conservative when we said that £1bn of cost savings would cost £1.25bn. It looks like it might cost slightly less, but it's too early to call that right now. But we keep this under constant review. It's one of the things I really like about Centrica is there are many levers to pull. We have a lot of levers to pull in cash. The logic I think still holds at the moment, but we'll learn more at the end of this quarter when we see the bids for Spirit Energy.

Iain Conn

Can I add a comment? This is strategic decision, and that's not an excuse, that's an intent, which is being a company with lots of bits, with exploration and production and customer businesses and consumer businesses and bits of nuclear, it's quite confusing as to what Centrica actually is. It's much more coherent if we're a customer facing energy services and solutions company in multiple geographies. And as Chris says, we're relatively neutral in the sense that we can maintain strong investment grade credit ratings to run that customer business really independent of how much of these asset businesses we hold. But we don't want to hold them for strategic reasons. And we'll get the bids in for Spirit at the end of this quarter.

You had a question for me.

Sam Arie Yes I did, and it's actually a follow on from what you're talking about there. And thank you Chris for your answer on the balance sheet. It's very helpful.

Iain, mine for you was, look I think everybody in the room knows it's been a difficult few years. I think you talked about some of the external shocks you had to deal with, but there is a process now to find your successor. And I'm just wondering when you think about the strategy going forward, do you think a successor CEO essentially has to take forward the strategy as it is today? In other words you're doing everything you have to do and that's the only choice or do you think there are some big decisions on the table that a successor is going to have to look at? And can you talk to us about what those big decisions might be?

Iain Conn

Let me share this answer with Scott Wheway who's sitting in the front row, our Interim Chairman. What we said last year about me leaving hasn't changed, and I'll leave Scott to talk about that.

In terms of the strategy the Board has been clear, and we went through a six-month update last year, on what the strategy is, and it is towards the customer. And in the discussions I've had with the Chairman and the non-execs the desire is not to change the strategy. And we've had a lot of incoming from long only shareholders saying exactly the same thing. So, I think it is one of execution.

Now, I'm not in any way saying you never say never; obviously things can change. But as I see it today, and you asked me the question, I don't think that the company has another direction of travel other than towards the customer. We do have to increase the ratio of services and solutions to energy supply in my view if we're going to improve the margin quality and returns of the company. And that's something which clearly a successor will have to look at. And also we have the issue of completing these divestments, which I hope to progress materially before I go, but there's still a lot to do.

Scott, would you like to give the Board's perspective on this?

Scott Wheway, Interim Chairman

I would. Good morning. I feel like I shouldn't start this conversation without just expressing the fact that it's a difficult situation for me to be here. The whole Board wishes Charles very well and looks forward to seeing him return shortly.

But in that context the Board did want me to land another message in this environment, which is we understand, given the unique context of where Centrica is right now, we can't afford to pause for a moment for any intervening interdicts or difficulties that might come across, like Charles' unexpected absence. So, we announced the process that we were going to undergo in terms of the CEO change. That process has been going on for a while and it won't pause and I will continue to lead that process. Clearly we can only update when we've got something to say, and that isn't today.

In terms of the broader question of the Board's alignment with the strategy, the strategy that you see and the priorities that you see today have been thoroughly discussed by the Board. We don't see that 2020 is a year of suddenly throwing big strategic chips back up into the air, but we do see it as a year of increased execution and increased speed and prioritisation on the things that we need to do.

And I would give you the assurance that no one is sat in the boardroom thinking that it's steady sailing at the moment for Centrica. There's a lot for us to do and we will be applying the necessary energy to make it happen at the right speed.

Iain Conn

Thank you, Scott.

<u>Question 4</u>

Chris Laybutt, JP Morgan

Just a couple of questions. One for you Richard just in terms of the legacy gas contract. My understanding is that if there is a move in natural gas prices versus a basket of commodities then that can create some of the issues for you. Can you give us an indication of what the composition of that basket is? So if we see say Brent and coal prices move relative to gas over the coming year or two we can have an idea of how that position might be moving. Any sense would be very useful.

