2015 Preliminary Results Announcement: video interviews

Iain Conn, Chief Executive

Q: 2015 has been a challenging year for Centrica with profits down for the second year in a row. So what's happened?

A: Well it was a challenging year and the principal difficulty was the collapsing commodity prices which had a very strong impact on our Exploration and Production business. And I would actually say that the result that we achieved of earnings down 4%, while clearly down, was actually quite a resilient performance and very importantly our operating cash flow, which is a key measure, was up 2% on the year.

Q: You mentioned resilience but how resilient is Centrica given the current price environment?

A: Clearly volatile commodity prices are impacting a number of different sectors at the moment, from minerals to oil and gas, and one of the things that we have to plan for is a range of prices. One of the things we did last year when unfortunately we had to cut the dividend was to cut it to a level that we believed would allow the company to withstand a range of environments and commodity prices. And in fact that has been borne out and I'm pleased to say that even at $35 a barrel and equivalent levels of gas prices in the UK and power prices today, that the company can more than balance the cash coming in with the cash going out for the next three years.

That also means that we will be able to balance our cash flows, even at lower prices, perhaps with some regret costs, but the company as a result is very capable of managing its own needs over the next three years in this difficult environment and with some spare capacity besides.

Q: And how confident are you that you can achieve a 3% to 5% growth in your operating cash flow in a low commodity price environment?

A: Clearly the low commodity price environment has impacted the absolute level of cash flow that we can generate but we are confident in our ability to deliver over £2bn of operating cash flow again in 2016. As far as the growth rates are concerned, clearly there's part of it that is about if you like the top line, which is selling more things to more customers and giving more offers and generating more revenue. But a very big component of this is our cost efficiency programme where we do believe we can deliver £750m per annum of efficiencies over the next five years.

And we've said that we can deliver £200m of that in 2016. This gives me the confidence that even in the very difficult environment we can generate underlying operating cash flow growth. And if we do that and are confident in it, that will underpin our ability to deliver a progressive dividend to our shareholders.

Q: What progress have you made against the new strategy that you announced and is it still an appropriate strategy given the background environment?

A: The strategy we announced last year was to reposition the group with a primary focus on satisfying the changing needs of our customers but having a mix of businesses that makes the group strong enough and resilient enough to do that, because serving the needs of 28 million customer accounts involves quite a lot of risk, and risk management.

I'm more convinced than ever that the strategy was right. We've seen that the effect on our group of the falling commodity prices has been significant, but it hasn't been so significant to undermine the ability for the group to balance its own cash flows and to pursue its strategy. We have said that we do want to reduce, but not eliminate, the exposure to exploration and production and we still have to do that. This is not a good time to be rushing to sell E&P assets.

However, we've also recognised that in the customer facing businesses we need to pursue growth; we need to pursue growth through offers, growth through better service, growth through being more efficient and to focus on some new sectors. All of that is underway; we've reorganised the company in line with those goals and I'm satisfied with the early progress. We saw very significant profit growth in our customer facing businesses last year and we are seeing good capability development in some of these new areas.

So the strategy I believe to be absolutely appropriate, if anything more appropriate in a difficult commodity price environment, and we're making strong progress.

Q: Profits from your energy and services business are up 19%. So is the read-through from that that the downstream businesses are supporting the rest of Centrica?

A: The diversity of cash flows we have makes the group very resilient, which was an important part of our strategy last year. Part of the year on year improvement in the downstream businesses is not sustainable in the sense that 2014 was particularly impacted by warm weather in the UK and low consumption, and it was particularly impacted by very complex weather patterns in the United States. So some of it is a restoration relative to where we were in 2014.

But it's true that the profits of British Gas in aggregate were stable; the profits in our small business in Ireland actually trebled and the profits in the United States more than doubled. We saw good underlying performance with a big focus on the customer and a focus on making our offers better and making ourselves more efficient. So I'm very satisfied with progress to date.

Q: Given the reduction in prices that we're seeing in the wholesale market, are you really doing enough to bring your customers' bills down?

