National Grid

Half Year Results Presentation
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National Grid

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Andy Agg, Chief Financial Officer

Questions

John Musk, RBC

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Deepa Venkateswaran, Bernstein

Mark Freshney, Credit Suisse

Dominic Nash, Barclays

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Chris Laybutt, Morgan Stanley

Elchin Mammadov, Bloomberg

Martin Young, Investec

Nick Ashworth, Director of Investor Relations

Thank you, Felicia. And good morning everybody and welcome to our half year results presentation. Thank you for joining us remotely. I hope you're safe and well.

So firstly I'd just like to draw your attention to the cautionary statement you'll find at the front of the presentation. Secondly, after the presentation, as usual, the IR team will be available by phone to help if you have any further questions.

And so with that I'd like to hand over to CEO, John Pettigrew.

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Key Highlights

John Pettigrew, Chief Executive Officer
Thank you, Nick, and good morning and welcome everyone. As usual I'm here with Andy Agg, our CFO. And after our respective presentations this morning we will of course take any questions you have.

But before discussing our performance in the first half of the year I want to start with an update on how we've been managing against the backdrop of COVID, and the impact it's been having across our businesses.

Overall the business has adapted incredibly well to new ways of working over the past eight months. Despite the new regulations and restrictions COVID has brought, operationally we've delivered safe, reliable networks for our customers, whilst making strong progress in key areas. Such as capital investment, where we've delivered on our substantial investment programme broadly in line with the first half of last year.

In the US where we've had to respond to a greater number of storms. Cost discipline where we've made good progress in mitigating some of the COVID cost pressure, as well as continuing to shape the organisation for the challenges and opportunities ahead.

Progress on regulation as we work towards settlements across our UK and Downstate New York businesses, and we've done this whilst ensuring we behave as a responsible and purpose led business. Ensuring continued focus on our safety culture, supporting our people, for example by increasing our focus on mental health and wellbeing, and supporting our communities, our customers, and our supply chain.

So, I'm really pleased with the way the business has stepped up and delivered a strong first half performance.

Turning to the numbers on an underlying basis, that is excluding the impact of timing, exceptional items and re-measurements, operating profit of £1.15bn was 11% below the prior year at constant currency.

This largely reflects increased COVID related costs, particularly in the US by storm costs in the period. And it will be partly offset by expected revenue increases in the US, and significantly better operating profit in UK Gas Transmission given the low rate set in the first half of last year.

Andy will go into more detail on the financial impact of COVID but our full year guidance from June remains unchanged, and as I mentioned in June given current regulatory mechanisms and precedents, we expect to recover the majority of the COVID impacts over the medium term.

Underlying earnings per share was down by 14% to 17.2p for the period, and the Board has proposed an interim dividend of 17p per share, reflecting 35% of last year's total dividend which is in line with our policy.

Investment in critical infrastructure remains strong, with capex of £2.6bn. This was driven predominantly by continued investment in large capital programmes in our UK Electricity Transmission business. Continued high levels in US capex, much of it mandated on safety spend, and increased spend in National Grid Ventures as we progress our interconnector projects.

Overall we maintain our financial guidance for the year and expect investment to be around £5bn driving asset growth towards the top half of our 5% to 7% range.

So, a strong half of operational performance, albeit like all companies, COVID costs have had an impact on our financial results.

Turning now to our safety and reliability performance. On safety, our businesses have continued to deliver good performance with their lost time injury frequency rates trending down.

However, 20/21 has brought unique safety challenges as a result of COVID which has required us to adapt our processes. For example, in the US at the onset of the pandemic our safety teams created our COVID-19 health and safety plan for all employees and contractors. They delivered over 400 field visits across their operations in the month of May to ensure the new ways of working and safety expectations were clear. This has allowed us to deliver our critical investment with limited disruption.

Turning to reliability, performance has remained strong across our businesses. We've successfully managed low levels of demand, particularly in the UK, with the electricity system operator developing new flexibility tools to maintain security supply.

And in the US, we responded to a series of big storms. Including one of the biggest ever in early October where we saw over 450,000 customers lose power. I'm pleased to say that the response was excellent with a tremendous performance from the team.

Looking ahead to the coming winter in the UK, the electricity system operator published its outlook last month and forecast an electricity capacity margin of 8.3%. Lower than last year, although well within the security standards.

And in terms of the UK Gas, expected cold day demand is forecast to be 426 million cubic metres against available capacity of almost 500.

In the US given the ever-present possibility of storms and potentially for colder than expected weather, we reviewed our procedures as we always do and are well prepared for the coming period.

I'll now turn to our operational progress we've made across our businesses, starting with the US. In the first half we've invested just over £1.6bn with much of it mandated on safety and reliability, a little more than we invested in the first six months of last year.

Our single biggest area of investment continues to be our leak prone gas pipe replacement programme. COVID has meant that we're behind schedule at the half year, but in the past few months as restrictions have eased, we're catching up and expect to reach our full year target of 300 miles of mains replacement.

On the electricity side we've seen limited disruption from COVID on our overall investment levels and work output. This is largely due to the huge effort that the teams have put in to review all of the transmission and distribution projects, to prioritise work required to keep the lights on.

Turning to regulation, we've made lots of good progress. In Downstate New York we remain in discussions for a multiyear settlement for our KEDNY and KEDLI Gas businesses. Whilst we've not yet reached a settlement, we remain hopeful that an agreement will be reached by the end of the calendar year that can be approved by the Commission.

I'm also pleased that we're delivering solutions for the gas supply constraints in Downstate New York. Focusing on enhancing our existing CNG and LNG infrastructure, as well as significant increases in energy efficiency and demand side response.

Moving to Upstate New York we submitted a filing for our Niagara Mohawk businesses at the end of July, for new rates effective from July 2021. Our filing proposes a multiyear rate plan with capital investment of $3.6bn across three years, including significant investment in clean energy infrastructure, new incentives and earnings adjustment mechanisms, all whilst managing customer bills in response to COVID.

Finally, we'll file for new rates for our Massachusetts Gas business tomorrow, it becomes effective in November next year. As part of our filing we're proposing a multi-year agreement with a performance-based mechanism similar to what we agreed for our Massachusetts Electric business last year. If approved this will give us longer term visibility for our investments, greater protection against cost pressures, and more incentives to innovate and create value for our customers.

Moving to the UK, I'm really pleased with the team's focus as we approach the end of the RIIO T1 period. We've invested £633m in the half, broadly in line with our investment in the first half of last year.

On the electricity side our two biggest projects, the 33km London Power Tunnels 2 project from Wimbledon to Crayford. And the 46km Hinckley Point connection to Bridgwater and Seabank in the southwest, are both progressing well. And we've worked closely with our contractors across both projects to minimise delays associated with COVID.

And on the gas side we've completed the tunnelling and are near commissioning our largest gas project in a decade, the Feeder 9 pipeline under the Humber. Which I'm proud to say holds the Guinness World Record for the longest hydraulically inserted pipeline at a little under 5km.

This goes to show that our UK businesses continue to deliver world class engineering solutions that will benefit consumers for many years to come.

As you know we submitted our response to Ofgem's draft determination in September, highlighting three main areas of concern. Firstly, reduction to the reliability and resilience of our UK's energy network. Secondly, jeopardising the pace of progress to a net zero energy system. And thirdly, erosion of regulatory stability and investor confidence in the sector.

