

Iain Conn, Group Chief Executive

2016 Performance and Outlook

Centrica in 2016 delivered a robust performance with earnings, both pre-tax and after-tax, up 4% on an underlying basis. We also delivered a very significant amount of cash flow with underlying adjusted operating cash flow up 14% against our long-term target on average of 3% to 5% per annum. So that gives us a very good foundation for the future.

The cash flow we delivered allowed us to invest for the future, pay down a significant amount of debt while also paying a very attractive level of dividend to our shareholders. So a solid financial performance in the year.

In terms of our strategic progress. Clearly our strategy is built around a shift towards the customer and we saw significant progress last year. We also acquired some excellent capability through the acquisitions of Neas Energy and ENER-G Cogen. And all of this is starting to build towards a sustainable customer-facing future.

In the asset businesses we did reduce investment in them with exploration and production capital down about £200 million, to our target levels. But we did see good operating performance on average; we saw particularly strong performance in our nuclear business. And in exploration and production we reached some very important milestones including the Cygnus field coming on-stream which is now producing really well.

When you take all that together the Company is on track strategically. And we've just announced the move to two new divisions for our customer-facing businesses organised around the customer; one organised around the residential consumer and one organised around the business customer. The platform we've established in 2016 clearly gives us very strong underpinnings for the next few years.

And if I start with the medium-term goal of 3% to 5% underlying adjusted operating cash flow growth, clearly having delivered 14% in 2016, that nearly underpins the bottom end of that range. We've also said that we would look to restore a progressive dividend in line with that average cash flow growth once we've got net debt of the Company back into the range of £2.5 billion to £3 billion. Which we'd expect to happen at the end of 2017.

In 2017 we are going to maintain capital discipline. We're going to invest more money into our revenue investment businesses, in our growth areas - about £100 million. We are spending more money on customer loyalty and - through our rewards programme - and we're investing in technology and innovation.

Focus on Customers

Well first of all let me say about our customers. That our whole strategy is built around focusing on their changing needs. But when talking about our customers, clearly you have to ask what do they want from us? And first of all they want good service. Secondly, they want to know that they're appreciated and we need to reward their loyalty to the Company. Thirdly they want new offers and services and of course they need good value for money.

So let me expand on those points. Firstly customer service; we've seen service levels on a lot of our metrics improve in all of our geographies. Our brand promoter scores are up. Complaints have been down, again, in all of our geographies and in the UK down 31% year on year. These are really important basic underpinnings of what our customers expect from us.

The second thing is rewarding our customers' loyalty. And I'm very excited that we've just launched a rewards programme called British Gas Rewards.

The third area that we're working on is offer innovation and propositions generally. And this ties into our strategy. We've just announced new strategic frameworks for our Consumer division and our Business division. In the Consumer area the new ones that we are adding are around giving customers peace of mind about their life and about their home. Secondly about home energy management. Managing their energy and getting insights around it in the home. And the third one is home automation. People are continually trying to do more and more using their phone and we can provide that.

In the Business area - in addition again to the traditional offerings that we make - something that our business customers want is detailed energy insight. The second thing they want is optimisation of their own resources. And thirdly energy solutions involving deploying technology at their premises so they can get a better overall energy management system.

I'm very excited about this and under each one of these pillars we are now developing capability and technology in order to deliver better for our customers every day.

UK Energy Market

Let me just touch on the UK energy supply market. Which I know is a hot topic for a lot of our customers and for people who read about British Gas in particular. First thing to say is after the two year investigation into this market, it's highly competitive. There are over 50 suppliers and it's really challenging actually to acquire and to hold on to customers. That's a good thing. It's good for our customers and it keeps us on our toes.

When it comes to our commitments to our customers, just towards the end of 2016 we made some important, new commitments in the UK. The first one was that we were going to keep our prices frozen until April and I'm pleased to say that we've just extended that out to August, just as some of our competitors have been increasing their prices. We've been able to do that thanks to your own efforts on our own costs. To keep them under control and be more efficient and give our customers better value.

The second commitment that we've made is to engage with up to 4.5 million of our standard tariff customers by June to help them understand the types of offers that we are going to make available. And a big part of that is also our recently announced rewards programme. The third thing that we said that we would do is that our new customers and our existing customers would get the same

energy offers. And the fourth and final thing we announced is that we're going to give everyone an annual health check to make sure that they're getting the right things from us and that they're on the right tariff for them.

I know a lot of people talk about British Gas as though we must be the expensive offer in the market. But actually our standard tariff is now positioned - thanks to our own actions and our cost efficiency - as cheaper than 95% of the standard tariffs out there in the market. Or fixed price tariffs are competitive. And we believe positioning ourselves there is going to demonstrate and represent real value for our customers.

We believe we're now starting to deliver for our customers in the UK energy supply market. We believe it's highly competitive and our profit levels last year were actually down, reflecting that competition. But we're holding our own.

Innovating for Customers

Technology and innovation is to the heart of what we must offer for our customers, what we want to offer and how we are going to position ourselves competitively in the future. Why is this so important? Well the energy market and the energy world is really changing dramatically. Firstly you've got decentralisation of the energy system with new technologies appearing at the point of use.

The second thing you've got is customers becoming much more aware of the technologies available and the choices they've got and they're becoming more demanding. And the third thing is that digitisation and data are accelerating all of this. Now we believe we've got a very strong platform to build from and we've made a lot of progress in the last year.

