nationalgrid

Full year results Presentation
7 November 2014

NATIONAL GRID

John Dawson, Head of Investor Relations

Steve Holliday, Chief Executive

Andrew Bonfield, Finance Director

QUESTIONS FROM

Mark Freshney, Credit Suisse

Dominic Nash, Macquarie

Deepa Venkateswaran, Bernstein

Bobby Chada, Morgan Stanley

Jamie Tunnicliffe, Redburn Partners

Peter Atherum, Liberum Capital

Ashley Thomas, Societe Generale

John Musk, RBC

Ed Reid, Lazarus Partners

Iain Turner, Exane BNP Paribas

Introduction

John Dawson, Head of Investor Relations
Good morning ladies and gentlemen and welcome to the National Grid's half year results presentation for 2014/15. Welcome to those of you here at the London Stock Exchange and also to those of you joining online. I'm John Dawson, Head of Investor Relations at National Grid and it's my pleasure to introduce the team.

Before we start can I ask you to switch off your mobile phones?

During today's presentation we will as usual be referring to adjusted profits. Our presentation may include forward looking statements, please refer to your slides for the forward looking statement and read that at your leisure. Just as a reminder you will find all the materials of today's presentation online, in the packs you have here and on our investor relations app now available on all platforms.

The order today will be as follows Steve will take you through the highlights of the last six months, Andrew will then review the financials in more detail and then Steve will return to cover the priorities and outlook.

With us here today are also John Pettigrew and Tom King Executive Directors of our UK and US businesses respectively. All together they will have time to take questions and answers at the end.

Thank you and I'll now hand you over to Steve.

. . . .

Highlights

Steve Holliday, Chief Executive
Thank you John and good morning everybody. We are on track, on track for another year of good asset growth and strong returns, in fact that's very similar to what I said at this time last year and indeed is what I expect to say this time next year again. Our track record of consistent growth and consistent performance shows the benefit of clear regulatory arrangements and the benefits of good and continued execution against our plans.

We've now a year and a half of experience of RIIO under our belts, the UK is doing well, growing strongly and set again to deliver strong returns. We've finally completed our US systems implementation, an important milestone as we now look towards future performance improvements and new regulatory filings. And at the same time underlying asset growth in the US is increasing.

This added growth is clearly a major benefit in the long run, it will drive value for shareholders as these new assets attract incremental revenues, but in the near term it creates a small headwind and reinforces our drive and our need to update some of our regulatory arrangements in 2015.

Importantly we're continuing to deliver the core requirements, safety, reliability and customer service, things that fundamentally underpin the value of this business. In fact over the past six months UK safety performance has remained world class and I'm delighted the US is making excellence progress towards that level as well.

Network reliability across all of our businesses remains strong and we're delivering another year of substantial investment driving benefits for customers as well as growth and good returns.

Before I take you through some of the broader highlights of the first half let me just touch on the financial headlines. Overall IFRS results are in line with our expectations, headline operating profits are up 2% at £1.61bn.

Earnings of £883m or 23.4p per share are 16% up reflecting a lower interest cost helped by the reduced cost of carry half on half. The interim dividend will be 14.71p per share that's 35% of last year's final dividend as we said it would be. We're on track for total growth in the dividend at least in line with UK RPI inflation.

Finally our capital investment of £1.6bn is £100m down from this time last year yet still representing an extensive programme of work both here in the UK and the US. Importantly notwithstanding a few moving parts that Andrew will take you through we're maintaining our guidance for both asset growth and overall group returns for the full year.

But a few other highlights for me. In the UK as I've said many times before the priorities are really about execution, after a period of restructuring all the businesses are now settled and delivering well. Our focus remains on driving efficiencies and in particular innovating, innovating on solutions that can deliver the outputs that customers require us at the least cash cost.

At the end of September we hosted an investor visit to our UK construction office, there the capital delivery team set out a whole series of examples of many projects demonstrating the scale of what we're delivering year on year and in particular the challenging pipeline of projects that we've got coming up. And importantly what we're doing to deliver this programme on time and below budget year after year.

An example, here in London the £1bn London Power Tunnels project is now expected to come in around 5% below budget and is ahead of schedule for some key elements. The cable installation is due to complete a year earlier than expected with connections to many customers including Cross Rail ahead of the programme.

For a project of this complexity in the heart of London this reflects outstanding project management, in particular for the first time we've concurrently laid cable and had tunnelling contractors working. That's reduced time and cost which all of course will flow through into returns ultimately.

In gas transmission our emerging strategy around compressors is a perfect example of how we are fundamentally rethinking our approach innovating and lowering cost. At Aylesbury we've proposed a unique application of catalytic converters, this will avoid a complete replacement of a compressor installation that otherwise because of European environmental legislation would be retired long before the end of its natural life, this should generate significant savings and of course those will be shared with customers.

Both those examples just go to show how the totex incentive under RIIO is working, working both for investors and for customers. These examples and the team that John has put in place give me a high degree of confidence in our ability to deliver, strong totex performance throughout the RIIO period.

In the context of more traditional incentives, as I said back in May, one of our key priorities was in our gas distribution business improving our customer service metrics particularly the areas of new connections. We've recently piloted a new streamlined process in the North West of England with really encouraging results.

Stakeholder innovation is one of the new incentives under RIIO and incentivisation is really working we are already delivering a step change on our results last year. In fact I was delighted that the recent stakeholder scores for our businesses were above those of the other transmission owners and all of the gas distribution networks in the UK so good progress. Overall UK business is on track with a clear ambition to continue to make step changes.

In the US the priorities we set ourselves at the start of this year were again clear, complete the installation of the financial systems and sustain the growth and returns in our business. On that first priority we are done, it is complete, the final stabilisation upgrade was successfully installed in July and the systems are now fully integrated into our business.