Since then we've provided Ofgem with detailed information and evidence to support investment levels to maintain network reliability and resilience. Proposed solutions on how the regulatory framework can be modified to support the UK goals to achieve net zero by 2050.

And we continue to make our case to Ofgem on the importance of striking the right balance between customer bills in the short term and ensuring fair returns to encourage much needed investment in UK infrastructure.

We'll continue to work towards a settlement that is acceptable for all our stakeholders and remain hopeful that this is an outcome that can be achieved in December.

Moving on to National Grid Ventures and our other businesses. We've invested £261m in the half, higher than the same period last year, excluding our acquisition of Geronimo Energy. Progress on our new interconnectors remains on track with IFA-2 going live at the end of this calendar year. And our Norwegian and Danish interconnectors expected to be completed in FY22 and FY24, respectively.

We announced a co-operation agreement with TenneT on the 22nd of September to explore the feasibility of connecting Danish and British wind farms to the energy systems of both countries, so called multi-purpose interconnectors.

And we continue to make good progress with our onshore renewable projects in the US, and recently rebranded Geronimo energy to National Grid Renewables.

In the half we signed a PPA with Cargill for a 200MW solar project in Illinois, which is on track to be commissioned by the end of 2021.

So in summary a strong first half of operational performance, with good progress on our strategic priorities despite the impact of COVID on our financial results.

I will review shortly our outlook for the rest of the year, but first let me hand over to Andy to discuss our financial performance in more detail.

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Financial Review

Andy Agg, Chief Financial Officer
Thank you, John, and good morning everyone. I'd like to highlight that as usual we're presenting our underlying results excluding timing, and that all results are provided at constant exchange rates.

Before covering the Group's half year performance I'd like to provide some more detail on the financial impact of COVID that we've experienced to date.

During the first half we estimate that COVID impacted our underlying operating profit by £117m in three broad areas. An increase in our bad debt provision of approximately £56m, a shortfall of revenue under existing regulatory agreements of £41m and net direct costs of £20m.

In addition to this the delay to updating rates in KEDNY and KEDLI at that start of COVID resulted in a further impact in the first half of approximately £24m.

We continue to expect a full year impact of COVID of around £400m on underlying operating profit, given the seasonal nature of our US regulated business.

Whilst we see future uncertainties from COVID, I'm really pleased with the great progress we've made in alleviating much of the direct cost burden, with around £60m of direct COVID costs mitigated during the first half. And of course, we will continue to find ways to maintain this progress and drive further cost efficiencies in the second half.

We also maintain our guidance of up to £1bn of cash flow impact in the full year. On top of the underlying operating profit impacts I've just covered, we expect continued weaker demand and lower revenues which will be recovered as usual through regulatory true-ups in later years, lower cash collection from our US customers, which whilst below prior year levels, are in line with our expectations. And a small impact from revenue deferrals related to system charges in the UK that we'll recover next year.

In the US we remain confident that we'll be able to recover a majority of this COVID related costs. Either through the usual course of rate filing such as recouping revenue deferrals and collecting higher levels of bad debts or through separate filings. We're currently engaged with regulators across our states on this.

For example, in New York and Massachusetts we've already made submissions around cost recovery, following discussions with peers and our regulators. And as you'd expect we'll continue to work with all stakeholders on this within the second half of FY21.

Now turning to our half year performance, as John mentioned underlying operating profit decreased by £147m to £1.1bn. Operating profit benefited from higher revenue from the US rate case increases and higher capacity revenue in UK Gas Transmission.

These were more than offset by COVID and storm costs in the US business and adverse mod adjustments in UK Electricity Transmission. Compared to the prior year earnings per share decreased by 14% to 17.2p.

Capital investment was £2.6bn, 5% lower than the prior year. This reflects the increased investment in our US regulated business, UK Electricity Transmission, and the spend on the Viking interconnector, all more than offset by lower asset health work in UK Gas Transmission and the non-recurrence of the Geronimo acquisition.

Our strong balance sheet continues to allow us to fund this investment efficiently and to navigate through COVID successfully.

In line with our policy we'll pay an interim dividend of 17p per share representing 35% of last year's total. Scrip uptake on the fully year dividend was around 5%, and we'll again be offering the scrip option at the half year.

Now let me take you through the performance of each of our business segments.

Underlying operating profit for the UK Electricity Transmission business was £524m, down £59m compared with the last half year. This primarily reflects adverse MOD adjustments for lower data centre and cyber security allowances and the non-recurrence of prior year electricity system operator incentives, partially offset by RPI and lower controllable costs.

We invested £548m on system resilience, asset health and new connections. This was £77m higher than the last half year reflecting progress on multiple large projects such as London Power Tunnels 2 and Hinkley Seabank. Partly offset by lower spend on Western Link.

For the full year totex our performance, and other performance are expected to be slightly down with incentives above last year.

Overall return on equity outperformance is expected to be slightly above the 200-300 basis points range broadly in line with last year.

In UK Gas Transmission underlying operating profit was £108m, this was £42m higher than the prior year driven by higher capacity income, favourable MOD adjustments and lower year on year controllable costs.

Gas Transmission capital investment was £85m, £82m lower than the prior year. This primarily reflects lower asset health and emissions work, and the completion of the Feeder 9 Humber Estuary Pipeline project.

We expect the Return on Equity to reduce marginally compared to last year, owing to totex and incentive performance falling due to cost pressures.

Finally, I'm pleased to report that for the UK Transmission business as a whole our cost efficiency programme remains on track to exceed the targeted cumulative £100m cost savings in 2020/21.

In our US regulated businesses underlying operating profit was £403m, £115m lower than the prior year. This reflects higher revenues and rate increases, more than offset by COVID related bad debts, incremental costs, and major storm costs. Depreciation also increased from our higher investment levels.

Capital investment was £1.6bn, £75m higher than prior year at constant currency. Increasing capex was driven by higher electricity transmission and IT expenditure, partly offset by lower gas spend due to COVID related working impacts in Downstate New York.

We've seen high levels of storm activity so far this year with $61m of deferrable storm costs impacting our first half results. As a reminder our approach is to remove these costs from underlying operating profit if they're above $100m in a year. And with the recent big October storm we expect this will be the case by the full year.

Our cost efficiency initiative is progressing well, and as with the UK business we expect to exceed our targets and deliver savings of over $50m from 2020/21 onwards.

Overall, we expect full year Return on Equity to decrease as a result of COVID related costs which require certainty of regulatory treatment before an associated regulatory asset can be recorded.

As we explained at our full year results, we still expect to recover the majority of these costs in due course after the regulatory approval process has concluded.

Overall National Grid Ventures continues to perform well, delivering high levels of profitability compared to last year. Operating profit for Grain was £48m, £9m higher than the prior year. Primarily driven by lower depreciation from extended asset lives after the phase one contract extension.

Metering and interconnector profits were broadly similar to last year.

Excluding the £206m acquisition of Geronimo in the prior year capital investment increased from £223m to £261m in the period. This reflects higher Viking investment, partly offset by lower Capex of the IFA-2 project.

The operating loss for other activities for the half year was £30m compared with £1m last year. This principally reflects the lower land sales in our property business, and reduced sales in the St William business.