Sarwjit, a question for you in terms of the SVT cap. There is now a very large gap between the SVT cap and marginal prices. Can you give us a sense for how much you hedge your wholesale exposure in your customer base on that cap? And whether your margins are relatively stable or will you benefit from the sharp reduction we've seen recently in the wholesale prices? And so is there a temporary benefit or not going forward as we roll through this year, given that timing issue that Iain mentioned earlier?

Richard Hookway

Why don't I start on the gas asset book? It's a contract of a different era. It was a contract that was signed back in 1988 when the world was very different, certainly the energy world was very different. You are right the purchase price is sort of a basket of commodities, some of which are no longer actually traded, some of the gas, oil and fuel oil components within that. However, that's not the only variable that you have to bear in mind. It's a contract that also volume flexes from one period to the next. It's done on a four-year rolling backward look basis. There are years in which you have high volumes, years in which you have lower volumes. There is some flexibility around that to influence the take in the year.

There's another complicating factor in that the contract year doesn't tie up to the calendar year, and so you have flex across the contract year which actually crosses from one calendar year to the next, and hence the profit or loss that you see depends on that as well.

And lastly of course, we've hedged, and we've actually hedged forward for a couple of years or so.

So, if I were to give you the basket today I'm not sure it would be hugely helpful because of all those other factors. I think the best guidance we can give is what Chris says that it will be a loss-making contract, certainly at the current spread between oil and other commodities and gas. That will endure until the end of the contract in 2025, and it's likely to be in the range of £50m to £100m.

I hope that helps.

Chris O'Shea

The way we would think about this is just like a debt item: we have it, we'd rather not have it, but we do and we have to run it to maturity. And I would encourage you to think about it like that rather than as an underlying part of the business. It's why we split the EM&T results on an underlying basis from this gas asset book. We had one that rolled off in 2018, the Bruce field that was profitable, so some were good, some were bad. But this is just like a debt that we've got to pay over the next five years.

Richard Hookway

The one build on that, Chris, is that obviously the traders watch it minute by minute, hour by hour, day by day, and if there's an opportunity to optimise and reduce that loss they do that. So, they don't sit there and passively watch it it's very actively managed.

Chris Laybutt

A quick follow up. Would it be fair to say that if gas prices were to close the gap on Brent and coal that that would be positive for you? Is that too simple or is that a fair statement?

Richard Hookway

That would be fair to say that it would be positive in terms of the direction of travel. But it's not completely linear because of all those volume effects I spoke about.

Iain Conn

Another risk management question, Sarwjit, on the price cap and hedging.

Sarwjit Sambhi

The straight answer, Chris, on the question of does the current wholesale price present us an opportunity on our capped products, the answer is no. And this is why we were quite vociferous with the JR on the wholesale part of the price cap. Because for risk management, for our default books, which are the SVT book and the temporary tariff book and the prepayment book, we hedge the wholesale load requirement. So, the key risk on those books is churn risk. But we've managed that quite well during the course of 2019, and we expect to do that in 2020.

The opportunity is created by the fact that in the fixed-term market we can compete with a lower price. But just in terms of your reference to the current price differences, it's a combination of wholesale price reduction, but then competition where competitors are competing at a lower gross margin.

Chris Laybutt

Thank you very much.

Question 5

Dominic Nash, Barclays

Two questions please. Firstly, could you just tell us what the rationale is for not deconsolidating Spirit and nuclear assets held for sale and what would be the underlying EPS if you were to account for it on a deconsolidated basis?

And then secondly, I've got a question on page 23 of your presentation, which is the cash flow 2019/20 guidance. I think you're basically saying broadly that your consumer business is going to be better next year and that's going to be offset by weaker Upstream. But when I look at cash flows between 2019 and 2020, excluding Spirit and Nuclear – apologies because I haven't got my glasses on – but it looks lower.

And the other little thing that I want some guidance on there, and maybe some sort of clarity from yourselves, is that dividend part of the pie looks smaller than 2019. Have I missed that or is the dividend 5 pence guaranteed?

Chris O'Shea

I'll give you the most interesting one first, the accounting rules. We couldn't recognise the assets as held for sale because there's quite a high bar, you have to be highly certain of a sale. And to go back to the point about these are not for sale at any price. If we don't get a decent price we're not selling these assets. So, we didn't meet that requirement at the end of 2019. We'll review that at 30th June, but that's why it wasn't there.

