8 May 2014

Centrica Interim Management Statement

Centrica today gives a business update and full year outlook, and confirms its intention to continue to invest in technology and service, for the benefit of our customers and the long term health of the business. We are also announcing a strengthening of our strategic relationship with Qatar Petroleum International (QPI) and a refocusing of investment in UK power generation.

- The average British Gas residential energy bill was around 10% lower this winter than last, reflecting mild weather conditions
- No change expected in residential energy prices this year, reflecting the competitive market and wholesale price environment
- UK residential energy supply post-tax margins expected to be around 4% this year, lower than long-term expectations
- Reduced outlook for earnings in 2014, with full year adjusted earnings per share expected to be in the range 22-23p; earnings growth expected in 2015
- Continued help for customers to reduce and control their energy consumption through our leadership in smart connected homes and innovation – the sustainable way to keep bills down
- Support for the proposed independent competition review to restore trust in the sector; important that all aspects of the bill are examined
- Continued investment in security of supply; large-scale Cygnus and Valemon gas developments on track; £60 billion of commitments in place to procure gas and power for our customers
- Further strengthening of our relationship with QPI through sale of 40% of Centrica's gas assets in North America into joint venture partnership for C$200 million
- Refocusing investment in UK gas-fired power generation on flexible smaller plant; releasing capital from larger power stations with a book value of around £500 million
- Commitment to real dividend growth reaffirmed

Sam Laidlaw, Chief Executive of Centrica, said:

"Customer relationships are core to the long term health of Centrica. The investment we are making in smart connected homes and innovation is helping customers reduce and control their energy consumption, which is the most sustainable way to keep bills down. The combination of mild weather, and our expectation that we will not change energy prices this year, means the average British Gas household energy bill is expected to be lower in 2014 than in 2013.

"Investment in security of supply remains a key priority. We continue to invest in new sources of gas for the UK and we have commitments totalling around £60 billion to help secure energy for our customers. We have further strengthened our relationship with Qatar Petroleum International through today's transaction, and look forward to continuing to work with them as we consider investment opportunities in gas and power on both sides of the

Atlantic. We are also refocusing our UK power generation investment towards more flexible plant, with a view to bidding into the capacity market.

"The decisions and actions that management is taking across the Group will leave the business well-placed for the long term. While earnings are anticipated to fall in 2014, we expect an improvement in 2015, assuming more normal weather conditions and reflecting the prospects for underlying growth in Direct Energy, UK gas storage, British Gas Services and British Gas Business."

Full year outlook

Market conditions have been challenging for the Group in the year to date on both sides of the Atlantic. In the UK, the downstream business has experienced lower consumption due to mild weather, an unprecedented focus on the energy sector and a highly competitive environment for energy supply. In North America, extreme weather conditions have resulted in significant one-off additional costs in the first quarter.

UK market prices for gas and electricity have declined since the start of the year, although political tensions in the Ukraine have focused attention on security of supply and the potential impact on European energy prices. Assuming that energy market conditions remain benign, and recognising the competitive conditions in the UK energy supply market, we do not currently expect to change our residential energy prices during 2014. When also taking into account lower levels of consumption in the year to date, we expect full year residential energy supply revenue to be around 10% below 2013 levels and the post-tax margin to be around 4%. This is lower than last year and below our consistent expectation of long-term post-tax margins in the range 4.5%-5%, which we believe are necessary to underpin investment in the business.

As a result, with additional costs associated with the exceptionally cold weather in the US, offset by a lower depreciation charge on our UK gas-fired power generation fleet, we expect 2014 full year adjusted earnings per share for the Group to be in the range 22-23 pence per share.

Looking ahead to 2015, while the outlook for gas prices is currently benign, there is upward pressure on the market cost of power, including an increase in network charges, and higher costs associated with renewable energy (renewable obligation certificates, feed in tariffs and the carbon price floor). Overall, assuming similar or higher levels of operating profit for British Gas Residential in 2015 compared to 2014, and with underlying growth and normal weather conditions in North America and the prospect for improvements in UK gas storage, British Gas Services and British Gas Business, we expect the Group to return to earnings growth in 2015, subject to the usual variables of commodity prices, weather and asset performance.

Transparency and fairness

In March, Ofgem announced that they were minded to recommend a Competition and Markets Authority (CMA) investigation of the UK energy market. Centrica is committed to an open, transparent and competitive British energy market and welcomes an objective review, by an independent and respected regulatory authority, which could help rebuild trust in the sector. However to do so, it is important that all aspects of the bill, including network and social and environmental costs, are taken into account in any reference. For example, network costs, which represent over a fifth of the average British Gas dual fuel bill, have increased by over 40% since 2007, while environmental costs have doubled over the same period. To maintain a stable business, pricing needs to reflect the underlying costs impacting the business.