The post-tax profit share for our St William joint venture was £4m, £7m lower than last year, reflecting the timing of sales from its development sites. Capital investment was £25m, £38m lower than last year.

Finance costs were £468m, down 15% on the prior year, this primarily reflects a fall in average UK RPI, lower refinancing rates and the effects of the buyback and a reissue of hybrid debt last year.

Our effective interest rate was around 1% lower than the prior year at 3.3%. At constant currency second half net interest costs are expected to be slightly higher than the first half.

The underlying effective tax rate before joint ventures was 16.5%, 330 basis points higher than the prior year, reflecting reducing in the value of US tax settlements.

For the full year the underlying effective tax rate, excluding the share of joint venture post tax profits, is now expected to be around 21%.

Finally underlying earnings were £604m, with earnings per share of 17.2p, down 14% on the prior year.

Cash generated from continuing operations was £1.8bn, down 13% compared to the prior year. This reflects adverse working capital movements from higher US receivables, and lower year on year cash collections.

Net cash outflow in the period amounted to £2bn and after more than £0.5bn of positive exchange rate and non-cash movement, net debt increased by £1.5bn to £30.1bn. For the full year we expect ongoing business requirements to increase net debt by up to a further £1.5bn excluding the impact of exchange rates.

In the summer Moody's and S&P moved the Group's credit rating outlook from stable to negative. Reflecting concerns following Ofgem's publication of the RIIO-2 draft determination, and delays to expected revenue increases in the US. We expect both agencies to review this outlook after the RIIO-2 price control arrangements are agreed.

Lastly, I'm pleased to announce that we'll be issuing our first Green Financing Report in the next couple of months, currently allocation and associated impact metrics of the green bonds we've issues since January 2020.

So to summarise our half year, we've delivered strong operational performance in the first half, and for the full year we expect to deliver asset growth in the top half of our 5 to 7% range.

Like all companies we felt the financial impact from COVID, however I'm pleased to say we've largely mitigated the direct COVID costs. Therefore overall our performance remains on track and our full year forward guidance remains largely unchanged.

With that I'll hand you back to John.

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Priorities and Outlook

John Pettigrew, Chief Executive Officer
Thank you, Andy. So let me now turn to the outlook for the rest of the year.

As you hear me say on many occasions, this is a hugely important and exciting time to be part of the Energy industry. In the UK, the Prime Minister has put offshore wind at the heart of his vision for a clean energy future. And in the US the election of President-elect Bidon brings greater focus to the Energy transition with his potential $2tr Clean Energy Programme.

National Grid's vision is to be at the heart of a clean, fair, and affordable energy future. With that in mind we started the second half of this year with the publication of our Responsible Business Charter, setting out our commitments and ambitions for the years ahead.

This includes our emission reduction targets, our commitment to our people, building and developing an inclusive culture and a diverse workforce, and our commitment to our communities to provide skills development to 45,000 people by 2030.

Our progress across all our pillars can be tracked each year in our new Responsible Business Report that we'll launch alongside the Annual Report next summer.

Given this context, I wanted to spend a few minutes talking about three priorities for us in the coming six months as we move forward with the energy transition. An update on the progress we're making to deliver clean energy infrastructure, how we see the future role of gas and getting the right RIIO-T2 framework and building on our existing Efficiency Programme to identify further opportunities.

Starting with our progress on delivering cleaner energy infrastructure, as a reminder the regions we operate in have some of the most progressive decarbonisation targets in the world with the UK, New York and Massachusetts having a 2050 net zero target and Rhode Island requiring 100% renewable power generation by 2030.

Whilst we recognise the challenging economic backdrop that all companies are working against, we'll continue to work with regulators, politicians and consumers on finding cost effective and efficient ways of driving forward clean energy investment.

Firstly, in the US whilst we remain focused on our rate case negotiations in New York and Massachusetts, we're also working on separate filings that will help deliver smarter grids. For example, we're working across all our states on filings that will replace old meters with new smart advanced meter infrastructure.

In New York we expect a decision by the end of the year on our six year $650m funding request.

We're planning a similar $200m filing later this year in Rhode Island, and in Massachusetts the DPU has just scheduled a series of sessions on advanced meter infrastructure beginning next week.

Taken together these programmes would allow us to switch over 3.5 million electric meters and just under 1 million gas modules, provide our customers with greater information and more control over their energy usage and ultimately reduce their consumption and their bills.

We're also working with our regulators on EV infrastructure. Our NIMO rate filing includes proposals to expand the EV charging infrastructure to support 850,000 EVs by 2025.

In Massachusetts we plan to file for around $150m of funding next summer which will include investment to modernise the distribution network, commission 14MW of energy storage and expand our EV infrastructure proposal.

And in Rhode Island further EV programmes will be proposed through our next planned rate case later in 2021.

We'll also continue to be a strong voice, influencing and shaping the energy transition debate in the UK. And in particular in the next six months we'll continue to work with government and industry to ensure we've got the right policies and legislation to enable effective delivery of infrastructure that can support 40GW of offshore wind by 2030. This includes getting the right planning to deliver the necessary onshore cabling as well as furthering the work we're doing on an East Coast solution, ultimately to reduce the number of connections required.

We're also working with the Office for Low Emissions Vehicles on ways to deploy the government's £500m infrastructure commitment to electrify transport with further announcements expected from the government on this topic in the coming months.

Turning to our next key priority, the role of gas in a clean energy future. We know it's a topic of debate that will grow in importance and we believe we've an important role to play in shaping this debate, given gas is an affordable and trusted source of heating across 60% of homes in our US regions and over 22 million homes across the UK.

We're working with regulators, legislators, utilities, environmental and consumer groups and more besides to build a coalition to deliver alternatives to natural gas. For example, in the US we're working with NYSERDA and Stony Brook University on a hydrogen blending demonstration project.

In addition in New York we're close to commissioning on the Newtown Creek RNG plant, which will produce enough energy to heat an additional 5,000 homes reducing annual emissions by more than 90,000 metric tonnes.

And in the UK, we're working with Ofgem on funding for a project to build a hydrogen transmission test facility from decommissioned assets in the north of England, we will test blending hydrogen with natural gas up to 100%.

In our recently published Responsible Business Charter we committed to reducing our scope 3 emissions by 20% by 2030 and to meet the net zero target across all our regions.

The roadmap we're developing on some of these projects to deliver cleaner sources of gas will help us meet these targets.

But we also recognise the important role that natural gas can play as we transition to a clean energy future. For example, in our National Grid Ventures business, we recently signed an agreement at our Isle of Grain LNG facility with Qatar Petroleum that will allow us to invest in re-lifing our existing assets and in an additional tank.

This investment will bring our future annual throughput capacity to 25 billion cubic metres of natural gas underpinning its use for many years to come.

The contract will help the UKs security of gas supply as we move to cleaner sources of energy and could potentially see Grain playing an important role in a hydrogen future.

And also in National Grid Ventures as you know, we're evaluating a carbon caption storage project to decarbonise industry. Working with Drax and Equinor the project could deliver the world's first net zero industrial cluster in the Humber region by 2040.

You'll hear more about our future of gas work at our first 'Grid Guide To..' event on 21st January, which will be the first of a series of events where you'll learn more about the areas of work we're undertaking as we move forward with the energy transition.