The EPS you can see on page 23, although it is kind of small font, but the EPS impact is 0.4 pence for Spirit and Nuclear in 2019.

The reason that the dividend looks smaller, the 5 pence dividend is never guaranteed, but we took a lot of time to think about the future of the Group over the medium term before we took the dividend down from 12 pence to 5 pence. If you remember though the final dividend, this is cash flow, the final dividend paid in 2019 related to 2018 was 8.4 pence, and that was based on 12 pence with a Scrip. And then the interim dividend paid in November was 1.5 pence, that was 30% of the expected full year. And so what you've got is a total dividend of 9.9 pence in 2019, with about 20% of the 8.4 pence, so about 1.6 pence taken up at Scrip. So, you've got about 8 pence cash dividend. Then in 2020 we expect the 5 pence. So, the 3.5 pence we announced today which, as long as the shareholders approve that at the AGM, we'll pay some time in June. And then our anticipation at the moment, but it's obviously subject to performance, is that we have a further 1.5 pence interim dividend declared around about October, November time.

There's no magic in there, there's no hidden message.

Iain Conn

And just to help you, Dominic, with the cash flow picture. A number of you I know will be wondering about the £1.83bn we delivered in 2019 and this £1.6bn to £1.8bn range and then the current commodity prices we're towards or around the bottom of that range.

Very simply, clearly two things have changed year-on-year before I get to the commodity prices. This legacy gas contract is swinging from a positive to a negative. And going in the other direction is the one-off price cap impact which is obviously improving, we don't have that this year. Commodity prices at the current price levels are broadly going to impact us by about £200m of adjusted operated cash flow. Chris can correct me on the finer details of the price, there are tax differentials between Norway and the UK, but it's roughly £200m.

And then you've got the cash flow from the earnings momentum from the rest of the Group, including our efficiency programme. And so what you can see is that we could be around the bottom of this range, and depending on the tax treatment of the cash flow, but we would also hope that we can deliver the underlying improvement in the customer facing businesses so that we will be in the range.

And the final point we made very clearly is, and Chris reiterated a moment ago, we have capital flexibility and flexibility on our restructuring programme so that we're confident we can keep free cash flow such that net debt is effectively broadly constant on a cash basis pre-IFRS 16.

<u>Question 6</u>

Martin Young, Investec

Just a couple of questions please. The first is regarding the tariff cap, both for standard credit and prepayment consumers. Ofgem put out three consultations the other week, one you've alluded to which is 'please give us our £70m back', but there's also a consultation out there about smart metering costs and the prepayment meter uplift. Have you any feel for what this might mean numerically to yourselves, both in respect of full year 2020 and then obviously full year 2021, working on the principle that it's probably more likely to be a 2021 issue than a 2020 issue? That was the first question.

And then the second question is for your stand-in Chairman. Could you give us a bit of a feel for why the process to appoint a new CEO has been taking quite a long period of time, given that Iain had said he would be staying to the AGM? It could well be the case that you might not have somebody in situ by the time of that AGM?

Iain Conn

Sarwjit, on the tariff cap and the components?

Sarwjit Sambhi

The consultation that you referred to on smart was to determine what the allowance should be for smart in the cap. And Ofgem have left it unchanged and they've deferred the decision as to when to change it till later in the year, and probably the fourth quarter.

In terms of what impact it has, I think we need to join it up to what BEIS are projecting in terms of the smart meter programme beyond 2020. And that is the key thing that we are pushing on with both BEIS and Ofgem, that it has to be joined up. We don't mind what the smart allowance is, providing it's aligned with what BEIS are projecting, and that we can adjust our smart meter programme accordingly.

Scott Wheway

I don't think I can do very much for your speculation I'm afraid. But I would just make two comments.

The first one is it's never helpful to speculate in these circumstances. I've done a number of these processes in a number of different sectors, they take as long as they take when you're looking at both internal and external candidates. And the most important thing for the Board to do is to ensure that it takes the appropriate amount of time to get the right candidate. Beyond that it's never helpful to speculate.

