Centrica plc EM&T investor teach-in – 1 December 2022

Transcript

Chris O'Shea, Centrica
Thanks for joining our call today. I hope you're all safe and well.

You'll have noticed this is the third investor and analyst call that we've had in a little over one month, following the Rough reopening announcement at the end of October and then our Trading Update in November. I'm delighted that we've got the chance to connect with you all again today with a teach-in focused on our Energy Marketing & Trading or EM&T business and zooming right in on our route-to-market activities.

I'm joined today by Cassim Mangerah, who is the Managing Director of Energy Marketing & Trading and Kristian Gjerløv-Juel, our Director of Renewable Energy Trading & Optimisation. Kate Ringrose, who you all know, our CFO, is also with us today. That's just in case you've got any really difficult financial questions that you want to ask.

I'm just going to spend a few minutes reminding you how EM&T fits in our portfolio and its crucial importance to the group. Cassim will then spend a bit of time covering the scale and capabilities in that business before Kristian goes into more detail on the route-to-market activities. I'll then briefly summarise, and we'll try and leave plenty of time at the end to take any questions that you've got. We've got an end finish time of about 10:00am.

As we outlined at the Interims in July, we've now got a far more simplified, focused business, with activities that participate selectively across the entire energy value chain. Each and every one of our businesses is core to us.

We're the largest supplier of energy to domestic and small business customers in the UK through British Gas. We also have a number of other strong and recognisable retail brands in the UK and in Ireland. We've got a brilliant infrastructure position in the UK and Ireland, with flexible generation, gas production, and nuclear assets, and a unique facility in Rough, which is now operating as a storage facility again this winter.

These positions mean we've always had a requirement to manage our commodity exposure and the risk in our core markets, given the scale of the positions. That's where Energy Marketing & Trading comes in. The expertise that we've got in managing commodity and market risk has proved incredibly valuable in the current environment with our world-class power and gas trading positions a genuine differentiator for Centrica.

We can also use the knowledge and expertise that we gain through doing this to add value in related areas. We've been steadily building expertise in LNG and route-to market to add to our capability in optimising storage and taking measured risks in proprietary trading and energy markets. Some of this activity does at times utilise working capital or margin cash, but we only deploy capital into optimisation activity where the rewards more than outweigh the risk.

Cassim will provide a bit more detail on the activities in EM&T. You're obviously aware of the remaining Sole Pit legacy gas contract, which, as we've said previously, we expect to lose around £150m in total before it thankfully ends in 2025. But we split the rest of the business into three main profit pools: Power and Gas Trading, Route-to-Market for Renewables and Optimisation Assets, and LNG Trading and Shipping.

As I said, today's teach-in will be mainly focused on the Route-to-Market part of the business. This is a part of the business that we're very excited by, and we see as being able to materially benefit from the energy transition to net zero across Europe. We also intend to follow up with a similar session on LNG in the first half of 2023, but for now, let me hand over to Cassim, who will then take you through some information on EM&T, and he'll then hand you over to Kristian. Cassim, over to you.

Cassim Mangerah, Centrica
Thank you, Chris. You've heard how EM&T fits into the Centrica group, so now, I want to give you a brief overview of the business and, in particular, a sense of our capabilities and scale.

EM&T was created in 2010 by bringing together a number of optimisation, risk management, and trading teams across Centrica into one business unit, thereby establishing a centre of excellence. We are a 24/7 logistics and physical energy trading business, and this is at the heart of our business model. Unlike, for example, many hedge funds, which will only trade energy as a financial product. Over the years, we have developed our capabilities and grown the business to what we now believe to be a leading position in our markets.

The scale of our business today demonstrates the sophistication of our capabilities. For example, we have nearly 16 gigawatts of third-party largely renewable assets under management in our Route-to-Market business. We trade across 24 countries in Europe. All are connected to each other, and there are strong adjacencies in terms of market structure and access. However, each country has its own unique supply and demand dynamics, which allows us to capture any regional arbitrage opportunities. We have to date delivered LNG cargoes to 36 different countries, enabled by our global perspective on the physical flow of gas, with Europe being the global balancing market.

We now have a mature operating model with strong symbiotic relationships between the elements required to make it effective. Our ability to develop a world-class capability in one element requires other elements to be reinforced. For example, developing leading risk management capabilities requires investment in a comprehensive trading platform, and the scale of our trading platform in turn underpins our ability to access different markets and products. We trade a wide range of physical and financial products, which provides the benefit of diversification in our revenue streams.

In addition to this broad product coverage, we have also invested in improving our productivity by investing in digitalisation of our platform, and automated execution and processing of more straightforward trades. Combining the scale and sophistication of our business together with our best-in-class risk management capabilities, we have successfully developed a third-party risk management business focused on renewable and optimisation assets. This business is able to benefit from the change in the ownership model towards independent producers who can’t replicate our trading capabilities and therefore need to outsource their risk management needs. This activity is the main focus for today’s presentation.