Moving finally to RIIO-T2 where the focus in the coming months is on getting the right regulatory framework whilst building on our existing efficiency programme to identify further opportunities.

The next key regulatory milestone is the publication of Ofgem's final proposals expected in the second week of December.

The next five years is a crucial period for the UK infrastructure and rapid change is expected in the energy system to reduce carbon emissions and get the UK on track to meet its long-term environmental goals.

Therefore we need a RIIO-T2 settlement that can unlock investments that will be needed in the most efficient way. This means a final settlement that allows incentives which will drive innovative solutions through the period, creates the right framework that can deliver the investment needed, which should mean clarity around competition and additional net zero spend, but also means a fair base level of the return commensurate with the risk companies will undertake.

As you'd expect we'll take our time to go through the proposals in details, in particular against the concerns we said in our September response.

Following publication of final proposals in December, Ofgem will then set out a statutory consultation on licence modifications, which runs for 28 days. After a period to consider any changes it may need to make it will then enact the licence modifications, at which point if we're appeal to the CMA, we will need to do it within 20 days. Otherwise we accept the modifications, with new rates implemented on 1st April.

And as we work towards RIIO-T2 we're also keeping our focus on our efficiency challenge. As I said in June, our efficiency focus for this year is on streamlining our maintenance operating procedures, further digital innovations to increase productivity and making improvements in our back-office processes.

Some of these benefits will come in the way we manage our day-to-day operations. For example, over the next six months we'll be launching the first phase of our new digital tool to transform work management and scheduling across electricity and gas transmission, consolidating legacy technology.

But we're also working on ways to deliver larger scalable benefits across major projects. For example, looking at how we use contractors though the project lifecycle as well as ways to deliver greater capex efficiency through our supply chains. And once we have greater clarity on the RIIO-T2 framework we'll be able to understand how much further we can drive efficiencies.

So in summary, National Grid has delivered strong first half operational performance. The Company has overcome the disruption and uncertainty COVID brought, and we're prepared for the further challenges that the pandemic could bring as we head into the winter.

With politicians and regulators across all our jurisdictions pushing for faster cleaner infrastructure growth, we're well placed to help deliver these targets as an enabler for the Energy Transition. And of course, we'll do all of this whilst keeping our financial discipline and doing what's right for our customers.

Thank you for listening, ladies and gentlemen. Now Andy and I would be happy to answer any of your questions.

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Questions and Answers

Telephone Operator
As a reminder ladies and gentlemen, please press * followed by 1 on your telephone keypad to ask any questions. And when preparing to ask your question please ensure your line is unmuted locally.

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Nick Ashworth, Director of Investor Relations
Should we make a start.

So I can see John Musk from RBC has got a question. John?

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John Musk, RBC
Yes, morning everyone. Two questions from me. Firstly, quite a simple one just on the net debt guidance which was guided to increase by £1.5bn by the end of the year, was that including the £1bn COVID impact within that or is that on top?

And then secondly given I'm first up I'll start the raft of RIIO questions no doubt. Can you just update on your discussion, I guess, with Ofgem in the past couple of months where you think there's been the most progress? Is that more on the totex side or on the return side and what have Ofgem said to you around how they will potentially incorporate the findings from the CMA on the Water businesses?

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John Pettigrew, Chief Executive Officer
Okay, thank you John. Why don't I start with RIIO and then I'll hand over to Andy just to talk about the net debt guidance.

So in terms of RIIO itself, I think our focus if you stand back has been in three key areas. First, ensuring that we've got the right level of capital investment, and asset health capital investment in particular to maintain the levels of reliability and resilience that we have today, which we think is really import given the changes coming over the next decade.

The second area has been around making sure that we've got a stable regulatory environment that will encourage investment going forward given the scope of investment needed in the energy infrastructure.

And the third area is around making sure that the regulatory framework really aligns with what we're seeing from government in terms of the aspirations around net zero and green recovery.

Over the period since the draft determination, we've been in really constructive and detailed dialogue with Ofgem at the most senior level and at the working level. I mean I would say down to we're have conversations on a daily basis.

In terms of asset health we've provided a significant amount of information to explain and justify the capital investment that is needed. We tried to set out some thoughts about how we can better align the regulatory framework with the aspirations around net zero, and at the same time you'll know that Jonathan as the CEO of Ofgem has always said that you know, they're willing to listen in terms of the overall financial package as long as we can provide evidence, and we've been focusing on doing that.

Obviously in terms of the CMA draft determination with regards to PR19, I'd say I was pleased that the overall tone of that document I think aligns with our view that it is really important that we get the balance right between focusing on cost for customers today, but also encouraging investment and rewarding investors commensurate with the risk they're taking, so the tone of the document was very positive.

Ofgem have said historically that they would consider the CMA and the outcome of that, so I'm sure they're doing that.

So I think at this stage, John, what I'd say is that we've had good dialogue, we've tried to be constructive in proposing ways forward with regards to the regulatory mechanism that would support those objectives that I've set out and we're hopeful that we'll get to a sensible outcome in December.

Andy?

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Andy Agg, Chief Financial Officer
So on the net debt point, so the answer is yes, the £1.5bn of further guidance for the second half includes the COVID impact so it's not additive, it's already incorporated.

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John Musk, RBC
Okay, that's great. Thank you.

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Nick Ashworth, Director of Investor Relations
Thanks, John. I can see Fraser's got his hand up, so Fraser from Bank of America.

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Fraser McLaren, Bank of America Merrill Lynch
Good morning, thank you. I hope you're all well.

Just a couple of questions please from me. Just staying on UK regulation, I'm just wondering about the ESO discussions. I mean what has the legal separation not delivered that a split or a full divestment would? And could you speak a little bit about how the compensation would work and any impact on wider operations for the TO?

And the secondly, I'm just wondering about your attitude to acquisition opportunities especially in the US where opportunities could arguably be more attractive than in the UK. Would you consider recycling capital from the UK to the US if the right deal were available? Thanks.

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John Pettigrew, Chief Executive Officer
Okay, why don't I take the first and Andy take the second. So in terms of the ESO, there were sort of multiple parts of that question so let me just start by saying I don't think that the legal separation hasn't delivered.

Actually I think over the course of this year with the challenges that we've seen in COVID and the very low demands, the Electricity System Operator as a legally separate entity to National Grid Plc has performed incredibly well actually in what have been challenging times. So I think it's demonstrated it's worked very effectively.

I think the broader issue with regards to the future of the Electricity System Operator is really in the context of what role it should play as we move towards net zero. I think it's clear that to achieve net zero more broadly we need you know, to find the key decisions that need to be made, the actions and initiatives that will deliver those decisions and then get into what are the roles and responsibilities to make that happen and then finally, you get to institutional arrangements I think.

National Grid's working really closely with government and with Ofgem and with others to explore what are the changes that are going to be needed to deliver net zero. Inevitably part of that discussion is what role should the Electricity System Operator play? I've always said that we are very open that that role will continue to evolve you know, Fraser, it's evolved over the last 20 odd years and it will continue to evolve. So we're very open to those discussions about what role should it play.

I think it's important as we think about that, that whatever changes are made that it's stable in terms of moving us forward, it does support net zero and that it doesn't introduce any risks to things like resilience and reliability.