We've been underpinning our strategic intent with building our own capability. So, for example, in data analytics where we have developed our own ability to manage structured and unstructured data lakes all the way through to acquisitions of new technology.

Last year acquiring Neas Energy allowed us to acquire technology for managing and despatching remote power assets owned by other people. ENER-G Cogen gave us leading capability in design and packaging of integrated, combined heat and power units. Panoramic Power, which we bought in 2015, gives us really important energy insight products. And then of course in our Connected Home we've been developing our own technology for home automation and home energy management.

Another example in the case of Distributed Energy systems is our project in Cornwall where we're working with the European Union, National Grid and local government and local providers in creating an energy market place involving 150 different customers and end users. This is going to be a really important example of how the Distributed Energy system is changing and a proof point as to how local governments could work with energy companies in order to deliver better things and better service for their local community.

Technology and innovation is here to stay and it's to the heart of what we do.

Centrica Innovations

Recently we just announced a further addition to our stable, which is the creation of Centrica Innovations. The goal of Centrica Innovations is through an investment of up to £100 million over the next five years, we are going to be incubating new technology, scouting for new technology, accelerating technology that we find and enabling and building further innovative capability within the Company. Centrica Innovations will also have within it our existing Ignite social enterprise fund, which has been very successful over the last two to three years.

I'm very excited about where Centrica is going. We are very well positioned for the trends that we see occurring in energy and very well positioned to serve the changing needs of our customers as those trends occur.

Jeff Bell, Group Chief Financial Officer

Financial performance:

The Group delivered robust financial performance in 2016, against a commodity price environment that was lower in 2016 than it was in 2015. We delivered 4% growth in operating profit and in earnings. And in our customer facing businesses we saw 9% operating growth, primarily driven by strong trading performance in our energy, marketing and trading business and a return to profitability in UK business.

Our key financial metric, adjusted operating cash flow, was up 19% compared to 2015 and even adjusting for the one-time recovery of working capital from UK business and making foreign exchange and commodity prices on a like-for-like basis we saw underlying adjusted operating cash flow up 14%, well above our long term 3% to 5% annual average growth target.

As a result, along with strong capital discipline we saw net debt fall by £1.3 billion, or just over 25%, leaving net debt at the end of the year just below £3.5 billion, and a much stronger balance sheet as a result. So overall, a strong and robust financial performance in 2016.

Turning to 2017, we would continue to expect to target greater than £2 billion of adjusted operating cash flow in the year and with continued progress on our disposal program would be more than sufficient to meet our uses of cash and, indeed, we would expect to continue to strengthen the balance sheet and reduce net debt by the end of 2017.

We would expect by the end of the year to be targeting net debt in the range of £2.5 billion to £3 billion, consistent with the financial metrics that the rating agencies are looking for, to support our strong investment grade credit ratings and also to support a return to a progressive dividend.

We would expect to also make further continued efficiency gains in 2017 and are targeting an additional £250 million towards our £750 million program.

It is too early in the year to have a forecast of where earnings per share will turn out, but we would expect by the middle of the year at our interim announcement to be able to give better guidance.

Balance sheet guidance:

One of our key financial objectives has been to strengthen our balance sheet, giving us the financial flexibility to invest behind the strategy and realise our strategic ambitions. We've made good progress in 2016 against that goal. We saw net debt reduce by just over 25%, by £1.3 billion, to just below £3.5 billion in total.

Of that £1.3 billion, about two-thirds of it was from our own organic cash flow generation and working capital management and the remaining third was the net of our equity placing, less the cost we invested in our two material acquisitions, ENER-G Cogen and Neas Energy.

As a result, we've made good progress against the rating agency financial metrics that would be consistent with the strong investment grade credit ratings that we're targeting. This has been particularly important in 2016, not only with the uncertainty that we saw around the lower commodity price environment and the regulatory uncertainty related to the CMA process and the Brexit referendum, but as a result of the lower interest rates following the Brexit referendum, we like many others, saw our pension liabilities and the accounting for those increase significantly. That has created some additional headwinds in terms of our overall balance sheet strength.

We are continuing to target net debt reduction in 2017 and would expect in the current environment to be in the £2.5 billion to £3 billion range by the end of the year.

Efficiency programme:

We delivered a little over £380 million in 2016 of efficiencies, against our like-for-like target of £750 million that we were targeting at over five years. That has required an enormous amount of effort from across the Group in all business units and functions.

In our energy supply and services businesses, for instance, we saw a reorganisation and a simplification of our management layers. In our E&P business we saw dramatic reductions in our lifting and other cash production costs, both from lower supply chain cost but also from changing the way we run that business.

In our Group functions, IT, finance, HR, procurement, we reorganised our functions on a global basis in 2016, which has allowed us to, again, standardise and simplify and unlock further efficiencies. With respect to third-party cost, we've been able to leverage our global scale and significantly drive down those areas of cost in particular.

We announced in July 2015 as part of our strategic review that we would be targeting £0.5 billion to £1 billion of disposal proceeds out to the end of 2017. A key component of that was our windfarm joint ventures. We've now realised the proceeds from disposing of both of the wind farm joint ventures we had, the GLID Wind Farm and the Lincs Wind Farm. That has delivered, in aggregate, around £350 million.

In addition, the second area that we were focused on was in our exploration and production business, where we have announced the disposal of our Trinidad and Tobago operations, as well as some smaller fields in the North Sea.



With respect to our Canadian E&P business, that disposal process is ongoing and we continue to target to complete that by the end of 2017.