Operationally the US business has performed very well with tight management of underlying costs and delivering high levels of network reliability. At the same time the growth in regulated assets has been stronger than we expected, this has particularly been driven by gas investments in both extra mains replacement and new customers who are connecting to the system.

That additional growth in assets together with the removal of bonus depreciation which Andrew will cover will impact our expected US GAAP returns by about 20 basis points this year. And you'll recall back in May we were talking about the cold weather, the polar vortex in the US that had led then to us experiencing six record gas demand days, that meant running our gas system at much higher pressures than usual which led as it always does to an increase in leaks.

That was then followed up in March by a very unfortunate incident in the Con Edison's system in Manhattan that heightened frankly the awareness of gas leaks across the whole of the North East of the US. And like everybody else we experienced a huge increase in emergency calls and then subsequently to fix leaks and replace mains. That work continued beyond the winter in fact through the spring and the summer, in fact our workload in the first half has doubled versus what we've normally experienced like many other utilities in the North East.

It's all been successfully delivered however extra costs are expected to impact returns of between 10 and 20 basis points this year. So overall we expect the US returns in 2014 to be a little lower than last year in the range of 8.5 to 8.9%.

In our other businesses we continued to deliver strong financial performance and we're continuing to drive further value. This morning we've announced the major property deal for 24 of our London sites into a joint venture with Berkeley Group. The first ten sites are already prioritised, we invest the properties and Berkeley Group invests cash and their expertise in development. This will develop into a mixture of housing including affordable homes, schools and open public space.

The venture's got the potential to realise a significantly greater value than the £500m book value of our surplus land that currently sits in our company accounts. But importantly it brings out a great resource for the wider community. Our own contribution and our own risk is limited to the sites which will be input into JV on a phased basis. So a good six months.

We operate long term assets and that long term nature has always driven the way we think about the way we conduct our business. I'm pleased after years and years of our people being very involved in the communities in which we operate in and live in and our focus on just doing the right thing has increasingly been recognised, in particular by being awarded Responsible Business of the Year by Business in the Community.

That award recognises the way we run our business in both the UK and the US, all that work we do in our communities, our focus on sustainability and the work our employees do on developing skills and talent for the next generation. In a world where every aspect of company's activities these days are under constant and intense scrutiny, recognition of strong performance in this area is an important achievement.

I will now hand you over to Andrew to cover the financial performance and as John says I'll return then to touch on our priorities for the second half of the year. Andrew.

. . . .

Financial Review

Andrew Bonfield, Finance Director
Thank you Steve and good morning everyone. Our results for the half year are in line with our expectations and we are on track to deliver another year of strong overall performance. In the UK electricity transmission was ahead of our expectations principally due to a £53m litigation settlement and this should flow through into our full year results.

Our revenues in gas transmission are weighted towards the second half of the year which caused a fall in the underlying operating profit but we remain on track to deliver the full year outcome. Gas distribution is in line with the small decline in profit reflecting the lower expected revenues that we expected at the beginning of the year.

Our US business is slightly below, this is in part due to the additional gas leakage costs that Steve mentioned a moment ago along with increased bad debt expense. Timing is negative as we start to refund the 18A balances that we've discussed in the July interim management statement. Our other businesses are a touch ahead and US system costs are inline. So overall we are where we expected to be at the half year at the operating profit level.

Of course our reported IFRS results are only one of the measures we use to monitor our business performance. At the full year we'll have a more thorough discussion of performance including our value added metric, operating company and group returns and regulatory financial performance and position.

As these measures are calculated annually I can't discuss them today but I'll talk through some of the key drivers which will influence them, I will also give you a view of how we expect our full year returns to develop.

Let me start with electricity transmission. The legal settlement I mentioned a moment ago will not be included in the calculation of returns, however we expect totex efficiency performance to improve on the level we achieved last year driven by savings on our capital projects such as those Steve mentioned a moment ago.

We continue to deliver good incentive performance and we will keep the legacy price control benefits for the full 8 year regulatory period. So overall we expect improved returns in electricity transmission.

In gas transmission our totex spend is much lower and we expect to spend broadly in line with our allowances. The key opportunity to outperform in gas transmission is in traditional incentives and we expect additional permit income will boost performance in the second half. The legacy price control benefits should remain about the same level as last year however unlike electricity transmission these will not last for the duration of the price control and will begin to ramp down from 2015/16.

For gas distribution we anticipate another good year in our mains replacement activities delivering strong totex out performance at a similar level to last year. Other incentives are not a significant part of returns but as Steve noted we are targeting improvements in customer service. And the small amount of additional benefits we saw last year will also continue. So in aggregate gas distribution should have another strong year.

Before I discuss the US business I would like to provide a little bit more background about the increased rates base growth we expect to see as a result of the end of bonus depreciation. Bonus depreciation was a stimulus measure designed to encourage investment, it essentially has lowered the amount of cash we paid by accelerating tax deductions on capital expenditure.

In the US we are funded by the regulator for the book tax charge rather than the cash tax we pay, as bonus depreciation reduces cash taxes it creates a deferred tax liability which is offset against rate base. With the end of bonus depreciation we expect our cash tax will rise, we will no longer be providing deferred taxes so the rate base will grow faster. It’s important to remember that the end of bonus depreciation will have no impact on our revenues going forward aside from the potential upside when we true up rate base growth.

In May we anticipated that this incentive would be reviewed but this hasn’t happened yet, as a result we now expect our calendar year end rate base will grow by an additional $350m which will of course increase our denominator in our returns calculation. We estimate this represents about 20 basis point headwind on US returns.

Steve has already taken you through the impacts of the cold weather which together with the changes in expectations around bonus depreciation has resulted in a reduction of our forecast US returns which we now see in the 8.5 to 8.9% range. The fundamentals of our US business remain attractive but we do need to get back into rate filing mode and Steve will cover our priorities in this area in a moment.