So I think that's where we are. In terms of the interface for the TO well with legal separation we've already sort of formalised that interface. I'm not sure there is a huge impact on that.

So with that, Andy.

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Andy Agg, Chief Financial Officer
No. Thanks, John. So Fraser, in terms of the question on M&A, I think consistent with what we've said previously we're very fortunate that we've got significant growth in our regulated Networks business and also a number of attractive opportunities in National Grid Ventures as well.

So for us, I think delivering on that programme is always in the forefront of our minds. And as John's just talked through sort of the regulatory arrangements around that. That said you know, a Group our size will always have an open mind around M&A opportunities, but they'd have to be you know, obviously clear from a shareholder value for us to pursue, and at the moment we're very focused on our organic growth.

So in terms of the recycling point, you know, I think we've shown in the past a willingness to look at our assets as a portfolio, and we have taken action where we think that that's appropriate to add shareholder value. I mean there's no reason – we will continue to look at the portfolio in that way, but I think at the moment we've got attractive growth and opportunities on both sides of the Atlantic, so that's where we're focused.

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John Pettigrew, Chief Executive Officer
Thanks, Fraser. Deepa, I can see you've got your hand up.

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Deepa Venkateswaran, Bernstein
My questions were a bit similar to what John has already asked, but maybe I'm going to try asking the same question slightly differently.

So with Ofgem, in the event that they don't take this CMA provisional ruling fully into account on the basis that you know, Ofwat has raised objections and Ofgem have also submitted. If you see an outcome where the allowed cost of equity is significantly lower but maybe it is acceptable on other counts like totex and so on, where is the Board's thinking on appealing to the CMA on that? And given that you have quite a lot of lead time you only have to make up your mindsets by which you probably know the final payment decision. So that's point number one.

And on point two, just on the ESO separation, could just help quantify what is the EBIT from ESO business? When I've looked at your financials it's fluctuated quite a bit. So on a steady state basis what's the kind of EBIT contribution, 30/60 million per annum? Just some financials around that. And would you expect the government to obviously compensate for this loss? I mean the government and [audio jumping]?

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John Pettigrew, Chief Executive Officer
Okay, thanks Deepa. Again, I'll do the first one and I'll let Andy answer the one on the finances.

I mean first of all I'd say that we are very focused on trying to get to a position where there is a sensible final determination that doesn't require us to go to the CMA. I think it would be you know, with great regret for all parties if we end up at the CMA.

In terms of the specifics of your question, I think I'll come back to what I said in June which is ultimately what is really important is if the overall package is a sensible package. So rather than look at each individual item, returns of course are important but so is the speed of cash in terms of fast and slow money, the level of incentivisation and the opportunity to drive innovation and efficiency to deliver returns as well as the overall challenge with regards to efficiency.

So I think we have to quite rightly look at it in the round in terms of what does the overall financial package look like and is that appropriate for the risk that we bear and the capex that we need to deliver?

So ultimately, I think that is the way that our Board will look at it when ultimately, we see the final determination.

As you know, Energy is slightly different to Water is, in that rather than referring the full price control, you can refer elements of it. So in the event that we can't get to an acceptable decision there is always the option for the Board to go to the CMA either in its entirety or in elements. But as I said, our focus is to try and make sure that the overall package is one that works for our investors and for our other stakeholders.

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Andy Agg, Chief Financial Officer
Yeah and just on the numbers, I mean just as a context the RAV of the Electricity System Operator is around the £200m mark. In the first half the operating profit for the ESO was around £37m. Last year was slightly higher than that, but that was because of some specific allowances that we collected last year, so that's probably more in the normal run rate.

But what I'd say is looking forward obviously we're having the RIIO-2 dialogue around the system operator as well, so there's still a lot of work to be done to finalise the arrangements going forward.

And in terms of the compensation point, I think again as John said, we're very early days, there's a lot of dialogue. But if we reach the point where that was the outcome then absolutely, we'd be expecting an appropriate level of compensation.

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John Pettigrew, Chief Executive Officer
Okay, thanks Deepa.

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Deepa Venkateswaran, Bernstein
Thank you.

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John Pettigrew, Chief Executive Officer
Mark, Mark Freshney from Credit Suisse.

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Mark Freshney, Credit Suisse
Hello. Yes. Thank you for taking my questions.

Just coming back to the ESO, when I look at the ESO, there's a lot of totex, a lot of scope for efficiencies and incentives, and a lot of fast money. So, presumably, even though it's only a small fraction of EBIT and RAV, am I fair in assuming that it's massively accretive to the Group credit rations?

And, secondly, on the balance sheet, I mean, gearing, you know, you don't disclose financial gearing at half year, but, you know, on my maths it looks set to hit 66%, 67% again at the end of this year, would you consider an asset disposal plan, A, to bring the gearing down, but, B, to capture some of the very, very low returns being taken in the private markets for some of the assets that you have?

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John Pettigrew, Chief Executive Officer
Okay. Thanks, Mark. I'm going to ask Andy to pick those up.

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Andy Agg, Chief Financial Officer
Yeah. So, thanks, Mark.

I mean, on the first point, so, yes, sort of, the gross amounts going through the system operator are slightly larger than the ultimate operating profit. A lot of that becomes pass-through costs. So, in terms of the impact on credit to get it is relatively small in terms of the Group as whole.

Sorry, there's a bit of background noise. Hopefully, you can hear me.

So, yes, so not a significant impact on the overall credit position.

In terms of the second part of your question, leverage, so, you probably remember, at the end of last year, we closed around 63%. That was partly because of the Cadent proceeds, or the second tranche of Cadent proceeds that had been received in the year. And we guided to expecting that to tick back up.

You know, we've always said, sort of, mid-60s is where we're comfortable in terms of the rating. So, in terms of being, sort of, you know, at or around, or maybe slightly able because of COVID this year, yes, that's probably in line with our expectations.

But, I think, in terms of the rating, as we've said in our statement, whereas the main agencies have taken a position in terms of, you know, the draft determinations, our focus is on working through the final determinations to ensure that we reach a sensible settlement, and the agencies have said they'll very clearly look at that again at that point. And that remains our focus for the time being.

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Nick Ashworth, Director of Investor Relations
Thanks, Andy. Thanks, Mark.

Dominic Nash from Barclays. I can see you've got your hand up.

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Dominic Nash, Barclays
Yes. Good morning, everyone. A couple of questions from me as well, please.

Firstly, on National Grid Renewables – also known as Geronimo - have come up, or do you have a view of, sort of, like your vision of this on where the number of gigawatts that you think you could own by, say, 2030? And the reason why I'm saying that is that more and more utilities are coming up with sort of five-year, ten-year pipelines of gigawatts. So, have you got like a view of how many gigawatts you're going to do?

And, secondly, I think we got, well, we might have an Energy Act white paper, coming out, we might not. We've been waiting for a long time for this. We might have a, sort of like, 10-point plan coming out, we might not. On your wish list, if you could have anything that you could have would you like to see in the upcoming, sort of, government documents, please?

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John Pettigrew, Chief Executive Officer
Okay. Thanks, Dominic.

Look, with regards to National Grid Renewables, I think I've said, you know, on a number of times, we do see onshore solar and wind as being, you know, an exciting opportunity in an adjacent market where we can bring some of the capabilities we have. And, with the acquisition of Geronimo, I think it gives us a great set of capabilities to be able to take developments forward.