A: Just a word on the obvious question. Commodity prices have gone down and your profits have gone up in energy in the UK. How does that work? We absolutely have passed on the low costs of commodity prices as they fell to our customers. The reason the profits went up in 2015 versus 2014 actually is very simple. It's about the weather and about consumption. And we saw a very mild 2014 and we saw a more normal 2015 and therefore the amount of energy that our customers used went up and therefore the actual total profit went up. But very importantly the profit only went up to a level that's a little bit below the average of profit over the last six or seven years.

Q: The CMA will conclude its investigation later this year. What's your view on how effective it's likely to be?

A: The CMA investigation into the functioning of the UK energy market is very important. The market today is very competitive; we have approaching 30 different suppliers; we have a lot of switching sites; customers have a lot of choice. We've had lots of opportunity to contribute new ideas, to answer their questions, and now really I'm looking forward to hearing their provisional decisions.

We now have enough competition that this market is flourishing quite well. If they drive more ability to innovate and be competitive, we welcome that. And I know they're looking at a number of other things to try and safeguard certain categories of customer, which we also think is a good intent. Exactly how that would work though is something that we have some concerns about. I'm very confident that it will enable the market to move forward, and us to move forward.

Q: So looking ahead now, what's the outlook for Centrica in 2016 and what are you going to be prioritising?

A: So as we look forward my first priority, as it always is, is safety performance and compliance. After that what we've got to focus on clearly is our customers and customer service and delivering excellent operations with what we've currently got.

Then it comes down to the strategy we've laid out and it is about cash flow growth. And I'm pleased to say that we've indicated, despite further deterioration in the environment, that we still expect to deliver over £2bn of operating cash flow this year. That's very important in order to make sure that the company is resilient. And we've also said that we are going to be able to grow cash flow at slightly more than 3%-5% per annum over the next few years. And those two together give our owners both returns and confidence in them and growth. And we will be looking to develop our strategy and implement in many dimensions to underpin that.

Jeff Bell, Group Chief Financial Officer

Q: Earnings per share are down 4% to 17.2p, so can you take us through that?

A: We had a strong year in our energy supply and services businesses, British Gas, Bord Gais Energy in Ireland and Direct Energy in North America, where operating profit was up 19% year-on-year. However, that wasn't sufficient to offset the impact on our exploration and production and central power generation businesses from the steep fall in commodity prices that they experienced during the year.

Although our tax rate was slightly lower, the net result was a 4% fall in earnings, to just over 17p share.

Q: You've posted exceptional charges of £1.8bn. Can you explain where that came from?

A: Our exceptional charges were primarily in two areas, exploration and production and central power generation asset impairments, driven by the steep fall we've seen in commodity prices. In exploration and production, the charge against our assets and the associated goodwill was just under £1.5bn post-tax, and in power generation, against our nuclear and Spalding thermal contract, by £485m, post-tax.

Q: Now, Group operating costs are up 5%, and that's despite your efficiency programme, so what are you doing to control costs across the Group?

A: Costs were up about 5% compared to 2014. It included both investment in customer service, as well as one-off items, the full-year impact of the previous year's acquisitions and an adverse foreign exchange rate. However, even allowing for that, underlying costs were up by about 1%.

However, with our cost efficiency programme, now underpinned in our plans, we expect to see like-for-like operating costs lower in 2016 than 2015.

Q: Net debt's down 9% across the Group, so what's driven that?

A: We made strong progress against our Group net debt in 2015. It was down £450m to just over £4.7bn. It was driven by a few factors. The first was a slight increase in our operating cash flow, which was up 2% to £2.25bn, but a larger driver was a combination of the capital discipline we had in 2015, lower organic capital expenditure, which was down by a third, as well as the rebasing of the dividend that we announced at this time last year, and a non-cash scrip alternative for shareholders, with the net result being that net debt fell by £450m.

Q: So how are you doing against the financial framework targets that you set for yourself in July?