I must also add as a second point that Centrica has got a very good management team right now, four of whom are sat in front of you, and a whole host of others who continue to work, and I've seen them in action over the last three years. And it would be wrong for us in any way to think that the entire operational management of the company hangs on one appointment; and actually it does a disfavour to the people that are sat in front of us that have been doing that work.

So, I'm confident that we'll give you the news flow when it's the right time to give you the news flow.

Iain Conn

Can I dare to add one comment, Scott? What we did say last year was that I would step down this year and that I would be with the company at least through the AGM. It wasn't until the AGM. That's just an addendum.

<u>Question 7</u>

Ahmed Farman, Jefferies

I just wanted to start with the UK Home Energy business. You alluded to a number of developments there. There's the £70m and the absence of the £70m charge. There is the positive momentum in the cost efficiency programme. The exit of some 14 small suppliers I think you mentioned. So I just wanted to see if you could share some of your thoughts about how do you think about the margin in that business for 2020 and probably beyond as you go towards achieving your cost efficiency target? Especially now that you've had a year or so of operating within a price cap environment. So that's my first question.

My second question is just on the non-core disposal programme. Should we just assume that now you have achieved that? Or is there any other assets outside of Spirit and Nuclear, is there any other part of the non-core that's still yet to come? Thank you.

Chris O'Shea

Maybe taking the second one first. As of 11:59 last night we've achieved the £500m, because we got the £105m for the King's Lynn power station late last night.

Richard Hookway

11:50.

Chris O'Shea

11:50. Excellent. We're not waiting for it to come in. That programme is now completed. But we always keep our assets under review, so if there are assets in the portfolio that we either think somebody else would be a better owner of, or somebody approaches us and gives us a bid where we can't get that value from them, then we certainly have that conversation. We're not allergic to selling other things. But that programme in itself has done. But it is a constant review.

Sarwjit Sambhi

Our outlook for the energy market in the UK. Cost efficiencies will continue in 2020, and that will make us as competitive if not more than we were in 2019. We're going to continue the strategy of bundling with services because we're attracting new to brand customers with that offer. And actually we haven’t talked about it, but one of the things that we've done is refreshed how the brand shows up with customers, and the new 'Here to Solve' campaign is actually appealing to a different customer segment, both in services and in energy.

On the specific of the JR and the price cap, clearly we won't be impacted by that in 2020. The question as to how we recover the £70m, that's under consultation at the moment with Ofgem. The net margin in 2019 was 2%. I think at the very least it should be in line with, if you look at where the price cap levels are set with the headroom and the EBIT margin allowance, which is public information, it's nearer the 3%. We should be able to deliver in that region.

<u>Question 8</u>

Jenny Ping, Citi

Two questions. The first one for Richard. Just in terms of the LNG contract, the Cheniere contract, which you've talked about a web of hedged asset positions that's been put in place. Can you to some extent translate that into what we'll expect to see, or give us some feel as to what we'll expect to see in the short and medium term? Because clearly it's been an out of the money contract for quite some time, and how much of that have you been able to sell forward? And when we expect to see some of the potential big negative numbers coming through if we were to mark-to-market?

Then secondly, going back to the asset disposal question. Clearly we all wait to see what the price of the disposals comes at. But is there a scenario where you do want to press ahead with the cost reduction programme and spending that £1.25bn, but levers are hard to pull? Are there other assets, and I'm specifically thinking about the US business, where you could look to either reduce your stake or exit, especially given the limited synergies you have with the rest of the business?

Richard Hookway

Let me talk about the LNG portfolio, because if you look at Cheniere it's about 27/28 cargos a year, 1.75 million tonnes. Last year we traded 6 million tonnes, and so you always have to look at that contract in the context of the broader portfolio. I'll sound a bit like a broken record because I said this last year and I said at the interims that we were confident at the beginning of 2019 that we would write 2019 in black ink, and we did. And I will say again that we're confident that we'll write 2020 in black ink, because of the positions that we already have in place, not just against Cheniere, but in aggregate across the portfolio. And 2021 is also looking to be in a similar sort of place.