We haven't set, and don't intend to set, a target, Dominic, on the basis that, you know, we've always taken a very disciplined approach to the investments we make outside of our core network businesses. So, we will always look at opportunities and look on them on a risk-adjusted basis to see whether there are appropriate returns to make those investments to support the overall proposition of increasing the asset base by 5% to 7%.

Historically, if you look at what Geronimo's done, and what we're doing at the moment, then, typically, we're developing around about 400 megawatts a year relative to our sort of overall the capital investment programme that's probably in the £150m to £200m of investment a year. So, it's relatively modest. But we will continue to look for opportunities as we move forward.

And, as you've seen, we commissioned our first onshore wind farm in South Dakota last year, and we're currently in construction with our first onshore solar wind farm, which is 200 megawatts, in Illinois this year. So, we'll continue to do those developments where we think there are appropriate terms.

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Dominic Nash, Barclays
Can I just follow up on that? Is it inconceivable that we could have 10 gigawatts of capacity by 2030?

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John Pettigrew, Chief Executive Officer
Well, I say, at current levels of development, we still developing about 400 megawatts a year, Dominic, so, at the moment, we're at that sort of level. It could increase if opportunities increase, but it could decrease.

And remember, that we actually take those developments into a joint venture with Washington State Investment Board as well. So, there are shared investments that we undertake when we take them into construction.

In terms of the Energy white paper, Dominic, well, I'm not entirely sure when it's going to be published, and I think we're expecting the Prime Minister's 10-Point Plan pretty imminently, actually.

I think, from our perspective, you know, when you look at the levels of infrastructure, investments, that are going to be needed to deliver net zero and, indeed, to deliver 40 gigawatts of offshore wind over the next decade, I think, ultimately, what we're looking for is just clarity and stability. Clarity in terms of policy, clarity in terms of the business models to do the investments, and then clarity about where Government see the priorities.

I think, you know, there is still some uncertainty at moment, and I'm hoping the 10-Point Plan, together with the Energy white paper, will provide that framework that will allow us to invest going forward with a degree of transparency.

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Dominic Nash, Barclays
Great. Thank you.

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John Pettigrew, Chief Executive Officer
Just looking at Jenny, Jenny from Citi. I think you've got your hand up.

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Jenny Ping, Citi
Hello. Hi. Morning. A couple of questions, please.

Firstly, just on the US, one area we haven't touched on. Can you give us an update on what is causing the delays in terms of the KEDLI and KEDNY settlement? I think, if I remember correctly, we were supported to be looking at expecting the decision from that in Q3.

And then, just going back to the number of questions you've already had on ESO, if I look at '18/'19 results and '19/'20 results, there seems to be a huge amount of volatilities in the ESO EBIT contribution, and you've obviously indicated there's a lower number for the first half, what is causing that volatility, just for us to try and get a sense, if that were to go, what is the underlying impact on earnings? Thanks.

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John Pettigrew, Chief Executive Officer
Yeah. Thanks, Jenny. I'll take the first and I'll give Andy the second.

In terms of KEDLI and KEDNY, we continue to have really constructive dialogue and discussions with the PSE. I think it's fair to say it is taking longer than everybody would like. The reason for that is predominately down to COVID, I think.

You would have seen that, you know, in the space that we operate in in the US, COVID's had quite a significant impact in terms of unemployment and just in terms of the economics. And, what we're trying to do, through a multi-year agreement, is to try and get that balance right between delivering the investment that the regulators have asked us to do in terms of safety and resilience, but also in terms of supporting decarbonisation going forward, but also be mindful of customer bills at a time of difficult economic conditions.

So, we're just trying to work through that at the moment, and make sure we get that balance right, you know.

There are opportunities to the shape the capital investment that we do, particularly around things like decarbonisation, to help to mitigate bill impacts. And we felt, together, that it was sensible just to spend another couple of months just working through that to get to what I think will be a good outcome if we can get a multi-year settlement.

In terms of the ESO, Andy.

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Andy Agg, Chief Financial Officer
Yeah. So, Jenny, I think the year referred to, and I mentioned this in my comments, you know, my speech earlier on, in terms of, you know, the reduction that we've seen in electricity transmission. Much of that was driven by, as you say, some of those one-off collections through the system operator last year. And that's very much the model, which is there are additional costs related to projects like data centres, like cyber, that we would expect, you know, to collect those, and that's what you've seen.

So, I think the numbers we're seeing this year are a more sensible representation for that business. But I'd echo what I said a moment ago, which is clearly the negotiations are underway with Ofgem for the RIIO-2 price control for the system operator as well. So, we'll have to wait and see where we get to in that one, final determinations in terms of, sort of, future guidance for that business too from April 1st.

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Jenny Ping, Citi
Okay. Thank you.

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John Pettigrew, Chief Executive Officer
Okay. Thank you.

I think Sam from UBS has got a question. Sam.

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Sam Arie, UBS
Yes. Good morning. Thank you.

I think we've done a lot on the UK, so I wanted to ask one on the US, if that's okay. And, of course, there's a lot of talk about maybe a stimulus infrastructure plan coming, assuming Joe Biden is the new president. Of course, generally, that sounds good for you, but I was just wondered if you could have us understand what the Green US Stimulus Infrastructure Plan might actually mean? And would that just, basically, be allowed investment in your side?

And then how would you actually find the room to finance that, if a new programme comes and it's large? And, I supposed, relatedly, you know, what do you think of the timeframes for any of this, you know, to become concrete? Is it going to a few years away still, or could it happen quickly?

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John Pettigrew, Chief Executive Officer
Thanks, Sam.

I think what I'd say is, I think, it's early days yet. So, obviously, the most pertinent thing is we've seen from President-elect Biden that, potentially, they're looking at a $2tr federal package and programme to support decarbonisation.

It's probably worth just reminding people that, for a regulated network utility like National Grid, the state policy and regulation is, you know, it's hugely important to the investments that we made. And we are in states that are hugely ambitious. So, New York, Massachusetts and Rhode Island have all set out massively ambitious targets to get to a decarbonisation pathway, and, ultimately to net zero. So, we're already making significant investments at the request of those regulators to support those policies.

So, I think it is early days to know exactly what the timing of it is, and what shape it will take. I think it can do nothing, you know, it's going to add to the impetus of what we're seeing in our states and, therefore, it is likely that infrastructure investment to support net zero and decarbonisation is going to be, you know, even more positive than what we're already seeing in the states that we operate.

But, as I said, I think it's just early days to know exactly how that's going to shape up, but I see it as a positive in that regard.

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Sam Arie, UBS
Yeah, brilliant. Thank you.

I don't know if there's time. I had a follow-up on the storm question, but I don't know if you have time for a quick follow-up.

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John Pettigrew, Chief Executive Officer
You've got the mic, Sam, so go for it.

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Sam Arie, UBS
Very good. So, look, you flagged in your report this morning that the storm events have doubled since last year, and I think that's a trend we're going to sadly see more of, but I must admit I'm still a bit stuck in terms of who's on the hook for the sort of long-term resilience investment. And I guess it probably varies around the world, but can you help us understand this storm damage and repair costs, and storm resilience, and sort of mitigation investments likely to be a lot of expenditure and therefore growth in the rate base and more capex for you, or is there likely, to some extent, to be costs that you have to take on the chin and therefore a downside risk for you?