Moving on to other activities, operating profit from metering, Grain LNG and the French interconnected business continues to provide a good steady level of profit whilst yielding stable cash flows. We also saw increased profits on our property business. The full year outlook for all of these activities remains positive.

As Steve mentioned our joint venture with the Berkeley Group should allow us to realise more of the value from our property portfolio in London although it will not benefit profits for several years.

There were a number of one off benefits last year in UK corporate costs which have not recurred and we have also incurred some US corporate centre costs associated with business development and getting our regulatory findings up to date. These costs were more than offset by the reduction in systems implementation costs.

Turning to financing, costs were 19% lower than last year, foreign exchange and RPI both impacted the headline numbers, but we have also reduced the costs of carry and refinanced existing debt at very attractive interest rates. For example in September we raised $900m of bonds for the NiMo business, a ten year bond at a yield of 3.5% and a 20 year bond at 4.3%, both attractive rates which help us to keep that business well-funded.

In addition I'm also pleased to say that this month we've entered into a £1.5bn loan facility with the European Investment Bank, this loan can fund capital investment in our electricity transmission business at RPI linked rates and provides an attractive source of financing for our investment programme.

The effective tax rate was 22.7%, 0.3% lower than last year due to the reduction in the UK corporate tax rate. And overall earnings per share were up 16% to 23.4p per share.

Excluding the impact of the strengthening dollar net debt has increased £200m since March. Cash flows benefited from US working capital as a result of the recovery of last year's higher receivable balances due to the cold winter. We also saw strong operating cash flows from the wider business.

We do not measure gearing at the half year but we have maintained a strong balance sheet and we expect to deliver another year of solid credit metrics particularly RCF to net debt. This has enabled us to start buying back the shares to offset the dilution from the scrip programme.

Capital investment for the first half of the year was just under £1.6bn, 6% lower than the first half of last year. This largely reflects lower load related spend in the UK partially offset by increased US gas distribution spend. Looking ahead we continued to expect an underlying asset growth rate of around 5% for the full year and Steve will talk more about this in a moment.

As usual we provided a comprehensive technical guidance section in the statement. Some key points to note are that in the US the full year impact of the refunded 18A balances will be expected to be between $120 and $140m, as a reminder this is timing and has no impact on returns.

We also expect to see increased costs as a result of the gas leakages in the US that we've discussed earlier. Offsetting this, interest costs should be lower than the £1.1bn we saw last year and we are forecasting group tax rate of around 25% reflecting our expectations for the balance and mix of profits between the UK and US businesses.

We don't update guidance more than one year ahead but I want to remind you of the two year lag in our new UK regulatory arrangements. In 2015/'16 we will start to return part of customer shares of totex out performance and Ofgem will also make adjustments to other allowances where an output is no longer required. We will also start to recover revenues under incentives that now operate under a two year lag. Of course all of these movements do not affect underlying performance and we'll be able to update you more on this later in the month.

So in summary a solid first half represented good progress towards our year end targets. Overall we are in line with what we expected in May both in terms of earnings and more importantly returns. We continue to sustainably grow the group whilst maintaining a secure balance sheet and keeping in line with our credit metrics. This supports our dividend and helps us provide safe, efficient and reliable services to our customers.

Steve back to you.

. . . .

Outlook

Steve Holliday, Chief Executive
Thanks Andrew. So just before I turn to our outlook let me briefly remark on some of the recent developments in the industry here in the UK. As you will know we have the role of implementation body for electricity market reform, the important programme of change being introduced into the UK energy market.

As a result this has been a very busy six month period for our EMR team achieving some very important milestones. In particular we've successfully managed the qualification process which has resulted in 63,000 megawatts of de-rated capacity coming forward into the capacity auction against the target of 51.

The level of activity around EMR is set to continue in fact ramp up in the second half of our financial year. The first capacity auctions will take place next month in December and we expect the first contracts for difference awards to be scheduled for early in the new year in January. We work very closely with the Department of Energy and Climate Change and Ofgem to support the process and ultimately our role is to implement the final decisions that are made by government.

Turning to this winter, we published our winter outlook last week. On the gas system under every possible scenario you can create we see adequate and diverse sources of gas and currently have more gas in storage than for many years. Furthermore we have sufficient network capacity and availability.

In electricity supply margins are tighter than last year but in fact are very similar to the level that we saw and experienced in 2005. Based on thorough analysis the likely supply margin had fallen to just over 4% reflecting a number of closures of more power generation in Great Britain over the course of last year and of course some of the problems that we've experienced since the summer.

We've subsequently taken steps to mitigate these changes by using our new supplementary on demand side balance reserve mechanisms, once we include those measure the margin is back up to the 6% level we expected in the summer.

Overall National Grid is well prepared for the winter; we're ready to respond as best as we can to whatever supply and weather scenarios unfold. But these tighter margins do again highlight the need for the construction of new generation and to start that sooner rather than later. Over the longer term the new capacity auctions and contracts for difference processes should work to incentivise investors to build new generation here in Great Britain.

Our priorities for our UK business for the balance of the year are unchanged. A clear focus on delivering more of the same, a focus on efficiency as we undertake our significant investment programme, focus on upgrading important infrastructure, driving this base level of asset growth throughout the RIIO period. And secondly sustaining these improvements in customer service, it is an important component of the RIIO price controls and our incentives.

Turning to the US, we now have a number of short term priorities and an increasing number of medium term opportunities. Firstly we must drive operational performance and deliver further efficiencies will be supported by our new financial systems. Once our test year is complete in the middle of 2015, we'll as Andrew said, be making major rate filings. In the meantime we will look to increase recovery for some of our investments with smaller, more targeted applications for updates to our allowances.

By way of example Massachusetts recently enacted legislation that allows us to file for acceleration of gas pipeline replacement. In fact last week we made a filing to commence recovery of some of these costs totalling $175m. In addition earlier this year we filed a $700m capex and ongoing rate true up for the key span gas business on Long Island, and we expect a decision of that by the end of December.