A: The financial framework that we set out last July provides a set of parameters under which the Group can operate, really linking the

operating cash flow generation of the business and our reinvestment rate with the desired outcomes of a progressive dividend and a strong investment-grade credit rating.

We will be using 2015 as the baseline for that, and therefore, we'll have a chance to come back in July at our interims and give an update on how we're doing against it.

Q: And can you give us an update on where you're at with the disposals programme?

A: We announced last July the disposal program of £500m to £1bn that would be complete by the end of 2017. We wanted to allow that amount of time because of the difficult environment that we are in and wanting to ensure that we maximise value for shareholders in that disposal programme.

It had two main elements. The first was repositioning our exploration and production business to a smaller business, 40m to 50m barrels of oil equivalent, focused in the North Sea. And the second was an exit of our wind farm joint venture interests. We continue to make progress on all those fronts, and indeed, have announced recently the sale of one of our two wind farms for just over £100m.

Mark Hodges, Chief Executive, Energy Supply & Services, UK & Ireland

Q: Profits in British Gas were down 2%. Can you explain that?

A: If you look at the profitability of British Gas as a whole, it was down 2% in 2015. That really represents a bit of a mixed bag, with different performances from different business units. In BGB, we had a poor 2015, really as a result of migrating to a new customer relationship management and billing system, and I'll talk a bit more about that later.

In British Gas Services, there's really a continuing trend here as people move away from insurance-based products, which has impacted our profitability. And in British Gas Residential, profits were up to £574m, and that's really a reflection of gas consumption really due to 2015 being a more normal weather year than 2014.

Outside of the financial performance, we've been doing lots of other things, focusing on customer service. We announced that we would spend £50m on customer service, and we're recruited 350 additional agents to make sure that our customer service is improving. Good to see complaints down by around 18%.

And in terms of pricing, which is always a hot topic, we've reduced prices three times just over the last year, twice in 2015, and a further cut recently, which will save customers on average off of their dual-fuel bill around £100.

Q: So going back to BGB, can you explain the problems that you had there and what you've done to resolve them?

A: So as we announced at the interims last year in BGB, we have had operational issues linked to migrating from multiple legacy systems to a single new CRM and billing system. The good news is we are through the issues. We're operating largely as we would expect now, but that migration has had a real impact on service. It's had a real impact on cost, because we've had to bring in additional resources to make sure we could fix the issues and maintain service, and that's reflected in the BGB performance.

Looking forward in BGB, we have opportunities we can now exploit, given we are on a single system.

Q: Accounts were down by 4% in BGS for the year, so what are you planning on doing to improve sales and profitability in 2016?

A: In 2015, profits were down 5% in BGS and account holdings were down 4%. That's really the continuation of a long-term trend. It's a challenging market. People are moving away from insurance-based products.

That's not to say we can't improve our performance. We're looking at cost. We've simplified the product range. I think we can do more on pricing and on retention to improve the core performance.

But we also need to look at areas we can grow into, and we're announcing the strategy that we will be looking at landlord's cover, at on-demand cover, at emergency cover as areas where our uniquely skilled 8,000-strong engineering workforce can be deployed.

That's part of the response from us, is to look at those new areas and make sure we capitalise on the skills we have.

Q: And what progress have you been making with your Connected Home business, and how do you plan on growing that?

A: The Internet of Things is a global trend, and I think it's great that Centrica has a position in that trend with Connected Home, with the Hive brand in the UK, particularly. Our growth ambitions now are global. We have some great capability through the acquisition of AlertMe. We have a stack of technology that I think can do great things for customers.

We've sold nearly 300,000 Hive thermostats in the UK, and about 200,000 Nest thermostats in the US. So we really are building scale. We've now launched a new product suite with connected plugs, connected light bulbs, connected sensors, and there's a lot more to come in this area. So growth for us now is about taking the opportunity we've created.

Q: And can you give us an update on how Bord Gáis has been performing in Ireland?

A: In Ireland, the acquisition of Bord Gáis, which we completed in 2014, I think has been a great success story. The performance of the

business in 2015 is strong. We've led the Irish market in terms of price reductions, and we're growing the number of customers we serve in Ireland, so all round, a good performance from the business in 2015.