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John Pettigrew, Chief Executive Officer
Thanks a great question, Sam.

So, there is a very well-established regulatory framework for both resilience investment and for recovery of storm costs. So, in terms of the resilience itself, then, you know, much of the investment we've been doing on our electricity distribution network over the last decade has been what we call storm hardening, which is actually increasing the resilience of the networks so that when you do get an impact, such as higher winds levels than when there are more severe storms. So, that is always, you know, a key part of the regulatory discussions and debate. And, ultimately, that investment sits on our rate base.

In terms of storm repair costs, each state's got slightly different rules, but, actually, it's got very clear rules about which costs are actually captured within the rate case themselves, and which costs are actually deferrable and then recovered in future rate cases.

What we've seen in the first six months of this year is a significant increase in the number of storms. I think we've had 18 to date, which is more than we've seen last year. The vast majority of those storms have met the criteria to be defined as deferrable and, therefore, the costs of them are recoverable in future years. So, that's a well-defined mechanism.

The one thing we will start to have a conversation with the regulator about is just that we are seeing more storms. And, actually, some of the criteria that's been used historically probably needs to be updated to reflect the fact that the networks are more resilient, but also, we are seeing more storms. So that's part of our regulatory strategy going forward.

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Sam Arie, UBS
Very interesting. Okay. Thank you. I'm sure we'll speak about this one again, but thanks for that helpful answer.

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John Pettigrew, Chief Executive Officer
Thanks, Sam. Verity. I can see Verity's got a question and her hand up.

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Verity Mitchell, HSBC
Yeah. I've got a couple of questions.

The first one is just a very small one, that your central costs are up 17%, and I know you've delivered savings in the regulated business, so is that a trend given the growth and complexity of your business?

And then I think the second one is about the US regulatory timetable. You've explained the delays and COVID, but do you think there's any downward pressure on allowed ROEs given very, very low rates at the moment when we think about what Ofgem is proposing? Thank you.

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John Pettigrew, Chief Executive Officer
Well, I'll pick up the US regulatory timetable and ROE, and, Andy, if you pick on the central costs.

So, I think, in terms of the regulatory timetables, let me just sort of just paint a picture of where we're at because there's a lot of moving pieces.

So, with regards to KEDLI and KEDNY, I've already covered. So, we're in discussions for a multi-year settlement with the PSE, and we are hopeful that we'll get to a resolution by the end of the calendar year on that.

You will have seen that we were due to do the Niagara Mohawk rate filing at the beginning of this financial year, but it was literally at the time the COVID started to emerge, so we agreed to defer it. And we, ultimately, made that filing in July/August of this year for rates effective next year. And then, tomorrow, we will be filing for Massachusetts Gas well, again, for effective in 2021. So, we've got a number of rate filings underway.

In terms of returns, if you look at the most recent settlements that have been done in New York and Massachusetts, they've all tended to be in the sort of 9% to 10% range, Verity. So, I think the most recent one was in Massachusetts for Eversource, which was a five-year price control with a return of 9.9%.

So, I think returns have been relatively stable in the US in the most recent determinations that have been done. So we haven't, perhaps, seen the same pressure in the US that we've seen with some of the discussions with Ofgem as part of the draft determination at this stage.

Andy, central costs.

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Andy Agg, Chief Financial Officer
Yeah. Verity, I assume you're talking about that things, cash and corporate and others you describe as central.

So, I mean, that's as well as the corporate centre, that's other one-off projects, other sort of initiatives that go on through the year. So, there will always be volatility. There's not underlying particular cause this year. It's just the number of one-offs that happen in any particular year.

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Verity Mitchell, HSBC
Great. Thanks.

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John Pettigrew, Chief Executive Officer
Thanks, Verity.

Chris from Morgan Stanley. I can see you've got your hand up.

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Chris Laybutt, Morgan Stanley
Good morning, everyone. Thank you for taking my questions. Most of mine are done, so I had one remaining, which is your asset growth has, or looks like it's going to slip to sort of the top end of the guidance range this year, and there is some pretty clear explanations for that. That is a fairly big step down from last year. What are your thoughts going into next year and the year after, and the year after that, if we could tease any out of you? And what, in your mind, are the main sort of stress points at this stage of your negotiations here and in the US?

The second question, which is a very quick one, just on governance. You have a new chair starting a role soon, I understand will be based in the US. Was that a deliberate decision to sort of bolster your presence in the US with a view to relationships with regulators, etc, or was that just a matter of the best candidate came through and nothing further to think of on that level? Thank you very much.

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John Pettigrew, Chief Executive Officer
Okay. So, thanks, Chris.

In terms of asset growth, so, look, our guidance for this year is £5bn, thereabouts. It's slightly down on last year's but it's probably worth just reminding you that last year's number, which I think was £5.4bn, did include just over £200m for the Geronimo acquisition, so it's broadly in line with the capital spend, it's broadly in line with what we saw last year outside of that acquisition. And that takes you to the sort of top end of our 5% to 7% range, I think, in terms of what we said. So, it's pretty consistent.

In terms of our sort of medium-term outlook, what I would say is the drivers for investment remain very strong. So, in the US, we continue to see strong investment drivers around safety. A lot of that investment is mandated by the regulators, but we're also seeing an increasing amount of investment for supporting decarbonisation.

In the UK, obviously a little bit of uncertainty at the moment. That is, you know, at the heart of the debate that we're having with Ofgem between the draft determination and where we hope to get to by final determination.

In our business plan in the UK, we set out for gas transmission and electricity transmission a £10bn programme over the next five years in the draft determinations. Obviously, Ofgem were a lot lower than that. So that is a key area of focus for us as we move forward. And we'll be able to give better guidance on that, I think, for sort of the next five years once we see the outcome of the final determination.

In terms of overall governance, you know, I'm absolutely delighted that we've appointed our new chair. I think she brings fantastic experience, both from the Energy sector and more broadly, and sits on some great boards, so will bring great board experience as well.

As you'd expect, the Nominations Committee at National Grid ran a process, and identified the right candidates. So, there was no sort of pre-determination whether it should be a US or UK-based chair. It was about finding the right candidate, who has the right skills to support us going forward. And, you know, I'm absolutely delighted with the appointment that's been made, and looking forward to working with her.

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Chris Laybutt, Morgan Stanley
Terrific. In terms of follow-up, do you think there is an advantage in having a greater presence in the US, if I could squeeze that last question in?

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John Pettigrew, Chief Executive Officer
Well, I think what's important at the Board level is that you've got a right mix of capabilities, including understanding of the different geographies we operate.

If you actually look at the Board of National Grid, then we've got quite a nice mix actually of people who are US-based and people who are UK-based, with different industry experiences as well as experience in the Energy sector. So, I think the new chair will just add to that. And, therefore, you know, as I said, really delighted with her appointment.

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Chris Laybutt, Morgan Stanley
Thanks very much, John. Thank you.

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John Pettigrew, Chief Executive Officer
Elchin. Shall we take Elchin from Bloomberg next?

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Elchin Mammadov, Bloomberg
Can you hear me okay?