Our continued focus on transparency and fairness is essential in helping to rebuild trust in the industry. Earlier this year we were the first energy supplier to present an audited segmental statement as part of our year end results, while we also separated our downstream business legal entities from our power generation activities at the end of 2013. We continue to make progress against our targets to deliver industry leading service levels for all our customers and on our efficiency and cost reduction programmes across the Group. Delivering against these targets is critical, for the long-term benefit of customers and investors alike.

Investment and UK gas-fired power generation strategy

It is vital that we maintain our focus on capital discipline. We continue to invest in new sources of gas for the UK, including the large-scale Cygnus and Valemon projects in the North Sea which remain on track; we have an attractive opportunity to explore the potential of natural gas from shale in the UK; and we have commitments totalling around £60 billion to help secure energy for our customers, including the North American export contract signed with Cheniere in 2013. In total, we expect to deliver around £1.3 billion of organic investment across the Group this year.

Upstream in North America, we have today announced the sale of 40% of our gas and liquids assets in Canada to QPI for C$200 million (£107 million), fully aligning our interests and further strengthening the relationship with our Qatari partners. After completion of the transaction, the partnership will have 2P reserves of 1,664 bcfe and current production of 390 mmcfe per day. We will continue to examine the potential to invest in further energy-related projects together, on either side of the Atlantic.

Optimising our portfolio is an important part of our business strategy, as illustrated by the recent disposals of our Texas CCGTs and non-core North Sea E&P assets, for value. In this context, we have announced today that we intend to focus our UK gas-fired generation strategy on smaller flexible “peaking” plants and we will seek to release capital from the three larger operating power stations in the portfolio. This move follows the completion of a strategic review of our gas-fired power business, which reflected continuing operating losses from the fleet since the beginning of 2013, caused by low spark spreads and resulting low load factors, and the end of free carbon allowances. In addition, the generation market is undergoing significant structural change following the passing of the Energy Act at the end of 2013, with capacity payments due to be introduced from 2018.

Centrica currently owns eight gas-fired power stations. One (Roosecote) has been closed and is being decommissioned, and one (King's Lynn) has been mothballed. The smaller three remaining plants (Peterborough, Barry and Brigg) currently operate under Short Term Operating Reserve (STOR) contracts. The three larger power stations (Langage, Humber and Killingholme) have a combined capacity of 2.7GW and currently operate in the open market, albeit with low levels of utilisation. Centrica also has a tolling agreement for the Spalding power station until 2021, with options to extend thereafter.

With Centrica having successfully adapted its smaller assets to serve as flexible “peaking” plants, it will now focus on this part of the market for gas-fired generation, with flexible plants working alongside baseload nuclear output, variable output from our wind portfolio and peaks in downstream market demand. In this context, the review highlighted investment opportunities to upgrade and develop a number of the smaller plants. Under draft rules, the plants could qualify for capacity market agreements, if they were to participate in the capacity auction due to take place at the end of this year.

In addition, to address the continuing operating losses from the fleet, Centrica will seek to release capital from the three larger operating plants. Subject to the receipt of acceptable offers, a portion of the funds from the disposal may be recycled back into upgrading the smaller remaining plant. Centrica expects the larger plants to continue to operate under new ownership. The aggregate current book value of these three plants is approximately £500 million.

Centrica will maintain a development, construction, operating and market facing skill base relating to power generation. These skills will also be relevant for the management of the Spalding tolling arrangement and our nuclear and wind investments, as well as for the procurement of power for British Gas customers through power purchase agreements with independent producers. Centrica also intends to offer its services to third party owners of gas-fired generation assets, potentially including new owners of plants sold by Centrica. This will facilitate the introduction of new capital into the sector, including from infrastructure investors who may not have operating capability in the UK, and may be particularly relevant for development opportunities targeting the capacity market from 2018 onwards.

Centrica sees merit in vertical integration between electricity supply and generation. However in current market conditions with low plant utilisation, gas-fired generation offers reduced vertical integration benefit. Centrica is confident that its capacity from retained assets, together with liquidity in the wholesale power market, will enable it to cover its peak load requirement for the British Gas customer base.

Following this strategic review, for accounting purposes Centrica will classify Langage, Humber and Killingholme as "assets held for sale". As a result, depreciation will no longer be charged on these assets, reducing annual depreciation by approximately £60 million. In light of its revised plans, Centrica will review the carrying value of its power stations, including that of the Spalding tolling contract, which is accounted for as a finance lease, and it is expected that any material adjustment to the carrying values will be recorded as an exceptional item in the Group's 2014 results.

Business update

With warmer than normal temperatures in the year to date in the UK, compared to a cold start to 2013, average residential gas and electricity consumption for the first four months of 2014 was 25% and 10% lower respectively than for the same period last year. Overall, our residential customers' average energy bills were 10% lower this winter than last.