Q: Wholesale prices have fallen significantly in the last 18 months, so have you really reflected those falls in the prices that you're charging to your customers?

A: We remain fully committed to pricing for customers competitively. It's in our interests, and it's good for the customer. We want to win new customers and retain the ones we have, so making sure our prices are low really does make sense.

The other thing to remember I think is that the underlying cost of gas and electricity isn't the only component of the bill. There are other things in the bill, and really, that underlying gas and electricity cost these days represents less than 40% of the total bill to the customer.

And some of those costs have either been stable or actually have been going up, so yes, I'm happy with our price position. I think we're competitive, and actually, it's not just about pricing. It's also about the quality of our service, and as you know, that's something we've been investing in as well during 2015.

Q: And finally, what are you going to be focusing on in the year ahead?

A: Across the business in 2016 we believe we are in a great position competitively. Whether that be in the UK and Ireland or in Connected Home to grow. It’s really about taking the opportunity. We know what customers want. They want greater control. They want great service. They want pricing that’s appropriate and we can deliver all of those things. So for me it’s about delivering businesses that are growing, that are becoming more cost efficient and frankly that are delivering great customer service and great customer offers.

Mark Hanafin, Chief Executive, Energy Production, Trading and Distributed Energy

Q: What are you doing to deal with the challenge caused by the low commodity price environment?

A: Well, of course, we saw the commodity price collapse at the beginning of last year, and we had to respond quickly to that, and what we did was we said we would like to make our E&P business cash positive over the years 2015 and 2016. That meant cutting Capex. It meant cutting operating costs.

I'm delighted to say that in 2015, we were actually cash positive, free cash flow positive, and I don't think there are many E&P businesses that can probably claim that for 2015. Now, since that initial price collapse, we've seen prices continue to slide. So as we look towards

2016 and 2017, we have to continue to control costs, and we have to continue to reduce Capex where we can.

And if we look at the capital expenditure plans for E&P in 2016, we're planning around £500m. That's less than half the run rate of previous years, where we were above about £1bn of Capex. So across the asset businesses, capital discipline and operating cost discipline is the way that we need to address that.

Q: Your nuclear business performed well during the year, so what were the drivers of that?

A: The real story behind nuclear was the production performance - 60.6 terawatt hours was the highest production in 10 years, and that's despite the boiler spine problems at the four reactors of Heysham and Hartlepool.

Q: Centrica had mixed success in the recent capacity market auctions, so what impact has that had on the Power business, and what's the long-term outlook?

A: Yes, so when we look at the capacity auction and the changes in the power market that that's part of, we see a number of different aspects to our portfolio. So for example, Langage and Humber are mid-merit CCGT plants that will continue to operate in that market. We've converted Brigg to a distributed merchant generation asset, and we see that continuing in that market.

We're looking at Peterborough and the potential to convert that also to a distributed generation set, operating in that market. So I see those as four kind of core units; two CCGTs, two distributed merchant generation sets… and then I think on King's Lynn, which is a project that we had hoped to succeed in the capacity market. And when we look at Barry and Killingholme, the future of those plants really depends on the auctions that are being run by National Grid and the Department of Energy, the capacity market, the SBR auction and the store auction. And the success of those plants in those auctions will determine their future.

Q: And how are your plans going to grow the DE&P business?

A: So the progress is really good in Distributed Energy and Power. The first step was to bring the capabilities across the Group together to form the new business, about 1,000 people, actually, from British Gas, from Centrica Energy and from Direct Energy in North America, have come together in that new organisation.

The second step then is to build capability, both organically and inorganically, the technologies that we need to support the value propositions to our customers.

An example of building capability was the acquisition of Panoramic Power. Panoramic operates in 30 countries around the world, and it gives us the capability of offering customers great insight into the ways that they're using energy.