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John Pettigrew, Chief Executive Officer
Yes, I can.

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Elchin Mammadov, Bloomberg
I have two questions, please.

The first one is on the system warnings in Britain. We've seen a couple recently, I think, from National Grid. I think they used to be called notices or something. And, obviously, you came out really well during the last August blackout. Ofgem hasn't seen any fault of yours. What did the recent mean for the UK power system? And is it an opportunity for you to ramp up investments, or is it more of a risk if the blackouts happen again, or they may take another look at all the utilities, including yourself?

And the second question is on the US, on a similar wavelength, in terms of your relationship with the New York mayor. Obviously, you had some, you know, issues in terms of the gas connection, which looks like it's been resolved now, but, recently, the mayor threatened to take away the licences from ConEd and PSE I think because of poor treatment of storm. Is it concerning you as well, or not? And how do you see your relationship with the New York mayor evolving going forward? Thank you.

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John Pettigrew, Chief Executive Officer
Okay. Thank you, Elchin. So, two big questions there. Let me start with the recent system warnings that we've seen in the UK.

So, I think it's quite important to put this into context. So, although we haven't seen these types of warnings for three or four years, I mean, if you just stand back and look over a long period of time, then, actually, seeing tight plant margins during what we call the shoulder months, is not untypical.

So, what specially was happening on the network was that we still had a number of generators that were on outage for their maintenance that have not yet come back for the winter.

We saw, on those days that we had those notices, very low wind outputs. So, remember the UK's got about 23GW of wind now. And, at the same time, coincidently, we actually saw some higher demands than we would typically see at this time of year with slightly colder weather.

So, those three things together led the system operator, when it looked ahead to the day ahead, 24 hours ahead, it looked like some of the reserve margins were slightly tight, and therefore, actually, what it does in those situations, is let the market know that it looks tight so that the market can respond. And, on the three occasions it's happened, what we have seen is the market has responded and, actually, the system operator's been able to stand down those warnings. So that's what was happening. So, as I said, if you look at the, sort of, long timescales, it's not untypical.

If you look to coming winter, and, as I said in my remarks this morning, the plant margin in the UK is 8.3%, which is well within the security standards. And, in terms of the longer term, obviously, in the UK, we've got the capacity market, which is the main mechanism for ensuring that there is sufficient generation to meet demand.

So, I think it's more about how the market is operating than an investment opportunity for us.

Clearly, our role as the transmission owner and operator is to ensure that we've got the right infrastructure to support reliability 24/7, so I'm not sure there is a linkage between those two things.

In terms of our relationship with the Governor in New York, as you referenced, you know, I'm quite pleased that we've been able to progress a solution with regard to the gas constraints issue that we have in New York. So, we work very closely with the Governor's Office and the PSE to issue reports at the beginning of this year that set out some options. We're now progressing one of those options to make sure that we can meet demand going forward. So, I'm pleased that that has been progressed over the last six months.

In terms of more broadly, the Governor was critical of a number of utilities with regard to the recent storm. Fortunately, the National Grid was not one of those, but there's also been some criticism around telecoms and water in New York as well, and I'm very aware that the Governor has proposed some potential changes to legislation to ensure that utilities are focusing on customers and are doing the right things during storms. That has always been our priority, and we will look at the legislation that the Governor is proposing. I think it only came out last week, so it's at the very early stages. And, of course, we will comment on that to make sure that any changes align with that priority and make sure we can meet customer needs.

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Elchin Mammadov, Bloomberg
Thank you.

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Nick Ashworth, Director of Investor Relations
Okay. So, Martin. Martin Young. You've got your hand up.

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Martin Young, Investec
Yeah. Good morning to everybody. Just two questions if I may.

You talked about hydrogen in your presentation. If I look at the future energy scenarios that came out a little bit earlier this year, one of them, system transformations, basically calls for a wholesale repurposing of the gas network to carry hydrogen. From a technical perspective, how easy is that to do for a gas transmission, you know, network? And any idea whatsoever what the cost of doing that might be?

And then the second question is, hopefully, a simple one relating to the results and the guidance for the full year. If I look at what you're saying about UK ET, it suggests that there has been a little swing in the narrative from a suggestion that costs would go down when you communicated guidance at the full year stage to actually now indicating that costs will go up slightly. Given what Andy said about delivery of the cost efficiency programme in the UK being on target, and given that you haven't moved your COVID expectation on the cost hit, what is the swing factor in UK ET on the cost front that had moved from the guidance?

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John Pettigrew, Chief Executive Officer
Okay. Thanks, Martin. I'll let Andy pick up the guidance issue with ET.

So, in terms of hydrogen, it's probably just worth reminding people on the call that the future energy scenarios are exactly that, they are scenarios. So, they're based on the feedback that we get from the industry and what people believe could be sensible roadmaps towards either achieving net zero by 2050 or, indeed, I think some of the scenarios don't achieve it by 2050.

So, in terms of the specifics of repurposing natural gas networks to hydrogen, I referenced in my remarks earlier that we're spending quite a lot of time in both the UK and the US really undertaking projects to do exactly that, which is to really understand, if you are to inject either blended hydrogen or, indeed, all hydrogen into the existing network, what is the interaction it has with the steel, with the joints and with the other equipment, and what would you need to do to fully repurpose it.

So, I think, with the future of gas – and we'll talk about this in our event in January – the exact roadmap and the exact investment pathway is still uncertain. And that's not just National Grid, I think that's everybody. I think what is needed at the moment is quite a lot of work looking at these individual challenges to work out exactly what is achievable and what are the costs associated with it.

The project that we're doing in the north of England is taking some decommissioned transmission gas pipeline, we will test that pipeline by injecting different percentages of a hydrogen blend into it to look at how it interacts. And I won't get into details, but you'll know the molecules of hydrogen are smaller than natural gas and methane, so we need to look at those types of things. And then we're going to connect that project to one of the gas distribution projects to sort of do a beach to home impact assessment to work out what the implications are.

I think, Martin, it's going to be two or three years before we've got real clarity on exactly what the roadmap is for decarbonisation of gas, and what role hydrogen will play, and what investments will be needed, but that is a real focus area for us at the moment.

Andy.

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Andy Agg, Chief Financial Officer
Yeah, Martin, just on the guidance on electricity transmission, in reality, very little's changed. I think the words, probably, sent were slightly broad than intended. Effectively, you know, with the amounts involved both on COVID and on costs are very, very small, so it's a minimal change, and, effectively very much in line with what we've previously said.

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Martin Young, Investec
Okay. Thanks.

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John Pettigrew, Chief Executive Officer
Thanks, Martin.

Olivier, I can see you've got your hand up. [Pause] Is here there? Olivier from Exane.

Okay, in which case, he's not there, I'm going to go to Mark. Have you got another question? Mark from Credit Suisse? [Pause]

Okay, it doesn't look like we've got any more questions, so, in which case, I'm going to say thank you, everybody, for joining the call today. I do appreciate it. I know these are difficult times, and I hope that at some point we will be able to have these meetings face-to-face.

In the meantime, I'm not going to do a full summary other than say that the first half, very pleased with the operational performance. And, as you've seen, solid financial performance, and we're managing the COVID impact very well. And I think we're very well-placed for the second half of the year.

So, thank you for joining, and I'll see you all very soon.

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