Next up early in 2015 we're expecting to make a filing under the first phase of the new Reforming the Energy Vision, or known in New York as REV. As I said, expecting to make that very early in 2015. And then we get to the middle of 2015, and once we've completed the full test year we'll be submitting a general electricity rate filing in Massachusetts, coupled with various aspects of the Massachusetts grid modernisation programme.

And as Andrew indicated, thereafter we will be in a period of rate filing business for the next few years, as necessary investments for customers drive accelerated growth in our rate base.

And we'll have a new management team in the US to lead us through that period. As we announced two weeks ago, Tom King will move on from National Grid at the end of this financial year. Under Tom's leadership over the last seven years our US business has successfully delivered improving returns, reinforced its focus on our customers, made enormous improvements in the reliability of our systems, and huge enhancements to the processes by which we respond to storms. All of that's been achieved through a period of extensive regulatory engagement throughout which Tom's personal input and guidance and judgement has been absolutely invaluable.

As we transition onto a more performance focused business, he leaves behind a legacy of an organisation with strong jurisdictional and regulatory teams, and a real focus on driving process improvements across all of our operations. I have huge personal debt to Tom, and the company does, and we all wish him very well in his future ventures. It's a pretty tough act to follow. But I am delighted that we have been able to find a strong successor in Dean Seavers who you'll have the opportunity to meet once he joins National Grid at the beginning of December. Dean brings a wealth of experience, real experience in delivering performance improvement. It will benefit us as we continue to enhance our offering to our customers, and drive efficiency and overall returns.

We have an exciting agenda in the US where our focus on operational excellence should enable the business to deliver profitable growth for many years to come. We also have in the US a new CFO in Peggy Smith who recently joined us from Con Edison, and she'll be supporting Dean in his new role with her strong utility experience. Dean and Peggy's initial focus will be on further strengthening our processes and our operational changes that have underpinned our progress to date.

So our US priorities are really unchanged. We need to focus on driving operational performance, delivering further efficiencies that are required to offset otherwise the cost inflation. We've got to deliver this programme of interim regulatory filings, and prepare for a period of general rate filings that will lead to increasing overall returns in line with our long term objectives.

And finally we turn to look at the pipeline of investments that support the long term growth of the dividend. Across the UK and the US we have an outlook of good growth in our core regulated businesses. In fact as we set out in September here in the UK, our latest plans now forecast investments of between £16bn and £20bn in regulated assets, up to 2021. In the US our expectation is edging up from today's $2bn a year rising to around $2.5bn a year over the next few years as we see the need to modernise our networks, replace more gas mains and tie more customers in for natural gas. And it's becoming increasingly more likely that our regulators will look to further accelerate that current rate of replacing old gas pipes.

And all of that in part is why the regulators are rightly reviewing their rate making mechanisms, and we will work with them to design solutions that better track increased investment requirements and ultimately remove this need for very frequent and regular rate filings.

On top of all this core investment several of the new additional business opportunities that I have talked about in the past are making really good progress. Here in the UK a half a billion pound gigawatt interconnection to Belgium is close to achieving some important final milestones, with Ofgem already have published a proposed regulatory framework and the Belgian regulator has already passed agreement. We are aspiring and hoping for a final investment decision on this by the end of the financial year.

The £2bn 1.4 gigawatt interconnection with Norway is also making good progress. The procurement exercises are now at an advanced stage and regulatory and planning reviews are expected to come together over the next few months, again targeting an investment decision by the end of this financial year.

Finally switching to the US. By Christmas we expect to create a New York joint venture that brings together the transmission assets from ourselves, Central Hudson, Con Edison and Iberdrola into a new transmission utility. Overall that joint venture will have the opportunity to invest $2bn in new assets required for the transfer of power north to south, the so called new energy superhighway in New York. And FERC Order 1000 is also creating a wide range of opportunities that our team are investigating.

In summary we have no shortage of attractive opportunities that will continue to fuel our combination of growth and yield. But I want to be crystal clear. As a management team we all know the key to driving value in this business is safety, reliability, customer service and just continued good operational execution. That's what we've set up this business to deliver; we're very well positioned, we're confident in the future, not just for this financial year but for years to come.

And with that Andrew, and as John said, Tom and John and I would all be very happy to take your questions.

. . . .

Mark Freshney, Credit Suisse

Thank you. Two questions. Firstly on the property transaction you've announced today. Can you talk about the exact economics because my expectation would be that some of the £500m book value actually sits within regulated entities and would need to be returned to customers? So just to try and gauge the potential upside that could be left for equity shareholders.

And just secondly on the New York State Transco JV that you just flagged, can you talk about any assets that you'll be putting in there and any impact it might have on your accounts and your numbers?

. . . .

Steve Holliday, Chief Executive
Yes, certainly. Let me start off on the property one and then Andrew I'm sure will want to add to it. The £500m book value are not assets that are in the regulated businesses. They're in our unregulated property company. The way the process works and has worked over 20 years actually, is the asset and the land is taken out at a value that is ascribed by an independent arbitrator into our property company. That value comes off over time off the regulated asset base so customers see some benefits of that. We then invest to reclaim and clean up that land. In fact over 15 years I think shareholders have invested half a billion pounds in cleaning up land. The profits that historically we always report in our property segment are net of all of those costs. What this is doing is taking 24 sites in London that clearly have very high value in our large portfolio, and not only moving them across into the joint venture, but allowing us to capture the upside associated with development.

Do you want to add to that Andrew?

. . . .

Andrew Bonfield, Finance Director
No, I mean I think just to add I mean then the profits will flow through, obviously be equity accounted over a number of years. It's really the development profits which are the upside potential Mark on those, which are really, you know, the additional amount available for shareholders as you look forward.