Obviously if you look four years out, five years out, and you take today's gas price as an indicator, and you ignore everything else but the Cheniere contract, it doesn't look terribly pretty. But nothing remains static. So even though today we're at less than $2 Henry Hub, and less than 26 pence in the UK, gas prices will move at some point over the next couple of years, spreads will wax, spreads will wane, and we will have an opportunity as we see it to be able to build that portfolio in the outer years as well.

So whilst I'm not going to make a prediction for beyond 2022, the next couple of years look okay, and I'm pretty confident that the opportunities will arise to address the out years over the next 24/36 months.

Iain Conn

And Jenny, on the asset disposal programme, I think Chris answered that on the programme that's underway. If I missed any part of it then Chris can just complete that.

On your question about broader portfolio interventions, what I'd say, and you specifically mentioned North America, as you recall but also would expect, we reviewed this as part of our strategic update last year. What we concluded is there are synergies, and particularly in the fact that the skills in selling energy and managing risk around energy are the same. It's the largest energy market in the world. But very importantly, the business solutions that we sell, as I just gave you a very big example with New York Housing Association, they're the same solutions that we're selling over here. So there's growth potential in North America.

But what we did also conclude was that North America needs to perform, because we have had disappointments with it, and that's why we've set a returns bar on North America business. It's looking promising given where we are, the momentum is good, and there's further cost efficiency from the business. Therefore, I think it's logical for us to see this geographic diversity as part of the company as long as it performs and as long as the returns are above the 10-12% that we targeted. And that's what we concluded, that's what we announced last July.

Chris O'Shea

The point you asked, Jenny, was on the efficiency programme. The question is not whether we can complete the efficiency programme. The question's just one of pace. We can turn this up and down. So if we got an offer, for example, for Spirit that we didn't like and we didn't want to sell anything else, we might just ramp down the speed of the efficiency programme, or we might decide to pull back our capex and push forward very quickly with the efficiency programme.

Like Richard, sounding like a broken record, it's very flexible, and so obviously we would all like to get the efficiency programme done as quickly as possible, get through that part and focus on growing the business. But we are also very conscious about where our cash position is. And we prioritise, we trade off capex for efficiency, it's just an investment decision.

Iain Conn

As you've said also, Chris, the quality of it is very high. You can see the cost to achieve and the synergies that we've been getting consistently. So that would be, as you say, an intervention for cash flow. The other thing I'd refer to, is the very large efficiencies we're going to deliver this year are already underway and largely underpinned. I won't give you the number, but well over half is already defined and in action. So that's really good news, it's high quality. But as you say, as we get through this year, the remaining programme for 2021 and 2022 we can make some adjustments around.

<u>Question 9</u>

Bartlomiej Kubicki, Société General

Two questions if I may. First on those efficiencies of £350m expected for this year. I just wonder how much out of this will be reflected in lower revenues, i.e., you will decrease prices to customers to support your positions to slow down your churn, and how much actually could be reflected in higher profits?

And secondly, on your capex. I think you were guiding on £1bn capex previously going forward, so £500m on Spirit, the rest the rest of the business. Now you are dropping the rest of the business to £300m. I know you have those flexibility you mentioned. But my question would be, this £300m, would it be a new norm or just only a one-off, and later on we should expect a pick up to £500m? And another thing related to this. Would it endanger your growth somehow in business solutions, for this segment? Thank you.

Iain Conn

The question about how much efficiency you have to give back to the market has been one that we've had for a number of years. It's especially pertinent when you're not the most competitive provider, because then you basically have to give some back in order to capture new customers. And it's one of the drivers as to why we were losing customers. Very importantly, we're now at the point, as Sarwjit demonstrated and was on the slide, we're now able to price at a level where we see attractive or neutral customer lifetime value, and we can win new to brand customers and up-sell. That's very encouraging. But we've got further to go.

Therefore, I would see the proportion we have to trade into the market in order to compete, as shrinking. But as we also point out, especially in the UK energy market, with this weird dynamic of a lagging price cap calculated on a prior period set of inputs and spot prices, especially for people who don't hedge who then end up taking quite significant risk of not being around, and unfortunately, the rest of the industry ends up picking up the tab for any customer books that lose money if they go bust. There are clearly still some errors in the design of the market, and we are currently consulting with Ofgem on that. But I would expect in short, the proportion that we have to trade into the market to be diminishing materially, and that we can fight on our own two feet if you like.