Our business model has delivered strong growth across three main commercial pillars. Gas and Power trading across Europe remains an important activity for us as we utilise our knowledge of European markets and our trading capability to make attractive returns. However, we have also focused on diversifying into alternative activities, creating two main additional revenue pools. One of these is LNG Trading and Shipping. Here, we’ve built up a range of contractual positions across the globe, which, combined with our risk management capabilities, means we are well placed to benefit from the globalisation of gas. As Chris has said, we plan to follow the teach-in today with one on our LNG business in the first half of next year.

The other revenue pool is the Route-to-Market for renewable and optimisation assets. You can see from the chart on the right how this activity has gradually become a more significant part of EM&T’s profit mix and also how capacity has been growing over the years. Although the strong financial performance of the first half of this year is aided by current market conditions, which Kristian will explain in his section, this is the part of our business that is best placed to scale further as renewable assets grow across Europe.

Before I hand over to Kristian, I would just like to highlight how well placed EM&T is to benefit from key global trends. The drive towards decarbonisation will create significant opportunities for us, particularly for the Route-to-Market business, as a diverse set of energy owners invest in renewable energy across Europe. We’re also well placed to benefit from the increased importance of LNG in global gas, given our capabilities and range of contractual positions. Security of supply concerns in Europe are only accelerating the above trends and the opportunity for us.

Thank you for your time, and I will now hand over to Kristian, who will go into more detail on our route-to-market activities.

Kristian Gjerløv-Juel, Centrica
Thank you, Cassim. For EM&T's Route-to-Market business, we'll be zooming in on how we manage and optimise the power purchase agreements on our pan-European platform. We do this as power purchase agreements are increasingly the way utilities and businesses source electricity, and because this is a market we expect to grow materially in the future. We also explain how Centrica, with a wide market presence with technology and with risk management skill sets, is positioned for this growth and how we create value for our customers and also for our shareholders.

First of all, I'd like to explain the background of the surge in demand for power purchase agreements or PPAs. Whenever a country is reducing centralised power generation and starts building out its energy supplies on renewables like solar and wind, it materially changes the market structure. Power is no longer being produced and sold by a few utilities who manage their physical power in a control room and their market risks in large bank-style trading floors. Power is now being produced by tens of thousands of different generators, and they're scattered across the grid.

Renewables are typically owned by independent power producers, who are neither traders nor suppliers of energy. They're very often financial institutions who hold their assets as passive investments. They do not have physical power or commodity risk management capabilities in-house. This restructure of the energy markets has disrupted incumbent utilities who have suffered loss of market share by creating a new market. A market for providing route to market for renewable energy sources.

Throughout the past decade, there's been a massive growth in European PPA volumes following the growth of solar and wind capacities all across Europe. Initially, the demand was for physical route to market, with a limited need for risk management skill sets, as the majority of the revenue was secured by subsidies. However, as the cost of renewables, especially solar panels, has come down in recent years, and renewables no longer require support from governments, there's been an increased demand for management of energy price risk to be included in what we call unsubsidised PPAs. In parallel to this, we've seen an increased interest from large corporations to procure sustainably through corporate PPAs as they target to reduce their carbon emissions and to achieve their own net zero ambitions.

Looking into the future, growth in renewable energy connected to not only European grids but across the globe will accelerate even further, creating further increases in the demand for PPAs and, in particular, for corporate PPAs. We'll be diving deeper into this in a moment, but before I do this, I'd like to explain how Centrica has built a leading pan-European platform for PPAs and describe our portfolio of renewable contracts.

The share of renewables and flexible assets has grown substantially across all of Europe. It's been evolving for more than a decade now, and it means that as a business in providing route to market for these independent producers, we have developed an in-house virtual power plant or VPP technology to connect these assets to the market platforms and to the electricity grids. Through our VPP, we optimise the physical electricity connecting to 24 different European transmission grids, and we balance our portfolio, leveraging from several different asset technologies, including wind, solar, batteries, heat plants, and even electrolysis. We've been building our knowledge, technology, our data model, and our market reach for more than 15 years. I'll provide a few examples of how we benefit from our capabilities and our geographical and technological diversity in our portfolios.

Managing renewables in multiple markets in one portfolio provides substantial portfolio benefits for Centrica. When there's a shortfall in wind energy in one market, we can match this with any excess energy from another market, leveraging from our market access to the grid. Having access to 24 markets provides us with the ability to continuously rebalance our portfolios and move around the energy.

As the grid becomes increasingly congested with renewables and we cannot export any more volume through the grid, which is sometimes the case in some of the first-mover markets with high renewable energy penetration, such as Denmark and Germany and now also to the northern parts of the UK, we also benefit from having a diversification of technologies. When, for example, there's an abundance of wind energy on the eastern coast of Scotland, the cost of marketing renewables on the grid, the balancing costs will be higher. In such scenarios, it's of great benefit to our portfolio to be able to charge batteries or ramp up demand for electricity through our grid-scale heat pumps or even electrolysers. Rather than paying the grid for containment.

