National Grid

Full Year Results Webcast

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National Grid

Aarti Singhal, Director of Investor Relations

John Pettigrew, Chief Executive Officer

Andy Agg, Chief Financial Officer

Questions From

Chris Laybutt, JP Morgan

Jenny Ping, Citi

Argent Seni, Credit Suisse

Fraser McLaren, Bank of America Merrill Lynch

Dominic Nash, Barclays

James Brand, Deutsche Bank

Sam Arie, UBS

Martin Young, Investec

Simon Virley, KPMG

Introduction

Aarti Singhal, Director of Investor Relations
Welcome to our full year results presentation, and a special welcome also to everybody who's watching this online.

As always, we're going to start with safety. There are no planned fire alarm tests this morning, so if you hear an alarm, we do need to leave the building through these doors, and then out from reception. And I would also like to draw your attention to the cautionary statement that's included in your packs, and as always, there will a Q&A at the end of this presentation.

So, with that, I'd like to hand it over to John Pettigrew.

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Key Highlights

John Pettigrew, Chief Executive Officer
Thank you, Aarti, and good morning, everyone. I'm joined this morning by Andy Agg, our CFO, and as usual Nicola Shaw and Dean Seavers are also here to assist with any questions at the end of the presentation.

So let me begin with the financial highlights from last year. On an underlying basis - that is, excluding the impact of timing, major storms, and exceptional items - operating profit, at £3.4bn, was down 4%.

This reflects the expected reduction in UK gas transmission allowances, as well as the impact of US tax reform, and slightly higher than anticipated costs.

Underlying earnings per share was up 5% to 58.9p. This was driven by a lower share count and good performance from our other businesses.

We also incurred some significant exceptional charges in the last year that are excluded from our underlying results, and I'll expand on these shortly.

We achieved a group return on equity of 11.8%, delivering ongoing sustainable returns for our shareholders.

We invested heavily in network safety, reliability, and modernisation, with our capex increasing to £4.5bn, driving asset growth of 7.2%.

And in accordance with our policy, we have proposed a final dividend of 31.26p, taking the total dividend for the year to 47.34p. This represents a 3.1% increase on last year, in line with UK inflation.

So, as you can see, it's been a solid year of financial performance.

As you know, our safety, reliability, and customer performance are key to our success. During the year, we continued our campaign to make safe working second nature for all our employees and contractors, and as a result of our efforts, we've maintained an injury frequency rate of 0.1, which is comparable to world-class safety performance.

We also maintained excellent reliability across our networks despite significant winter storms in the US.

Customer performance has also been a major priority, and I'm pleased that our customer satisfaction has increased for both our UK and our US businesses.

Now, before I turn to the detail, let me outline the strategic highlights for the year, starting with capital investment.

As I just mentioned, we had another strong year of organic growth, investing £4.5bn and delivering asset growth of 7.2%.

As I announced last November, we exercised our option over our final stake in Cadent, with £2bn of cash proceeds expected in June.

In addition, we made good regulatory progress in the US, with all of our distribution companies now operating under refreshed rates, and we continued our regulatory engagement on RIIO T2 in the UK.

We also made good progress with our cost efficiency programme in the UK, taking action to remove costs to make us a more efficient and agile organisation, and we're also undertaking a similar exercise in the US.

With regards to our interconnector developments, they have continued at pace, with the commissioning of Nemo and the decision to proceed with Viking, and we also completed on our Fulham property site, transferring it into the St William joint venture with the Berkeley Group. So I'm pleased with the significant progress and continued momentum that we've made, underpinned by strong organic growth.

So let me now look at the key achievements and developments across the Group.

I'll start with operational performance in the US. We have achieved a Return on Equity of 8.8%, representing 93% of our allowed returns. We had good performance in most of our operating companies.

However, we incurred some higher costs as a result of additional compliance work in New York, and restoration work following a gas interruption in Rhode Island.

Our US business invested $3.5bn in the year, resulting in asset growth of 9.2%, up 180 basis points on last year.

