Group Financial Review

"In addition to the interim dividend of 3.6p per share, the proposed final dividend is 8.4p, giving a total full year dividend of 12.0p (2017: 12.0p)."

Chris O'Shea
Group Chief Financial Officer

Group Revenue
£29.7bn
2017: £28.0bn
▲ 6%

Full year dividend per share
12.0p
2017: 12.0p

Adjusted operating profit
£1,392m
2017: £1,247m
▲ 12%

Statutory operating profit
£987m
2017: £481m
▲ 105%

Statutory profit attributable to shareholders
£183m
2017: £328m
▼ 44%

Adjusted effective tax rate
41%
2017: 22%
▲ 19%

Adjusted basic earning per share (EPS)
11.2p
2017: 12.6p
▼ 9%

Statutory basic earning per share (EPS)
3.3p
2017: 6.0p
▼ 44%

Group revenue

Group revenue increased by £1.7 billion, or 6%, to £29.7 billion (2017: £28.0 billion). This was largely due to a £1.8 billion, or 12%, increase in Centrica Business, reflecting increased activity in Energy Marketing and Trading and increased gas sales volumes in North America Business. Centrica Consumer Group revenue fell by £0.2 billion largely due to the impact of lower energy customer accounts, and Exploration and Production Group revenue was broadly flat.

Operating profit

Statutory operating profit was £987 million (2017: £481 million). Adjusted operating profit was £1,392 million (2017: £1,247 million). A table summary reconciling the different profit measures is shown below.

Total adjusted operating profit increased 12% to £1,392 million (2017: £1,247 million). Centrica Consumer profit fell 15% with lower profit in UK Home reflecting the impacts of the UK energy prepayment tariff cap, lower energy account holdings, increased imbalance costs and high levels of central heating breakdown call-outs in UK Home services in Q1.

Centrica Business profit fell by 25%, due to the impact of continued retail power margin pressures in North America Business, legacy gas contracts in EM&T becoming loss-making and an increased loss in DE&P reflecting continued investment in growth. These impacts were partially offset by the improved performance from UK Business and the £62 million one-off charge in North America Business not being repeated. Profit from E&P increased 159%, benefiting from the transition of Rough from a storage facility to a production asset, higher European production resulting from the consolidation of Spirit Energy and higher achieved gas and liquids prices.

Group finance charge and tax

Net finance costs decreased to £273 million (2017: £344 million), largely reflecting the repurchase of £1.1 billion of gross debt which was completed in Q1 2018. This excludes costs of £139 million associated with the debt repurchase, which are included in exceptional items.

Adjusted operating cash flow

£2,245m

2017: £2,069 million
▲ 9%

Adjusted earnings

£631m

2017: £698 million
▼ 9%

Group net debt

£2,656m

2017: £2,596 million
▲ 2%

Operating profit

Year ended 31 December	Notes	2018 Business performance £m	2018 Exceptional items and certain re-measurements £m	2018 Statutory result £m	2017 Business performance £m	2017 Exceptional items and certain re-measurements £m	2017 Statutory result £m
Adjusted operating profit / (loss)							
UK Home		**668**			819		
Ireland		**44**			47		
North America Home		**123**			114		
Connected Home		**(85)**			(95)		
Centrica Consumer		**750**			885		
UK Business		**40**			4		
North America Business		**81**			71		
Distributed Energy & Power (DE&P)		**(81)**			(53)		
Energy Marketing & Trading (EM&T)		**54**			104		
Central Power Generation (CPG)		**27**			35		
Centrica Business		**121**			161		
Exploration & Production (E&P)		**521**			201		
Total adjusted operating profit	4(c)	**1,392**			1,247		
Interest and taxation on joint ventures and associates	4(c)	**–**			(7)		
Group operating profit / (loss)	4(c)	**1,392**	**(405)**	**987**	1,240	(759)	481
Net finance cost	8	**(273)**	**(139)**	**(412)**	(344)	–	(344)
Taxation	9	**(461)**	**128**	**(333)**	(191)	352	161
Profit / (loss) for the period		**658**	**(416)**	**242**	705	(407)	298
Profit attributable to non-controlling interests		**(27)**			(12)		
Adjusted earnings		**631**			693		

Statutory taxation on profit increased to a charge of £333 million (2017: credit of £161 million), with a statutory effective tax rate of 58%. Business performance taxation on profit increased to £461 million (2017: £191 million) and after taking account of tax on joint ventures and associates, the adjusted tax charge was £458 million (2017: £197 million). An adjusted effective tax rate calculation for both 2017 and 2018 is shown below.