. . . .

Steve Holliday, Chief Executive
It's a great transaction this because it is going to enhance the value for our investors of our portfolio. It will over time reduce the assets and customers will see some value. And importantly it puts housing into a part of the country that we're desperately short of housing as well. This really is a great transaction.

Can I go to New York and Tom? I mean the answer is we're not putting any assets in at the beginning of this at all; it's all the new assets. But Tom, do you want to tell a bit more about New York Transco.

. . . .

Tom King, Executive Director, US
Absolutely. It's probably worth a minute on a bit of a background. This has been a process that's been underway for roughly about four years. We have with all of the New York ISO and the

transmission owners in New York did a full state asset condition study, and looked for areas where we needed to upgrade capacity, new transmission and create - and debottleneck western central upstate New York on wind, Canadian access to hydro and wind. Ultimately that led into a recommendation of just under about $2bn of transmission investments to create a new corridor for resources in western New York and Canada down into New York City and Long Island. That's basically what the TO is set up to do. So all new investment for transmission will go into the New York TO and you'll see Con Ed and Iberdrola file their first two aspects of it over the next two months. And you'll notice in those filings that those assets once approved will go into the New York TO and it will be the beginning of a multiyear investment opportunity.

. . . .

Steve Holliday, Chief Executive
And those finds are with FERC so this is the first time that you've got transmission in New York that will be regulate by FERC and attract all the arrangements of FERC regulated transmission.

. . . .

Tom King, Executive Director, US
They're with FERC; it will be a FERC regulated transmission.

. . . .

Mark Freshney, Credit Suisse
And can you remind us what FERC 1000 is?

. . . .

Steve Holliday, Chief Executive
Sorry. Thank you for asking the question in a sense. FERC Order 1000 is the order that creates more competition in transmission across the US. So it removes in many ways the incumbency rights for transmission inside your own area. So it allows us to look at transmission opportunities that are point to point in other areas outside of our natural territory.

. . . .

Dominic Nash, Macquarie
Couple of questions as well please. Firstly on UK capacity payments and the mechanism you say that next winter gets tighter than this winter but we should all be all right because capacity payments should encourage new build when the auction kicks in in '18, '19. But looking at the numbers that are submitted it doesn't look like there's much scope for new entrants coming in here. Do we actually think we're going to get any new builds in coming out of this sort of the first auction?

And secondly on interconnectors, what is your economic case to get them built as to whether you would like to see regulated returns or merchant returns, and how closely do you - or when do you think we'll get clarity on how you're going to get remunerated?

. . . .

Steve Holliday, Chief Executive

On the capacities, just to be clear, we've got the mechanisms in place for the short term to manage through what are clearly tight winters, '14/'15, '15/'16, right out till 2018 actually. So we've already used a couple of those mechanisms for this winter as I alluded to. And the cost of that will cost all of us in this room 50p a year. So that's the cost of that incremental, just over a gigawatt of supply security.

We'll find out the answer in the capacity auction pretty quickly because we're going to start to run it in December. In the prequalification I mentioned, there is actually over 11 gigawatts of new capacity that's prequalified. So when the auction clears we will find out how much of that capacity gets a 15 year contract and will be built under that mechanism. So when we're here early in the New Year we'll have a clear answer to that.

In terms of interconnectors, Ofgem has already consulted on the Belgium interconnector and it's a cap and floor regime that we are comfortable with in theory. The Board has not yet made the investment decision as I say, it will be looking to make that decision hopefully before the end of the fiscal year, but the regime is a regulated regime of sorts. In between a cap and a floor there's a merchant opportunity for us. We're comfortable with the floor which underpins therefore our investments, and believe that in exchange for that the cap is in about the right place as well. So I think it's a mechanism that should work well. The intention is to put in place a similar mechanism for the Norwegian interconnector as well, and I suspect for subsequent interconnectors into the future.

. . . .

Dominic Nash, Macquarie
And sorry when will we get next news flow on the Norwegian interconnector?

. . . .

Steve Holliday, Chief Executive
Next news flow again is going to be towards the end of the fiscal year. If things continue as they are we'll be looking to make investment decisions on both of those, and at that time obviously we'll put out the financials so you can understand our investment decision. But they're both big investments and you can see in these half year results that the interconnectors that we've got today are generating very healthy returns.

. . . .

Deepa Venkateswaran, Bernstein
Thank you Steve. My question is on the US so you mention that the guidance or your expectation for the ROE is slightly lower at 8.5% to 8.9%. I believe it was 9% before. So could you just help us understand what might be some near term and medium term measures to get the returns back up?

. . . .

Steve Holliday, Chief Executive
Yeah, sure. I mean I think we said at the beginning of the year we're going to have work very hard to maintain the 9% which is essentially to hold our costs flat we're going to have offset all inflation. Hadn't anticipated the fact that that gas thing was going to run right the way through the spring and the summer, but it's something that all the utilities in the northeast have experienced, as indeed as Andrew said everyone has also experienced the bonus depreciation removal, which is interesting

because that could still change actually, that decision is not final, final. But our expectation is that it's not going to be available to us. So that's a structural change to an extent.

As I mentioned we've got some work to do on our costs next year which we will do again to hold off inflation. But we've got a number of these small filings going, all of which will bring in incremental small pieces of revenue. So my expectation is that we'll continue to hold this performance. What we really need Deepa is the Massachusetts electric rate case. That is $1.5bn of rate base, so it's about 10% of our overall business, and it's earning very low single digits returns. It desperately needs re-filing. That's the one step change then that will put the overall average return back to where it needs to be.

. . . .

Bobby Chada, Morgan Stanley

Thank you. Two questions, both on the US. You talked about the changes to New York regulation. Can you give us an idea of what you might hope for out of that new approach to rate making?