The final point I would make is, something very distinctive about us is we can offer bundled propositions where we own the gross margin of the other components of the bundle, which mean that someone who can only sell energy, that's all they can do. They could buy in someone else's services, components, but they'd have to pay someone else for it. So, I think we're nearing stabilisation, as is seen by the customer account numbers. Capital?

Chris O'Shea

There's a number of questions in there. I think what we guided to before, maybe February 2019, was £1.1bn, and then we brought it down to £1bn, and we delivered just under £800m of cash capex in 2019. And we're saying we'll do the same in 2020. I think any good company always has to have projects that it turns down. If you don't turn down projects then you're either not doing enough or your bar's too low. So I quite like there being some tension in the capex programme.

I think £300m for the non-E&P business is enough to keep it going. Sarwjit and Richard probably will think it should be slightly higher than £300m, but I think that that's fine. I don't think we're starving the business. I think we could bring capex down to about £100m in this but then we would have to pause any growth. There wouldn't be much for Centrica Business Solutions. It wouldn't be the right thing to do. But I think the minimum reinvestment rate to keep the capital base is about £100m.

The other thing I would say is we have identified over £100m of what we call IT change expenditure. Some of that's capex and some of that is opex. But we're taking over £100m out of the IT budget in addition to the £1bn savings target that we've got. We see an ability to do that by doing a bit less, going a bit slower, but actually achieving more. That is true efficiency. We expect to deliver more with £100m out of the IT budget.

All-in-all, I wouldn't worry about £300m. I would actually quite like to be at a point where we could increase it from £300m to a bit more, because probably what we're not looking at just now is inorganic bolt-on opportunities because we've got so much on our plate, and some of those things make sense. But at the moment, we did one last year, I wouldn't really expect us to do any this year. There might be customer books where it's cheaper to acquire by buying a small book than it is to go through normal channels. But I'm quite comfortable that £300m is actually quite a good level, and we could pair that back if we wanted to.

Iain Conn

Thank you, Chris. I'm just going to wrap up. On that last point, we haven't turned down lots of very big opportunities. Really important for you to know. I think if the trends continue, there are going to be some quite sizeable opportunities for growth organically, and maybe small inorganics as I've said, and we just need to keep that under review, and hopefully have enough cash flow to be able to do it.

Concluding comments: Iain Conn

In summary, thank you all for coming. Delivery was in line in 2019 versus consensus on earnings, and in line with our targets for operated cash flow and net debt. I realise that's already a distant memory and we're all focused on 2020.

As far as 2020 is concerned, commodity prices have done it again. This company is long commodity and is very commodity exposed. It's one of the reasons we want to simplify the portfolio and exit the asset base businesses, because all of the momentum that we delivered last year in the customer facing businesses was chewed up by largely regulatory and commodity price impacts. And the £258m underlying improvement that we saw in the customer facing businesses, I believe is extremely encouraging. But we do need to simplify the portfolio.

As we look into 2020 we expect to see similar momentum in terms of earnings momentum from the customer facing portfolio, including last year £80m of services and solutions improvement. We expect a similar improvement year-on-year this year.

As far as the questions about me are concerned, the only thing I want to say is I am totally committed to this company, and totally committed to delivering for this company in line with what Scott said earlier. And you can ask any of my colleagues, I don't think I'm spending two days a week at home at the moment, unfortunately. So, you my shareholders, have total commitment from me until and when I am no longer the CEO.

Last thing I want to say is thank you very much to the Centrica team. Not only this team that Scott referenced, but actually the wider team. This is an organisation that's been through some pretty tough yards, as Chris said, 12,500 people, and there's more change to go this year. But I am very confident that we've now created a platform that's facing into a future energy system which is going to provide growth for this company, as opposed to putting all of our money into carbon production, which I think would have resulted in a pretty bad outcome.

Thank you very much indeed for being here, and look forward to following up with some of you in the coming weeks. Thank you.

ENDS