The Group adjusted effective tax rate increased to 41% (2017: 22%), largely due to a number of one-off credits in the 2017 charge. Adjusting for these credits, the Group's underlying adjusted effective tax rate for 2017 was 40%.

Group adjusted earnings

Profit for the year from business performance decreased to £658 million (2017: £705 million) and after adjusting for non-controlling interests, adjusted earnings fell by 9% to £631 million (2017: £693 million). This reflects the increased tax charge, partly offset by higher adjusted operating profit and lower net finance costs, all as described on page 37. Adjusted basic EPS was 11.2p (2017: 12.5p) reflecting the lower earnings.

Exceptional items

A net exceptional pre-tax charge included within Group Operating Profit of £185 million was recognised in 2018 (2017: £884 million).

The Group recognised a net write-back of £90 million on E&P assets. It recognised £57 million of net write backs on UK and Norwegian oil and gas fields predominantly due to an increase in near-term liquid prices, partially offset by a reduction in long-term price forecasts. It also recognised a £33 million write-back of decommissioning provisions for assets previously impaired.

The Group also recognised an onerous contract provision of £44 million in relation to the Spalding tolling contract and an £18 million impairment in relation to gas-fired power station assets in the Distributed Energy and Power segment, following the suspension of the UK Capacity Market in November 2018 and reflecting reductions in clean spark spread price forecasts.

On 26 October 2018, the High Court of Justice of England and Wales issued a judgment requiring equality of treatment for men and women in relation to Guaranteed Minimum Pension benefits in contracted out UK pension schemes for the period 1978 to 1997. As a result of this judgment, Centrica's scheme liabilities have been recalculated and a past service cost of £43 million has been charged to the Income Statement.

As a result of the Group's strategic review announced in 2015, the Group incurred a further £170 million of restructuring costs in 2018, principally relating to redundancy, data migration, digitalisation of the customer journey, business closures and other transformational activity.

The Group also incurred one-off transaction costs within net financing costs of £139 million relating to the debt repurchase programme completed in 2018.

These charges in total generated a taxation credit of £89 million (2017: £408 million). As a result, total net exceptional charges after taxation were £235 million (2017: £476 million).

Further details can be found in note 7.

Certain re-measurements

The Group enters into a number of forward energy trades to protect and optimise the value of its underlying production, generation, storage and transportation assets (and similar capacity or off-take contracts), as well as to meet the future needs of our customers. A number of these arrangements are considered to be derivative financial instruments and are required to be fair valued under IFRS 9. The Group has shown the fair value adjustments on these commodity derivative trades separately as certain re-measurements, as they do not reflect the underlying performance of the business because they are economically related to our upstream

Group tax charge

	Non-E&P		E&P		E&P	Group
Year ended 31 December 2018	UK £m	Non-UK £m	UK £m	Non-UK £m	Total £m	Total £m
Adjusted operating profit	645	226	60	461	521	1,392
Share of JV/associate interest	(3)	–	–	–	–	(3)
Net finance cost	(277)	(42)	73	(27)	46	(273)
Adjusted profit before taxation	365	184	133	434	567	1,116
Taxation on profit (excluding PRT)	57	38	51	364	415	510
Petroleum Revenue Tax (PRT)	–	–	(49)	–	(49)	(49)
Share of JV/associate taxation	(3)	–	–	–	–	(3)
Adjusted tax charge	54	38	2	364	366	458
Adjusted effective tax rate	15%	21%	2%	84%	65%	41%

	Non-E&P		E&P		E&P	Group
Year ended 31 December 2017	UK £m	Non-UK £m	UK £m	Non-UK £m	Total £m	Total £m
Adjusted operating profit	794	252	(99)	300	201	1,247
Share of JV/associate interest	(1)	–	–	–	–	(1)
Net finance cost	(266)	(82)	32	(28)	4	(344)
Adjusted profit before taxation	527	170	(67)	272	205	902
Taxation on profit (excluding PRT)	35	(2)	(27)	242	215	248
Petroleum Revenue Tax (PRT)	–	–	(57)	–	(57)	(57)
Share of JV/associate taxation	6	–	–	–	–	6
Adjusted tax charge	41	(2)	(84)	242	158	197
Adjusted effective tax rate	8%	(1%)	125%	89%	77%	22%