The number of residential accounts on supply has decreased by 180,000 in the year to date, and although the number of customer accounts has stabilised in recent weeks, competition remains fierce, particularly from smaller suppliers who are currently benefiting from an exemption from some environmental obligations. Service levels in British Gas Residential have improved significantly during the year to date, with reduced answering and call handling times, and lower levels of complaints, following an intense period in the final quarter of 2013 which was driven by record levels of switching.

In British Gas Services, we delivered high levels of customer service during the winter and we continue to invest in the business to ensure continued resilience for the future. The market for central heating boiler installations is showing good signs of recovery and retention levels remain strong amongst our contract customers. However we are yet to see an increase in contract sales, and the number of product holdings has fallen by over 100,000 since the start of the year. The ongoing migration to a new SAP customer relationship management system is expected to complete this year, enhancing our ability to offer combined energy and services products to our customers.

We have now sold over 80,000 smart thermostat products in the UK, with the weekly sales of our innovative Hive product having increased over the course of the year. We also continue to lead the industry in the roll-out of smart meters, and have installed over 950,000 for residential homes to date. Over 300,000 smart meter customers now receive our unique Smart Energy Report, providing them with detailed information on their energy usage and advice on how to improve their energy efficiency.

In British Gas Business, the number of supply points has reduced slightly in the year to date. We are on track to achieve £100 million of annual cost savings across the business, helping to offset the impact of our decision to end the auto-rollover of contracts at renewal. The implementation of a new billing system, which is expected to be fully operational by the end of 2014, is proceeding to plan.

In North America, we have made good operational progress in a challenging market environment, although the business continues to face competitive market conditions. We remain on track to deliver $100 million of cost savings across Direct Energy, while the number of residential energy and services accounts are both broadly unchanged since the start of the year.

In business energy supply, the Hess Energy Marketing business is performing ahead of our investment case, with the integration proceeding well. However, as expected, margin pressures on sales made during the second half of 2013 in the legacy power business have continued to impact earnings in the current year. In addition, while we were able to hedge most of our commodity price exposure during the exceptionally cold weather seen across much of North America earlier in the year, we incurred materially higher ancillary and other charges across the first quarter. Taking this into account, the total impact on operating profit from the Polar Vortex is now estimated at approximately $110 million. Although there are early indications that the extreme conditions have led to positive re-pricing of risk, which should improve margins over time, we expect 2014 full year operating profit for Direct Energy to be lower than in 2013. For 2015, we expect to deliver good underlying profit growth in the North American downstream business, in addition to the benefit of a return to normal weather conditions.

In our international E&P business, we expect production for the full year to be around 83mmboe. With the impact of lower wholesale gas and oil prices, this reduces our expectation for 2014 operating profit, but with limited impact on post-tax earnings. We remain on track to incur capital expenditure of around £950 million in 2014, with average spend of around £900 million per annum over the next three years, as previously announced.

In UK power generation, our share of nuclear output in the first four months of the year remained strong at 4.0TWh, compared to 4.2TWh in the same period in 2013. However low market spark spreads continue to make conditions challenging for our gas-fired power stations and the load factor was 23% over the first four months, with year-on-year volumes down 13% to 2.8TWh.

Centrica Storage announced in April that it had sold all SBUs for the 2014/15 storage year at an average price of 20.0p, compared to the 2013/14 price of 23.3p. Forward summer/winter gas price differentials have increased slightly over the course of the year to date, although this will only have a modest impact in 2014. We now expect Centrica Storage to make a small profit this year.

In March, we announced that, together with Brookfield Renewable Energy Partners L.P and iCOn Infrastructure Partners II, L.P., we had agreed to acquire the vertically integrated Irish energy business, Bord Gáis Energy (BGE). Under the transaction Centrica will acquire

BGE's gas and electricity supply business in Ireland and the 445MW Whitegate gas-fired power station for approximately €150 million (£125 million) including net working capital and a contingent payment of up to €21 million, subject to certain conditions being achieved. The transaction is expected to close in the first half of this year and to make a positive contribution to earnings in the first full year of ownership.

The Group's interest charge is expected to be around £250 million this year and based on our current expectations, the Group's effective tax rate for the full year should fall to around 40%. At the end of March, Group net debt stood at £5.2 billion, which includes the impact of the disposal of three CCGTs in Texas, which completed in January.

The Group commenced its £420 million share repurchase programme in February, and to date has purchased 40 million shares for a total cost of £132 million.

We reaffirm our commitment to real dividend growth, albeit recognising that with a reduction in year-on-year adjusted earnings per share, the payout ratio will increase above historic levels in the short term.

Centrica is due to release its Interim Results for the first six months of 2014 on 31 July 2014.

Enquiries:

Centrica Investor Relations: 01753 494900

Centrica Media Relations:
Greg Wood / Sophie Fitton 0800 107 7014