We've spent years developing a great portfolio for ourselves and developed the technology and skills to optimise this VPP. I'll spend a bit more time taking you through our portfolio and how we support it with our skill sets. In our VPP, we manage approximately 5,000 individual assets, which in combination represent almost 16 gigawatts of installed capacity. While 75% is solar and wind, the remainder is flexible power assets, such as batteries, CHPs, large heat pumps, and large electrolysers. More than 85% of our renewable portfolio is contracted on long-term contracts with durations beyond 2024. The maturity and duration of our contracts create robustness to our portfolio, and it enables us to invest continuously in improving our platform and market access points.

Common to the flexible assets is that they are ready to directly support the balancing of our portfolio when renewable output varies. Centrica is paid fees to onboard both classes of assets, the renewables and the flexible assets, and as they complement each other, we financially benefit from these portfolio effects. We manage all of this in real time through our electronic control room and through our 24/7 trading set-up. Holding this portfolio also means that we hold competitive advantages against domestic competitors, who cannot flow their energy in and out of the country, and against single-asset portfolios, who do not have the opportunity to ramp their books up and down. In terms of our portfolio size across Europe, 15.6 gigawatts is substantial. It produces the energy to supply 9m UK homes or is equivalent to the combined capacity of the UK's five largest power plants.

Now, I'd like to cover what types of revenue we actually manage on our VPP platform and how we apply technology to extract value from our portfolios.

On our VPP platform, we onboard renewable customers, flexible asset customers, and corporate customers. Our customers seek value from us through the management of their physical power revenue, their financial risks or long-term energy price exposures, and through the management of their renewable certificate revenue.

When we make agreements with our customers to manage their physical energy volumes in the various electricity markets, we're typically paid a fixed fee. It provides our customers with sufficient revenue and security to obtain funding for their investments.

As explained, once we onboard our assets to our VPP, we create substantial portfolio effects from combining different types of assets and from locational diversification. We've invested significantly into real-time optimisation of our portfolios, leveraging from real-time data connections to our assets, which then feed into our real-time energy forecasting and subsequently into automated trade execution. As the majority of customers are subscribed on fixed fee terms, continuously improving our platform and optimisation technology provides a significant financial value to our portfolios. Generally, we expect our portfolios to perform better in elevated price levels with high volatilities.

With an increased proportion of renewables coming online, this creates a great opportunity for us, both due to the growing size of the market and due to the volatility in prices created by the increased intermittency of generation.

The second category of revenue we manage is that we help investors in renewables manage their long-term market risks through bankable long-term PPAs. Bankable PPAs are instrumental for making renewable assets attractive investments, as they guarantee that there's an energy offtake in place for the investments prior to the investor making their final investment decisions. We have origination teams on the ground in the UK, in Scandinavia, in Germany, in Benelux, in Italy, and in Spain to work on long-term PPA opportunities. Our reach is a clear advantage in sourcing PPAs and matching this with off-takers. With our PPA proposition, we provide liquidity to investors and to those businesses procuring renewable energy. Our portfolios also benefit from the fees our customers pay for managing their risks.

In terms of profitability for this part of our portfolio, we see increasing margins when prices are high because it's more expensive to transfer risks, but also because we're very agile in how we do business. When prices move quickly, our customers choose us because we can turn around PPAs in weeks, where competition often takes months doing the same thing.

Finally, we manage renewable certificates. Renewable certificates are becoming increasingly important as corporations are seeking to realise their net zero strategies. Trading renewable certificates, we benefit from our access to corporate customers, who demand the certificates and will pay a premium for them.

In the market for PPAs, there are several ways to transact. Sometimes we sign PPAs with the generators and subsequently market this to off-takers. We also offer corporate PPAs. A recent example of this is a long-term corporate PPA deal we did with Greek developer Mytilineos, and Vodafone. It's the largest solar PPA recorded in the UK to date. This PPA is an innovative way of balancing risks and creating value for all parties involved.

On the generator and investment side, Mytilineos is able to obtain project finance, as it has a pre-agreement for the sale of power from the five sites through the PPA, and at a price that exceeds debt service requirements for the financing institution. It also provides the service of physically balancing the produced energy onto the grid while nominating power directly to Vodafone's meter points.

On Vodafone's side, Vodafone will secure access to renewable energy on a long-term basis, meaning that future costs of procurement are certain, and they'll be able to report exactly from which source they procured the energy for their annual sustainability accounts. They also have access to additionality, which means that their procurement decision is directly linked to Mytilineos's renewable investment decision.

On Centrica's side, we onboard five additional assets for participation on our platform, with good location and diversification and for which we're paid a fee for 10 years. We also had the opportunity to develop a contractual format and implement platform enhancements to scalably onboard similar transactions in the future. We obtain risk premiums as a portion of the risk is covered through our portfolio diversification. Finally, it sends a clear signal to the market about our capabilities.

To summarise, Centrica is in a really strong position to benefit from the next stages of renewables transition, as we have a platform designed to scale in our existing markets and to leap into new markets, both within Europe and possibly also over time outside Europe. We've demonstrated this by adding several new types of assets to our platform and adding several new markets in the past few years. We also see a trend of more direct links between generators and off-takers, both from corporates but also from electrolysers demanding renewable energy for the growing hydrogen economy. Our platform, our capabilities, and our market presence means that we are ready to take part in this growth. All in all, it's our ambition to double our position within five years, which would increase the significance of our platform to

Centrica's future performance. The opportunity is there, and we have the capabilities in place.