Operating cash flow

Year ended 31 December	2018 £m	2017 £m
Net cash flow from operating activities	**1,934**	1,840
Add back/(deduct):		
Net margin and cash collateral inflow(1)	**(57)**	(136)
Payments relating to exceptional charges	**248**	176
Dividends received from joint ventures and associates	**22**	58
Defined benefit deficit pension payment	**98**	131
Adjusted operating cash flow	**2,245**	2,069

(1) Net margin and cash collateral inflow includes the reversal of collateral amounts posted when the related derivative contract settles.

assets, capacity/off-take contracts or downstream demand, which are typically not fair valued. The operating profit in the statutory results includes a net pre-tax loss of £220 million (2017: gain of £125 million) relating to these re-measurements, or a loss of £181 million after tax (2017: gain of £69 million). The Group recognises the realised gains and losses on these contracts in business performance when the underlying transaction occurs. The profits arising from the physical purchase and sale of commodities during the year, which reflect the prices in the underlying contracts, are not impacted by these re-measurements. See note 7 for further details.

Group statutory earnings

The statutory profit attributable to shareholders for the year was £183 million (2017: £328 million). The reconciling items between Group profit for the period from business performance and statutory profit are related to exceptional items and certain re-measurements. The difference compared to 2017 is due to the lower profit from business performance and a net loss from certain re-measurements compared to a net profit in 2017, partially offset by a lower post-tax net exceptional charge, all as described above. The Group reported a statutory basic EPS of 3.3p (2017: 5.9p).

Dividend

In addition to the interim dividend of 3.6p per share, the proposed final dividend is 8.4p, giving a total full year dividend of 12.0p (2017: 12.0p).

Group cash flow, net debt and balance sheet

Net cash flow from operating activities increased to £1,934 million (2017: £1,840 million), with higher EBITDA being partially offset by lower net working capital inflows and higher payments relating to exceptional charges. Adjusted operating cash flow, which is reconciled to net cash flow from operating activities in the table above, increased by 9% to £2,245 million.

Net cash outflow from investing activities was £1,007 million (2017: inflow of £32 million). The change compared to 2017 is predominantly due to proceeds from net disposals in 2017 of £825 million, mainly relating to the Lincs wind farm, UK gas-fired power stations and Canadian E&P assets, and slightly increased organic capital expenditure and acquisition spend in 2018.

Net cash outflow from financing activities was £2,540 million (2017: £1,070 million) reflecting the impact of the debt repurchase programme, a bond maturity in September and higher cash equity dividends reflecting a lower scrip take up.

The Group's net debt as at 31 December 2018 was slightly up to £2,656 million (31 December 2017: £2,596 million), which includes cash collateral posted or received in support of wholesale energy procurement.

Net assets increased by £516 million to £3,948 million (31 December 2017: £3,432 million). Total assets decreased by £122 million, including reduced cash and cash equivalent balances due to the impact of the debt repurchase programme and higher trade and other receivables and retirement benefit assets. Total liabilities decreased by £638 million, with lower borrowings resulting from the debt repurchase programme and bond maturity, and a reduction in the pension liability partially offset by increased trade payables. Further details on pensions can be found in note 22.

2018 Acquisitions and disposals

The Group completed a number of bolt-on acquisitions during the year.

On 28 February 2018 the Group acquired NJR Retail Services company for $24 million (£17 million). On 1 July 2018, the Group acquired North American mid-continent retail operations from BP Canada Energy Marketing Corporation for $39 million (£31 million). On 31 December 2018 the Group acquired certain retail power operations from Source Power & Gas Business LLC for $26 million (£21 million). These businesses will all form part of North America Business.

On 27 November 2018, the Group acquired T.A. Kaiser Heating and Air Inc. for $19 million (£15 million). This business will form part of North America Home.

Further details on acquisitions, assets purchased and disposals are included in notes 4(e) and 12.

Events after balance sheet date

Details of events after the balance sheet date are described in note 26.