The third area is developing the customer value proposition, and what we're proposing to customers in distributed energy and in generation is that we can provide an end-to-end offering, everything from the solution to their requirements, right through to installation of equipment, operation and maintenance. We have about 1,000 customers already, and I think bright prospects for the future for that business.

Badar Khan, Chief Executive, Energy Supply & Services, North America

Q: Direct Energy's total profits were up by 119% for the year. So what drove that?

A: We had a very strong year in North America this past year. We had extreme weather at the beginning of the year, at the end of the year and our team managed the weather events very well, producing a very different result in 2015 versus the polar vortex that we experienced in 2014. We also saw the benefits of the repricing that we've been doing with our commercial industrial customers over the last couple of years to return margins to more normal levels, and we're also seeing the benefit of the investments in innovation and the differentiation of our offer to homes and businesses.

Q: But despite that the profits for DES were actually down. So what's behind that?

A: Our services business did report a loss for the year and that was due to the accelerated investment in our solar business - residential rooftop installation - which actually grew at a pretty significant rate year over year. We also saw growth in other parts of our services business where we saw a 12% growth in our services annuity contracts and a 7% increase in installs in our residential and new construction business, which is the team that installs HVAC into new homes that are built in North America.

Q: Residential customer accounts fell by 223,000 so what's the outlook for your residential supply business?

A: Well about a quarter of the customer account drop in our residential energy business was from our Ontario market which has been in wind-down for the last few years, and the remainder was actually in the US North which is a very, very competitive market. However the investments we're making in the bundling of our energy and services in Connected Home products is really working very well. We saw 46% of new customers in 2015 sign up to one of those kinds of bundles versus only 14% in the year before. And we're also seeing investments in the differentiation of our offer - where we're helping our customers understand their own consumption and take control of their energy differently - pay off in terms of customer loyalty.

Q: How is the recently combined residential energy and services business working as a single entity?

A: We've chosen to organise ourselves around our customers, whether they be people living in homes or people running businesses. And last November we made the decision to bring together our residential energy and our residential services business into a single unit with a single management team with a common purpose to develop propositions and bundles that appeal to people living in homes. And it's progressing very well.

Q: And what are you doing to improve customer service?

A: Well as you'd expect, we measure customer service with a number of different indicators, net promoter score being the primary one, which has seen increases over the last several years. But we also measure a number of operational metrics, like the percentage of time it takes for us to resolve a customer's query the first time, and that went up by over 10% last year to over 80%. We're also investing in our digital offerings, helping our customers resolve their queries at any time of day or night, and we're investing in the systems and processes that our call centre agents use so that they can provide a better service to our customers.

Q: And how is your Connected Home activity progressing across North America?

A: We've actually put together our Connected Homes team in North America together with a global Connected Homes team so that we're pooling together our resources and developing a capability that we can leverage to all of our markets across North America. Last year we had sold almost 200,000 smart thermostats to date and we've been investing in the digital offering, again helping our customers understand their own individual consumption, for example through itemised billing where you can understand how much your bill is by appliance in your home. And those things are making a nice difference to the way our customers perceive our company and perceive our product.

Q: So what update can you give us on the delivery of cost efficiencies in the business?

A: Well first of all two and a half years ago we put together our call centre, our back office, our IT, our third party spend teams together with a very specific mandate to make those areas more efficient. And we've been executing against that with the strategy we just announced last summer. We reaffirm that strategy and actually expanded its remit to look at common ways of working across all customer-facing businesses across Centrica.

And secondly, we've been looking at the portfolio of businesses and activities that we offer to our customers and we have decided that there are a couple of areas that no longer make the most sense to be part of our business, and so we'll be exiting those activities over the course of this year.

Q: And so looking ahead now, what's the outlook for Direct Energy in 2016?

A: Well we ended 2015 with a very strong result financially, strategically, operationally, and we expect to continue that performance in 2016, both in terms of innovating and differentiating our offer to homes and businesses, as well as progressing the mandate to make the organisation more efficient, simpler to work in for our people and an easier company to do business with for our customers. And I expect to see solid results over the course of 2016.

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