With that, I'll hand back to Chris.

Chris O'Shea, Centrica
Excellent. Thank you very much, Kristian. Let me just briefly summarise before we move to Q&A. Energy Marketing & Trading is a core part of Centrica's portfolio. You've heard from Cassim about the capabilities and the positions that we've got and how we're well placed to benefit from key global trends. As well as providing risk management services for the group, it's evolved into a significant profit centre in its own right, having developed world-class optimisation capabilities and playing an important role in storing, transporting, and balancing energy supply and demand across Europe.

Kristian's helped to add some colour to the route-to-market activities. How we capture value today from our advanced proprietary pan-European renewable virtual power plant and how we're well positioned to benefit from the build-out of renewables across Europe. Route-to-Market is a profitable, sustainable, and growing business. We've built an incredibly strong ecosystem. These optimisation capabilities are also key to our infrastructure assets and any future investment we make in that space adding upside to the core asset returns.

What we've created is very hard to replicate. There are huge barriers to entry. We've been doing this for years now. We've spent years building a broad and diversified portfolio. We've spent years developing our own proprietary platform. We've spent years building a strong team and talent pipeline. We continue to grow and invest in our people and our systems. We move faster and farther than any competitor can. This business is repeatable, with long-term contracts which give a strong base return and provide optionality to capture further upside.

As I said earlier, we'll look to do a similar teach-in on LNG in the first half of next year to help demonstrate the value and the repeatability of earnings from that part of the business. Thanks very much for listening. Cassim, Kristian, Kate and I really look forward to taking your questions.

<u>**Question 1**</u>

Martin Young, Investec
If we can jump to slide eight to start with. You've got the development there of the EM&T gross margin obviously going in an upward direction. If the recent trading statement is anything to go by, there's going to be another big blue block for the second half of this year. I wonder if you could just sort of say something about where you think a fair run rate of gross margin for EM&T in normalised conditions would land. Then secondly, diving into the green part, which I appreciate was the real subject for today, when you look at the green bar, what's the sort of split in that

between what you gain in terms of fees from the people that you deal with, and how much of that then comes from the optimisation of the power that you have access to? Thank you.

Chris O'Shea, Centrica
Martin, thank you very much for the question. It's a brilliant attempt to get us to give you a profit forecast. I think you can see, if you look at the blue bars, obviously, the first half was strong, where we made as much in gross margin in EM&T as a whole as we did in 2021. I would look and say if you've got 2020 and 2021, you could say that they are slightly more normalised. However, what I would say is this business continues to move, we continue to grow. I think that there's obviously – it's not so much about the price in 2022; it's about the volatility. Where this business is able to capture value is where you've got volatility. Whether it's high price or low price, it's very stable. It's hard to capture the volatilities in there. I would say it's probably somewhere north of the 2021 number, but I wouldn't expect it to be the 2022 number, but if we saw similar volatility in '23, '24, and '25 as we're seeing in 2022, I'd be disappointed if we weren't able to capture that value then.

On the green bar, obviously there's some commercial sensitivity in there, but I would say that the growth that you see from '21 into '22, part of that is driven by the higher prices, but it's not necessarily just driven by the fact that we're able to capture the higher prices in 2022. As Kristian said, it's because as those prices come up, we see lots of people coming to us. We've done an awful lot of business this year, and that gives us a great baseline going forward. I wouldn't want to get drawn into splitting that, but the growth is not all because we've captured upside from the higher prices, but obviously, we want to keep a bit of commercial sensitivity – although I'm confident that we can move quicker than the competition, we don't want to give away all the details of the secret sauce.

Martin Young, Investec
Okay, thanks.

<u>Question 2</u>

Pavan Mahbubani, JP Morgan
Chris, thank you and the team for the great presentation. I have two questions, please.

Following up on Martin's question from slide eight, I appreciate that volatility is a big driver, certainly in the first half of 2022, but if I think of, on a recurring basis, how to think of the key driver of the Route-to-Market business, should I think of the capacity under management? Should I think of the number of PPAs that you sign? If you could say, what are three things we should be looking at? As if these things grow, then the Route-to-Market business should grow on a recurring basis. That would be quite helpful.

My second question is can you share your view on the power market reform or REMA upcoming and whether you see that as either an opportunity or a threat for the Route-to-Market business?

Chris O'Shea, Centrica
Thank you. I'll try and take the second one, and then I'll ask Kristian to give you a view on the higher-level drivers that you can look for as to how this business would grow. I think on the REMA, the power market reform, I look at everything as an opportunity, and I think the team do, I'm looking at Kristian, Cassim, and Kate and they're all nodding here. I think it's too early to say whether it will be good or bad, but in this business, everything I think is good for us because, as you see, what we've built is something that we provide services to electricity generators, and we're also an electricity generator, so we benefit from those services as well. Anything which changes the market gives us an opportunity to help electricity generators further, so I'd be quite hopeful on it, but we've just got to wait and see.