Risks and capital management

The nature of the Group's principal risks and uncertainties are largely unchanged from those set out in its 2017 Annual Report, although there continues to be a high degree of uncertainty surrounding the process for the UK's exit from the European Union. Further details are set out in this 2018 Annual Report on pages 41 to 51. Details of how the Group has managed financial risks such as liquidity and credit risk are set out in note S3. Details on the Group's capital management processes are provided under sources of finance in note 24.

Accounting policies

UK listed companies are required to comply with the European regulation to report consolidated financial statements in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union. The Group's specific accounting measures, including changes of accounting presentation and selected key sources of estimation uncertainty, are explained in notes 1, 2 and 3.

Our View on Taxation

The Group takes its obligations to pay and collect the correct amount of tax very seriously.

Responsibility for tax governance and strategy lies with the Group Chief Financial Officer, overseen by the Board and the Audit Committee.

Our approach

Wherever we do business in the world, we take great care to ensure we fully comply with all of our obligations to pay or collect taxes and to meet local reporting and disclosure requirements.

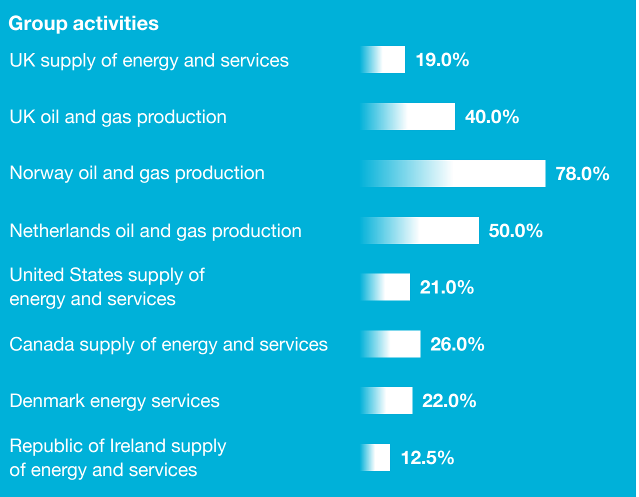
We fully disclose information on ownership, transactions and financing structures to the relevant tax authorities. Our cross-border tax reporting reflects the underlying commercial reality of our business.

We are committed to providing disclosures and information necessary to assist understanding beyond that required by law and regulation.

We do not tolerate tax evasion or fraud by our employees or other parties associated with Centrica. If we become aware of any such wrongdoing, we take appropriate action.

We ensure that income and costs, including costs of financing operations, are appropriately recognised on a fair and sustainable basis across all countries where the Group has a business presence. We understand that this is not an exact science and we engage openly with tax authorities to explain our approach.

Statutory tax rates on profits



In the UK we maintain a transparent and constructive relationship with Her Majesty's Revenue & Customs (HMRC). This includes regular, open dialogue on issues of significance to HMRC and Centrica. Our relationship with fiscal authorities in other countries where we do business is conducted on the same principles.

We carefully manage the tax risks and costs inherent in every commercial transaction, in the same way as any other cost. However, we do not enter into artificial arrangements in order to avoid taxation nor to defeat the stated purpose of tax legislation.

We actively engage in consultation with governments on tax policy where we believe we are in a position as a Group to provide valuable commercial insight.

The Group's tax charge, taxes paid and the UK tax charge

The Group's businesses are subject to corporate income tax rates as set out in the statutory tax rates on profits table. The overall tax charge is therefore dependent on the mix of profits and the tax rate to which those profits are subject.

Tax charge compared to cash tax paid

	Current tax charge/(credit) £m	Cash tax paid/ (recovered) £m
UK	(74)	(38)
Europe	234	86
North America	50	13
Total	**210**	**61**

During the year, the UK received a cash refund of tax overpaid in periods prior to 2015; UK tax charge includes a credit of £50 million of PRT related to its upstream activities.
For details on the Group's effective tax rate and a breakdown between relevant jurisdictions and segments, see pages 36 to 39.

Further information on the tax charge is set out in note 9 on
Pages 149 to 151

Our Group Tax Strategy, a more detailed explanation of the way the Group's tax liability is calculated and the timing of cash payments, is provided on our website at
centrica.com/responsibletax