And then just to follow up on US ROEs. I think you said your test year post all the SAP implementation would be done by middle of '15, so it feels like you couldn't file until at least the middle of '15, 12 months takes you through to middle of '16. Is that reasonable then that in order to get this decent uplift from Massachusetts we're actually looking at effectively nearly two years away?

. . . .

Steve Holliday, Chief Executive

Well let me answer that and Tom perhaps you'll come back on REV with a bit more detail. The test year with our new SAP system, you're absolutely right Bobby it goes from July to July. So the final filing of all of the detail is in the middle of '15. We'll be working with Massachusetts actually knowing that there's important investment under grid modernisation that they would like us to make as well, to look at how we can overlap parts of that process so that it doesn't take - in fact in Massachusetts it doesn't take a year, it's normally eight to nine months actually. So if you were on the old world you'd expect a decision in February or March 2016, then kicking in immediately. We'll try and overlap a few of those processes actually. Let's get all the modernisation and structure agreed up front, filing in July and try and shorten that process. That will be our objective and we'll be working of course with a new commission. The commission is going to change in January as a result of the change in government in Massachusetts. So a lot of work to do there. But they have a huge ambition on modernisation. So if we're to help them get the modernisation agenda in place, well then we need to see if we can actually advance that.

But a bit more flavour on REV Tom.

. . . .

Tom King, Executive Director, US

Yeah, and one other data point on Mass, and Bobby the new legislation for the accelerated pipeline replacement enables a very quick approval. So as Steve mentioned, we filed on Friday 31st, and it will have some key elements in it. One is that some of the costs we've already incurred through the mainline investment we've made this year as well as incremental O&M, as well as a forward look. All of that is in the filing. That filing was made on the 31st and I would expect an answer in the January, February timeframe. And then we'll go ahead and go into implementation on that. So that will be another positive uplift for Mass.

For REV, there's a couple of key elements in it. One is a new definition by the New York public service commission which has been an open discussion with the utilities as well as the general market, on creating an environment where they could begin to redefine the utilities role. And the redefinition of the utilities role is a system operator driving more control and automation and advancing technology on the networks to get real time pricing and demand management, demand response as well as energy efficiency. So that new definition opens up a new platform for us to think about not only investment on the networks, but also investment into energy efficiency and demand response etc. and automation of that.

In order to do that, that is an end result that New York would like to see as a fundamental reduction in demand to incent the utilities that were opening up the regulatory structure to how do we ensure that we have the right incentives and the right correct rate making to ensure that you are incented to deliver on what we have defined as the new role of the utility. So I think you will see similar things introduced that you've seen in Rio. Totex is part of the discussion; acceleration of capital is part of the discussion or advance the technology. And then we will place rate filings in that bring in new mechanisms with the right incentives. So it is a ground-breaking opportunity frankly for US regulation in general, and New York is very focused on finding the right regulatory structures to begin to start knocking down the regulatory hindrance to accelerate the investment.

. . . .

Bobby Chada, Morgan Stanley
Can I ask two clarifications - on that accelerated pipeline replacement, is that the 175m that Steve has referred to?

. . . .

Tom King, Executive Director, US
Yeah.

. . . .

Bobby Chada, Morgan Stanley
That's the revenue that you're asking or that's the capex that you're investing?

. . . .

Tom King, Executive Director, US
That's the capex.

. . . .

Steve Holliday, Chief Executive
That's the capex that we have invested, yeah.

. . . .

Tom King, Executive Director, US

We can follow up on other - we'll pull the numbers out of the filing for you on how that equates to revenue standpoint.

. . . .

Bobby Chada, Morgan Stanley
And on REV, because of the New York agreement to decouple revenues from volumes, energy efficiency - if you were able to make a step change in energy efficiency, it wouldn't necessarily affect revenues in a substantial way, right?

. . . .

Steve Holliday, Chief Executive
Would not, absolutely right.

. . . .

Tom King, Executive Director, US
Correct. However the interest of the commission is to open up the door for the opportunity that we accelerate energy efficiency, therefore what's the right cost recovery and incentives to do that. So it is an opportunity for us, it's not a risk. Okay.

. . . .

Jamie Tunnicliffe, Redburn Partners
Two questions. Just I suppose thinking about that US and then how you are trying to once again change where you end up and get the incentives right, what is your aspiration there? Is it still sort of - well is it getting to sort of, I don't know, 95%, 90% of your return, with the sort of - does seem to be this sort of constant lag and things hit you and it takes a while to get them back etc. etc. Or do you think you can ever get in a position where you can start being above that US return on a consistent basis because you can, you know, perform well against these deals? I'm just trying to understand where you think you can move this system?

. . . .

Steve Holliday, Chief Executive
That's a very fair question.

. . . .

Jamie Tunnicliffe, Redburn Partners
Sorry, and I'll just give you the other one so it's you talking.

. . . .

Steve Holliday, Chief Executive
I didn't want the second one.

Laughter

. . . .

Jamie Tunnicliffe, Redburn Partners

Yeah, maybe you don't. If I was really to be nasty and follow up Dominic's sort of - but because I think you did say when you were talking to that slide 35 about the UK and the capacity market register, that we need to start building new generation now. But your own numbers suggest there's just a huge amount of existing generation and there's no need now I presume on those numbers to build it, and it wouldn't be in customers' interests. And I just wonder how your sort of talk is lining up with your own numbers there, because surely it's not the right thing if you can use existing generation to incentivise new generation.

. . . .

Steve Holliday, Chief Executive

I'm perplexed with that Mike - I have to say. 11,000 megawatts of generation has shut in the last two years. There's more generation still to shut that is coming off in the next few years that has forecast particularly more coal to come off the system in the next few years. And some of the older nuclears will be reducing their capacity.

. . . .

Jamie Tunnicliffe, Redburn Partners

So is your comment Steve sorry talking about not this December, because your numbers are just this December? I thought you were talking about -

. . . .