I think what we've shown, and I'm sure you've picked up, that we're active in 24 different countries across Europe doing this business. Those markets are not all the same. We bring different things to different generators in different markets. The UK is simply one of a number of quite substantial markets that we're active in. Some very liquid; some not so liquid. Where they're not so liquid, we bring liquidity; where they're very liquid, we help people capture the benefit of that liquidity. So, I wouldn't be worried. Obviously, we'll be involved in trying to shape those reforms because ultimately, as the largest supplier of electricity in the UK, we've got a real interest in making sure that we get prices as low as we possibly can for our customers whilst making sure that those people that invest money in delivering that electricity make an acceptable return. That's the Holy Grail.

On the first one, in terms of what are the top two or three route-to-market drivers that you should be looking for to monitor growth, I'll ask Kristian to come in.

Kristian Gjerløv-Juel, Centrica
Thank you, Pavan. In terms of the key drivers for the performance of the Route-to-Market business, I would look out for a combination of the total capacity, but also our market reach has a significance, so watch out for what kind of markets we participate in. Then also, when the markets change, there's often the need to transact. Our business is to manage the risks of our customers, and whenever things change, whenever market conditions change, there's a good reason to transact with us. So that's also a key driver. Then obviously, market volatility, as this enables our platform to perform, as I also explained in the presentation. I hope this covers your question.

Pavan Mahbubani, JP Morgan
Yeah, thanks. Thanks both for the presentation and for answering my questions. That's very clear. Thanks very much.

Question 3

John Musk, Royal Bank of Canada
Thank you for the presentation. Two questions from me. Again, on slide eight. Just trying to understand in the optimisation element above the base fees, is there sharing mechanisms that you have in there with your customers, or does it all come to you, so it's a net number you show? Also, on that, how can we get comfortable that there's not a big negative potential in this optimisation activity that you do? What's the risk to the downside here? One final one, which is very quick, I didn't catch the duration of the contracts when you were mentioning that earlier.

Chris O'Shea, Centrica
John, thank you very much for the question. I'll ask Kristian to talk about the duration. The sharing mechanism – if there is a sharing mechanism, it depends on the contracts. Sometimes we share; sometimes we don't. The beauty of this business is that it's incredibly flexible. We give the customer what they want. That's why the customer comes to us. Some customers want to pay us a fee to do certain things for them, some customers want to pay us a fee and to be left alone, and some customers want us to optimise and share the upside. The number you see in slide eight is a net number, so that's our share of the benefit.

On the downside risk, obviously, there will be points at which if we warehouse power purchase agreements, for example, we'd be taking some risks before we offlay that to other people. But we have very, very strict risk limits and, as you would imagine, a very strong monitoring of that. So, I'm very comfortable that whilst you can't be in a business like this and take no risk, we have strong limits on the risks that we would take. If you find yourself, for example, having gone into some substantial PPAs but not yet having offlaid the risk or not having the risk offlaid at the start, then you slow down the kind of risk that you'd take on.

We've got more than 5,000 assets that we help. They're not all different. We don't have 5,000 different types of agreement, but we have an awful lot of variety in there, and we make sure that we don't take any more risks. What are the chances of that being a negative number? It's never zero. I'd say it's slim to none, though, in my view, because we've got this baseline of fees in there that are repeatable. They come every month, every quarter, every six months, every year.

Look, on the duration, I'll ask Kristian to just confirm what you said about duration during the presentation and add anything you wanted to talk about on the downside risk. How are we comfortable that this won't turn into a negative number?

Kristian Gjerløv-Juel, Centrica
Yes, thanks for your question. On the duration, as I explained, 85% of our portfolio has a duration beyond 2024. Generally, when we talk about unsubsidised renewable projects, they require long-term contracts. This is one of the main reasons why we make contracts that have between often five and 10 years. In terms of risk and

financial robustness, we have a clear risk governance, and we also have a clear strategy to offload the exposures related to the PPAs to off-takers. The majority of off-takers, we offload this to our corporate off-takers on the one hand, and it's the utilities, energy suppliers, who have supply portfolios, access to energy on the other hand. It's our ambition and what we do is to balance the book and provide two-way liquidity to the market. I hope that answered your question.

John Musk, Royal Bank of Canada
Yes, that's great. Thank you.

<u>Question 4</u>

Dominic Nash, Barclays
Thanks for this presentation. I've got two questions, please. Although it might be three. The first question I've got is, what balance sheet usage does this division use, and how do you calculate that? Like with your VARs, or how much capital you allocate it when you're making return decisions. The second question is, I think in the presentation you said that you plan to double the size of the RtM division in five years. Could I interpret that as basically saying – and I think the answer to Martin's question was that north of 2021 is kind of a normalised year. If we go north of 2021 and then double it in five years' time for gross margin, am I a million miles away from the mark? That'll probably do. Thank you.

Chris O'Shea, Centrica
Thanks very much. I'll take the second one first and then ask Kate to talk about how we think of the balance sheet. As you know, this is as close as you'll ever get to a forecast with me. I did wonder whether we should say we're going to double it in five years, but Kristian and Cassim were very confident, so I said that's absolutely fine, it'll be in the performance contracts to make sure that we deliver that. I would be disappointed if by doubling the capacity under management in five years, we didn't more than double the gross margin that we saw in 2021. I think it would be north of the doubling of the 2021 margin because the massive benefit in this business is – and this will touch a little bit on what Kate will say – the more you put into this incredible portfolio that we've got, actually you can reduce your risk and increase your returns. This is why I think we've built something that is going to be very difficult for anyone else to replicate because it's not a linear thing. You know, more assets, more risk. We can put things on that will complement existing assets, will allow us to provide more liquidity, may actually reduce the risk capital but give us a better than linear increase in the returns. I would expect more than double the 2021 margin if we manage to double the capacity under management. With that, I'll pass on to Kate, who will touch a little bit on how we think of the balance sheet and the return on capital and the risk.

Kate Ringrose, Centrica
Thanks Chris, Hi Dominic. Just a step back with regards to EM&T and how we think about balance sheet and cash utilisation more broadly. The key drivers around that

is how we trade in the markets, so whether that's on exchange or with counterparties, and what part of the portfolio uses inventory. If I narrow down to the PPA, then you're trading on exchange, and you're also trading with independent producers, there's different types of settlement. Broadly, as commodity prices go up, it's favourable. As commodity prices come down, it's less favourable, but it turns into cash quite quickly. There's quite a quick turnaround from profit production into cash. The only caveat I would put in, and this is something that's consequential for all of EM&T and anybody who trades in commodity, is initial margin. As you'll be aware, initial margin requirements have increased across the piece for exchanges, both in terms of percentage and also in terms of commodity price elevation. Because of the number of grids that we're trading on, there are multiple exchanges that this activity is traded on.

Dominic Nash, Barclays
Just to follow up on that one there, there's a difference between collateral and initial margin and the balance sheet that you need to keep aside for future margin calls or things that go wrong. Do you have a sort of an overview invested capital number that you sort of like do a return calculation on?

Kate Ringrose, Centrica
We do. We look at that on a portfolio basis because what you'll see in EM&T is it's a broad portfolio plate that comes in. It's a system that kind of goes beyond PPAs into the other activity as well, and that's how we holistically do that. But absolutely, as you'd expect, we plan for the margin that we'd need and the returns that are required to justify the investment in working capital.

Dominic Nash, Barclays
Great, thank you.

<u>Question 5</u>

Ahmed Farman, Jefferies
Thank you for taking my question. Two from my side. I'm just hoping you could talk a little bit about the competitive space in this Route-to-Market segment. Who are your competitors? How has that evolved over the last few years? Any thoughts on the outlook? Secondly, it's a similar question, but more on the PPA market, both in the UK and Europe. It seems like that's going to be a key driver. Could you give us some context? How has that developed over the last couple of years? How do you see that developing in the coming years? Thank you.

Chris O'Shea, Centrica
I'll maybe ask Cassim just to talk at a high level about how the PPA market has developed in the UK and Europe. Then Kristian will talk about the competitors, but obviously, we won't spend too long talking about the competitors because we're here to talk about how we are so far ahead of the competitors. But maybe I could ask Cassim just to talk about how the PPA market has evolved.

Cassim Mangerah, Centrica
Thank you, Chris. The evolution of PPA started with the independent producers. Historically, assets have been owned by utilities. With the surge in renewables, more and more independent producers have come to the fore to invest in these assets. They don't have the risk management capability of a platform to do what we can. Therefore, we have entered that market as an emerging opportunity several years ago. What we are seeing now is that you're seeing the consumers now coming into the market as well. You see more of the corporate PPAs that Kristian talked about.

We think this is a great development, actually, from our business model perspective because by having both producers and consumers interested in PPAs, we effectively become a broker in between, and we will risk manage that. The risk management requirements of both sides of that are actually quite different. Producers typically want longer-term contracts; consumers might not always want that. There's also load balancing because it's not the same. What you produce and what you consume will not be the same. That's the evolution that we see, but we are really well placed I think to take advantage of both sides of that. Like I said, they're different needs, we can manage the needs for both of them, but we can also offset risk. We talked earlier about how much risk capital we use – how much capital we'll use to grow this business. Actually, as we see the maturity of PPAs, we see a more efficient use of risk capital because we can layoff risk between producers and consumers.

Kristian Gjerløv-Juel, Centrica
And coming to the competitors, it's also been an evolving landscape, but the general pattern is that we have different competitors in different regions. As I mentioned, we're present in Scandinavia, in the UK, in Germany, and also in southern Europe, in Italy and Spain, and the general pattern is that we face local competition in all of these markets, which in turn gives us the benefit that we can scale on a pan-European platform. Our technology is funded by our presence in those different markets. We have a bigger scale than our local competitors. Also, we see a few competitors stepping in in an advisory form. We have PPA marketeers, but typically, they only do what I would call financial PPAs and do not have access to physical trading capabilities.

Chris O'Shea, Centrica
Hopefully, that gives you a good flavour, Ahmed.