Steve Holliday, Chief Executive

Actually Jamie, I mean the winter outlook is this winter actually. Clearly we don't want to particularly I think in the UK enjoy a 4% margin winter on winter on winter. We don't want to go out to the 17 we might have enjoyed a few years ago either, but there's more generation still shutting. We in the UK need new generation to be built.

When I talk about 2018 of course, those payments kick in from 2018 so if the auctions are successful, you're not expecting people to wait until 2018 to start construction. The government and indeed ourselves would be optimistic that people would start construction in the interim period. The first time they can collect the revenues from the new mechanisms is 2018. So that plant should be ready and operable by 2018. That's my comment about we need the UK to get on with building new power generation, absolutely fact.

. . . .

Jamie Tunnicliffe, Redburn Partners

Yeah, I suppose I was just looking at the 2018 numbers though. Your own 2018 numbers suggest the existing assets including refurb is a huge surplus to the target.

. . . .

Steve Holliday, Chief Executive

No. No, still tight, still tight. If we look out to winter 2017/18 we still think that we're potentially 1.8 gigabytes I think it is John, isn't it, in that winter tight without new generation that as yet has not announced to be built coming on stream. Because there's more generation being shut in the next three years still.

. . . .

Jamie Tunnicliffe, Redburn Partners
Okay.

. . . .

Steve Holliday, Chief Executive
Okay, but that's to your second question. Let's go back to your first question because I haven't forgotten it, and the answer it is hasn't changed Jamie, actually. I still believe, I think the team would all agree, what we need to do is consistently deliver 95% of our allowed returns. When you look back through the history of US utilities over a very long period of time, the best in class deliver 95% of allowed returns, the best executed and the best regulatory arrangements allow that to take place. That was our target and remains our target.

. . . .

Jamie Tunnicliffe, Redburn Partners
And incentives?

. . . .

Steve Holliday, Chief Executive
Well I was going to say that is under the old rules if you will there is an optimism as Tom says in New York, there's a whole set of new incentives that potentially come in that look a bit like Rio. At that stage you might start talking about over and above. Today those things don't exist though Tom, so today the baseline is let's get 95% of our allowed year in, year out.

. . . .

Tom King, Executive Director, US
Yeah, just a couple of key things that tie into this that I think are important. So as Bobby's question, both in Mass as well as in New York, there is alignment and interest on - and trackers, annual true ups and both the investment as well as the costs associated with that. Those tools have been what we've put in place over the last six years, and they really have helped us in the US true up on an annual basis. We don't have it in Mass Elec and that's - introducing it in gas is a great opportunity. We need to get it the next case. So the more that we have the business in the annual true ups, the better probability that we're going to be up in that target range, and then the incentives down the road as we get regulatory approval will help that.

. . . .

Steve Holliday, Chief Executive
I mean we'll do this at the full year actually but when you go through entity by entity you'll see exactly what Tom is saying. So you see it on Rhode Island that the new mechanisms and the true ups annually are just working very, very well. But we can go through all that at the end of the year.

. . . .

Peter Atherum, Liberum Capital
Thanks. I'll go for three if I may. Two quick ones on the US. The sort of the range 8.5 to 8.9 that's actually quite a big range given that we're already in November, the difference is quite a few dollars. Can you just give us a sense about what are the factors that would drive it to 8.5 or get you to the top at 8.9 given that we're already two thirds of the way through the year?

And then secondly on the US, what was the all in final, final cost of SAP?

. . . .

Steve Holliday, Chief Executive
And third?

. . . .

Peter Atherum, Liberum Capital
It's a follow on from Jamie so I'll come back to it otherwise -

. . . .

Steve Holliday, Chief Executive
Do you want to pick up the US returns?

. . . .

Andrew Bonfield, Finance Director
Okay. The reason why we've put the range in Peter is each 10 basis points equates to about £10m. We are obviously still working to see if we can find offsetting cost measures. Cost base in the US is about $2bn controllable costs. Actually £10m is not that big a number in that sort of context, so we are still working and trying to find it.

Secondly on bonus depreciation we're not absolutely certain that it won't be renewed. We are entering obviously the lame duck session in Congress. That could actually be passed. There are a number of tax bills that are out there. We've taken a conservative view which is probably it won't be renewed, and that's why we were highlighting it today. So that's the two major reasons why it's a bit of a range, and it depends on how we do for the remainder of the year and the team are working hard on that.

On SAP the all in cost including capitalised cost, cost paid by shareholders, cost paid by the Long Island power authority is just under $900m.

. . . .

Peter Atherum, Liberum Capital
Wow. So my question following on from Jamie's on reserve margin was Steve you referenced 2005 and we had reserve margins like this in 2005. But the sort of two differences I guess from 2005, 2005 reserve margins were sort of plain vanilla. Now they involve all the sort of de-rating of renewables, so involve a certain amount of subjectivity, not just science. And secondly the conventional fleet and the AGRs are ten years older and there are perhaps some reliability issues. So when you hear Ed Davey

go on the telly and radio and he says, you know, I can 100% tell you the lights are not going out because National Grid have promised me, are you really comfortable with the position?

. . . .

Steve Holliday, Chief Executive
I don't think National Grid have ever promised. In fact this morning we heard people ask that question as you know, and things can happen, can't they. You know, half the fleet could shut down tomorrow afternoon. Highly unlikely I think but there are those scenarios. Our de-rating is continually updated Peter actually. I mean John, you and I actually mentioned in our process, so in terms of the context of wind our experience of wind has changed our de-rating factor in terms of what equivalent capacity you would need to replace it. Our de-rating also reflects the age of some of the older plant as well actually. John, do you want to give a bit more colour on that?

. . . .