Ahmed Farman, Jefferies
Thank you

<u>**Question 6**</u>

Deepa Venkateswaran, Bernstein
Thank you so much for taking my questions. One question that I wanted to understand a bit deeper is the risks, but maybe you can put it in the context of, say,

the Vodafone deal that you've talked about. Obviously, many, many of these large corporates also have their own corporate PPA division, so why would they need to go through you? Are you, in effect, trying to convert a volatile, weather-dependent power source into something more reliable, so you're matching it with batteries or something else? Are you in this process taking some kind of risk that maybe Vodafone didn't want to take, or the renewable company didn't want to take? I'm just trying to understand, obviously, there's no free lunch here. There's some risk you're taking on behalf of somebody and monetising it. Just trying to see whether there's any duration risk or, I don't know, merchant power price risk or anything on the balancing payments. Anything that you might be liable for because you've promised something different to the customer. I think that's my main question.

Chris O'Shea, Centrica
Thanks very much. I think that is definitely one for Kristian and his more detailed knowledge.

Kristian Gjerløv-Juel, Centrica
You're absolutely right. We see PPA teams both sitting with the large corporations and also with the independent power producers. They broadly originate PPAs from both sides, but what they lack is the risk management skill sets. They also lack the physical trading capabilities. That leads to my answer to the question around what kind of risks are we then taking? Broadly, we take the residual risks that are not transferred between corporations and generators, and we then manage and market those risks onwards into the wholesale markets. The types of risks that we manage, you're right, we manage the balancing risk, which is balancing the renewable loads onto the grid. This is what our platform is designed to manage. This is where our portfolio effects come into play. This is also where we play the batteries and where we play other flexible assets to mitigate those risks. We have real option mitigation within our portfolio. Other types of risks we take, we take also sometimes what are called shaping risks, which means that when there's a mismatch timing-wise, when the renewable energy is produced, and the corporate customer is having a demand for the equivalent amount of electricity, we shape this, and we use wholesale market tools to restructure the shape of the transaction. I hope that answered your question.

Deepa Venkateswaran, Bernstein
Partly, but when you're shaping, say, the shaping risk, you're taking that on, you're trying to recover that as a premium to the PPA price or something, right? So, you're obviously charging a spread over whatever the renewable generator is getting in order to cover these risks, right?

Kristian Gjerløv-Juel, Centrica
We always charge a premium for the risks we absorb, and then we develop a toolbox for ourselves to manage that risk. Within that toolbox, of course, we use wholesale markets to offload the risk into the market. We have portfolio effects, in which we trade for the risks. Part of those portfolio effects is to have flexible assets that benefit when those differentials widen in the market. I hope that makes sense.

Deepa Venkateswaran, Bernstein
Okay, thank you.

Question 7

Richard Alderman, BTIG
Can I just come back to Dominic's question? In terms of just understanding a little bit more about how you use the balance sheet for collateral posting for other clients, your business model looks a lot like the investment banks in terms of you're using your balance sheet to work with clients who are smaller and don't have the collateral structure and strength of balance sheet to hedge their own business. Could you give us some comfort around what you're doing with your own balance sheet and the scale of collateral posting you actually have to do for this total book?

Also, a secondary question, how should we think about this business going forward when commodity prices do come down from these extreme higher levels? Does it mean that customers will move away from you because at this point, they don't have the capacity to do that sort of hedging, but in more normalised markets, they may be able to do it themselves?

Chris O'Shea, Centrica
Let me try and then maybe ask Kristian and Kate if there's anything else they want to add. First and foremost, I would say customers are not coming to us because they don't have the balance sheet to do this; they're coming to us because they don't have the capability. It's quite different. The ability to go in and trade and hedge and do the physical balancing is quite a skill. It's not so much that they don't have the financial wherewithal.

In terms of the margin that we post, obviously, for the largest part of our portfolio. The two largest parts are our assets, the generation and production assets. We've got a large long there, whether it's in in the UK, or in Ireland also with the Whitegate power plant. Then we've also got a large short, which is a retail book of over 8m residential and small business customers in the UK, and over half a million customers in Ireland. And EM&T manage all of that, and they manage the same collateral requirements for LNG and for route-to-market PPAs. The majority of the collateral that we post is often related to the hard physical assets we own and the shorts we've got on the books. One of the benefits actually, and one of the reasons I think that this is a very, very difficult business to replicate, is we're one of the largest electricity sellers in the UK and Ireland, and we've got a large position in Europe in terms of selling electricity, so we actually have a natural offset to a lot of this power that we buy. We might choose to increase our customer book and sell it to other people, but it's not so much that every bit of power that we bring on gives us a requirement to post more collateral. We can actually offset that against the downstream sales that we've got. As you know, the European market is interconnected.

It’s far more than a balance sheet play. If this was just a balance sheet play, we would not do it because we’ve got enough draw on our balance sheet from the assets that we’ve already got, but it’s the complementary nature of this. It’s having these large long positions and these large short positions and being able to match those. They don’t always perfectly match. That’s why Kate sometimes gets a few more grey hairs than she would like when we see prices moving up and down in terms of the draw on collateral, but that’s by and large for businesses other than the Route-to-Market business.

Richard Alderman, BTIG
Thank you. Going forward, if I look historically back at Centrica in the last 10 to 15 years, this business has been, broadly speaking, a business that matches risk for the parent rather than takes risk from third parties. What you’re saying here is that you feel that you can double the capacity that you have under management from third parties and still manage that risk in an even basis when you look forward to that five-year statement you made earlier on.

Chris O’Shea, Centrica
Yeah, most definitely. This is something that – I think, as you all know, I’m naturally quite a conservative soul in terms of showing you what we’ve got. I’ve heard loud and clear that maybe I have to be slightly less conservative and be slightly more expansive. We’ve been doing this for years, and it’s only now that we think let’s actually come out and talk about it.

This reminds me a lot of the LNG business that I saw when I was in BG Group, whereby we built a portfolio and we were able to actually manage risk far better and bring something to the market that didn’t exist, which is, if you think about it, if you’re a power provider, and you’ve got a wind farm somewhere, you’ve got a lot of risk in a single location. If you’ve got someone like us that comes along and says, look, we’ve got 5,000 different places, and we essentially aggregate power production and power sales, and if you want to, you can either take the risk yourself of having a single site where maybe the wind doesn’t blow, the sun doesn’t shine, or for a fee, you can put it into our portfolio, and you’ve got far less chance of not being able to deliver stuff and penalties, etc., far more stability. We bring something to those power producers that they can’t get. It’s the same as BG brought something in LNG, which was rather than being point to point, which is what power purchase agreements were before, we pool all of this.

We get to review – anything that has a duration of more than 10 years comes to Kate and I for approval. The team can move very, very quickly. We have a look at these things and if they’re above a certain financial limit. We always look at the risk, but what we look at is what is the risk of the portfolio. One of the really nice things about this business is we see often deals which come in and actually reduce the risk capital employed in the portfolio. That’s why I think that this is something that we’re really, really keen to grow. We’re very comfortable in growing, but we think that the bigger we get, maybe, actually, we can do that without putting more risk capital to work. That's what the team are always looking at. That's why, as Kristian said, we've got boots on the ground in lots of these different countries. Most of the competitors are local, so they can't do what we're doing. I can't claim any credit for having built this. I can only say that I'm very happy that we've got it in the business. The last time I saw something like this was the LNG business in BG Group, and that did quite well for them.

Richard Alderman, BTIG
And you're comfortable with the growing credit risk of the counterparties multiplying at that pace?

Chris O'Shea, Centrica
Yeah, look, I think, always you've got to manage – I mean, Kate talks about this kind of trilemma of you manage market risk, credit risk, and cash. We are constantly looking at that. We've got a very good team that monitors this. Obviously, the better the credit risk, the lower the fee that we require, the worse the credit risk, the higher the fee. We manage that. So far, touch wood, we've not had major credit events. What we try and make sure is we don't have all of our eggs in one basket. We monitor it very, very, very regularly, but I think, as Deepa said, there's no free lunch. You always take some risk, but we're very careful and controlled about it. We've got a very strong independent risk management function.

Kate Ringrose, Centrica
Just the one other thing to add to the credit risk point, as a reminder, we talked about 5,000 generators that we're dealing with, so that just points to the diversity point. But also remember this is about physical output as well, so to the degree that you've got access to the physical output, that in and of itself is a mitigator against the credit risk that you're taking to small independent generators.

Kristian Gjerløv-Juel, Centrica
And finally, the independent generators are held in special purpose vehicles where the counterparty is actually the asset. We don't run corporate risks from a credit perspective.

Richard Alderman, BTIG
Okay, thanks very much.

Chris O'Shea, Centrica
Look, thanks everyone for joining. We're not going to make this monthly. We'll probably take January off. We'll be back to see you in February with our results. We said the first half, but maybe we'll come back in March if we can and talk about LNG. This is part of an ongoing series of events that we'll hold to demonstrate some more detail on the quality of the underlying business we've got and the repeatability of earnings because I think that we see, in terms of the understanding of our business, our company has been described as being complicated. What we're trying to do is to

break down some of that complication and to demonstrate some of the huge value that we see already embedded in Centrica today that we think is not actually recognised by the market or in the share price.

Hopefully, you've got a bit more information, you understand a bit more as to why, firstly, we like this business and why we want to grow it, and also some more understanding about the repeatability of the earnings that we see from Energy Marketing & Trading, but also from the Route-to-Market business and why I think it's uniquely placed to benefit from the energy transition, which is coming thick and fast.

The last bit of upside that we have is the knowledge that we have by being in 24 markets around Europe allows us to decide where best to place our infrastructure investments in the UK and in Ireland because we know how electricity markets respond to different mixes. There's a huge symbiosis in having this business in the Group, and I'm really delighted we were able to unpack it a bit for you today. I hope you enjoy the rest of your day, have a good day, and if we don't speak to you all, have a super Christmas and see you back in January. Take care. Thank you.

END OF TRANSCRIPT