John Pettigrew, Executive Director, UK
Yeah, thanks Peter. So we did the modelling for this winter and for the next winter actually, working with DECC and Ofgem. We've taken into account de-rating for all the different types of technology, so when we apply what unexpected availability is for wind, it's around about 20% odd. And then we apply different availability for CCGTs and nuclear, and we've reflected that on what our experiences are over the recent winters specifically when we have the peak demands. And we've taken into account the age of the network as well.

Having done all that we've then tested that model against a whole host of sensitivities including low availability over that period, different flows in the interconnectors, really, really cold weather, average weather and so on and so forth. So we've done about 11 different sensitivities to really stress test that there's sufficient margin. Having done that of course we're then gone out and procured strategic balancing reserves to increase the 4% margin up to 6%. So we're really confident that actually we've really modelled and tested it really thoroughly to give us the confidence we have the right tools for the winter.

. . . .

Steve Holliday, Chief Executive
I also think it's been and will continue to be an area of good cooperation between the government and Ofgem and ourselves, with the government clearly in a position about power and Ofgem absolutely making sure that if we are taking decisions that go through to bills, those decisions are appropriate and right and they endorse them. And hence the 1 gigawatt of extra supply we've got this winter, and my remarks around 50p. So it's stress tested that that is the appropriate thing to do.

. . . .

Ashley Thomas, Societe Generale
Thanks for the throw Peter. Just two follow up questions. One on interconnectors. So if we look at Ofgem's cap and floor regime, I think their intention is for commissioning by 2020. So could you perhaps, you know if everything goes to plan and you do take the FID could you perhaps give us at this stage your expected commissioning for sort of potentially your four projects, so also including Viking and IFA2?

. . . .

Steve Holliday, Chief Executive
From memory Belgium is actually 2019, Norway is 2020, Viking is actually 2020 as well, IFA2 I think is 2019 as well. So they're all in that time window. Of course the other two aren't as far advanced, but France could be slightly easier in terms of some of the construction efforts. So the longest, most complex one is Norway. Clearly that's 750 kilometres, it would be the longest subsea interconnector in the world, but it's planned in the Norwegian plan as being online for 2020.

. . . .

Ashley Thomas, Societe Generale
And the second question was just on the SBR, and really sort of the intention to or the outcome of having contracted plant that was already within the store, I'm not quite sure how sort of fundamentally that has delivered sort of additional security of supply over this winter.

. . . .

John Pettigrew, Executive Director, UK
Yeah, so in terms of the strategic balancing reserve, the process that we've set up required us Ashley, so if someone nominated themselves to take themselves out of the market and to offer the strategic balancing reserve, then we had to take that into account. So in order to get what we felt was appropriate which is the 1.1 gigawatts of incremental capacity, actually we had to buy through the market for a small amount so we ended up on a de-rated basis buying just under 1.6 gigawatts to give us the 1.1 gigawatt of incremental capacity. But it is incremental to what would have been there against our base case.

. . . .

John Musk, RBC
Morning. Just a quick question on the balance sheet. You mentioned the RCF to net debt metric improving, can you just remind me I think the hurdle rate is 9% so how much headroom have you got there, and are there any implications for the script going forward?

. . . .

Andrew Bonfield, Finance Director
What I was saying is actually that it's comfortable, comfortably above the 9% John, rather than actually improving. With the debt buybacks at the moment we've pulled back about 7 million shares, we issued about 35 through the script. Our intention will be to try and offset as much of that dilution as possible through the remainder of the year.

. . . .

John Musk, RBC
Is there any quantum on that comfortable that you can …?

. . . .

Andrew Bonfield, Finance Director
Comfortably at the moment is comfortable.

Laughter

. . . .

Steve Holliday, Chief Executive
Despite the fact we're investing £3.1bn to £3.3bn a year, that is not forecast to get any tighter in the near future. Hence the need to do exactly as Andrew says in terms of buying back that script.

. . . .

Ed Reid, Lazarus Partners
A question about the interconnectors and security of supply. How do you think about the interconnectors when you look at security of supply? And I guess that slightly feeds into the previous questions about whether we actually do need more generation capacity. Are there other ways that we can improve our security of supply without needing to build new fossil fuel plants?

. . . .

Steve Holliday, Chief Executive
We're in danger of getting into a great - here. Let's get the analysis out in a great deal of detail. So let me keep it simple and be very happy to follow up, I think John would afterwards. In the base modelling we assume that interconnectors are 750 megawatts actually, that's the base modelling. In the sensitivities that John was talking about we clearly look at interconnectors actually going in the other direction as well as coming in our way. So I think we need to very careful that we just don't assume that it's always going to come this way. There could be a shortage in northern Europe at the same time as well. That's all part of the stressing of the model overall.

Having said all of that I think it's pretty clear to most people that more interconnection over time will enhance our security of supply, particularly when you're plugging into Europe into very deep power markets with a lot of capacity. And in Norway we're plugging into the hydro base there, so that's always been a project that looks really good for the UK in an old fossil fuel environment or even the wind, plugging into hydro as a backup. So overall those things will increase security of supply.

The logic for the investment though is an economic investment for National Grid, and all of the studies that have been done have demonstrated if we double the interconnection capacity of the UK today, there's £1bn of benefits for consumers per year by accessing lower wholesale prices. So you know it's good for consumers, it's good for us in terms of an investment, and absolutely you'd expect it to enhance security of supply.

. . . .

Iain Turner, Exane BNP Paribas
The £56m legal recovery, can you give a bit more detail about where that's come from? And then the US 18A refund, is there any of that in H1 or is it - or how does it break between H1 and H2?

. . . .

Andrew Bonfield, Finance Director

On the £53m unfortunately we are bound by a confidentially agreement so we can't provide any more details Iain, other than the amount that we actually received.

On 18A we've received about - we've paid back about $15m so there'll be about $100m in the second half to come out.

. . . .

Steve Holliday, Chief Executive
Okay, is there a last question? Okay, thank you very much for joining us, appreciate it.

. . . .

END