The focus of our investments has been to maintain the safety of our networks whilst also modernising them, providing better reliability and resilience. In addition, our new US cost efficiency initiative is vital, ensuring we deliver our capital investment programme as efficiently as possible. This is in the context of a business that has more than doubled its capital investment in the last seven years.

In summary, we're streamlining our operations, we're simplifying our supply chain, and we're rationalising our property portfolio. Whilst early in the process, this programme should deliver cost savings of around $30m this year and $50m in '20/'21.

I'm also pleased to say that in January we reached a satisfactory agreement on union negotiations with members of our Massachusetts Gas work force.

As a reminder, we entered into contingency work force plans in June, which affected about 1250 union members. We did this to seek agreement on the terms and conditions, in line with what we'd already agreed with many other unions, representing approximately 8,000 of our employees.

During the protracted labour dispute, we had to bring in contractors and additional supervision in order to complete almost 65,000 jobs. As a result of the contingency plans, we incurred exceptional charge of £283m.

While significant, this reflects our commitment to safety and implementing the right contracts for the future, and I'm pleased that, since January, we also reached agreement with a further two unions on similar terms to those agreed in Massachusetts.

I'm now going to move on to our regulatory progress in the US. During the year, we agreed new rates for Rhode Island and Massachusetts Gas. This completed the full refresh of rates for all of our distribution businesses, which was a significant milestone for us.

On Rhode Island, we've agreed a three-year settlement from September 2018, which allows us a Return on Equity of 9.3%, and an increase in our annual capex allowance to $240m.

On Massachusetts Gas, we were awarded an allowed return of 9.5% and annual capex allowance of $413m. This ensures that we can continue the vital pipeline replacement and other safety works that we're doing.

We're also seeking to support New York's Clean Energy Goals, with a filing in November for smart meter infrastructure. We've requested $650m to install over 2.3 million gas and electric meters between 2021 and 2024.

And finally, we submitted new rate filings for Massachusetts Electric and KEDLI and KEDNY. And I'll provide more detail on these later.

I'll now turn to the UK, but before I talk about the key developments in the year, I want to quickly remind you about what we've achieved over the first six years of RIIO.

Since 2013, the majority of our capital investment has been focused on maintaining our existing networks whilst facilitating the rapid changes we're seeing in the way energy is generated.

Some of our flagship projects have included the London power tunnels, the rebuild of Wimbledon substation, and the Aylesbury catalytic convertor project. And we've delivered these with innovative solutions, allowing cost efficiency to be shared with customers.

We have also replaced over 1,000km of overhead lines and upgraded almost 700 circuit breakers whilst delivering critical asset health work across our gas network.

All of this added together means we've invested £10bn since the start of RIIO, whilst generating almost £640m of savings for customers.

This clearly demonstrates the benefits to all our stakeholders of a regulatory framework that incentivises both efficient delivery and innovation.

I'll now move on to the key developments for the UK during the year, where our transmission networks have continued to deliver, with another £1.2bn of investment. This includes two projects that I'm particularly proud of.

We completed the first new electricity overhead line in England and Wales for 16 years. This Canterbury-to-Richborough connection is a 21km route that was built in only 15 months, enabling the connection of the Nemo interconnector.

And secondly, our tunnel under the Humber for our Feeder 9 replacement project is now 75% complete, and this represents the largest single investment in our gas infrastructure in a decade. It will also be the world's longest tunnel pipeline river crossing.

I'll now focus on UK operational performance. Here we've delivered another good year of returns, with a Return on Equity of 12.4%, within the range of 200-300 basis points of outperformance that we have committed to under RIIO T1.

As I announced in November, a cost efficiency programme is well under way, and this will make us more agile while strengthening our position ahead of RIIO T2.

As a result, we're on track to become a flatter and leaner organisation, with simplified ways of working and more efficient IT and back office activities.

We've incurred £136m of restructuring costs for this, and expect to deliver cost savings of £50m this financial year and £100 from 2021.

In September, Ofgem reached a final decision on funding for certain projects which were subject to reopeners as we entered into RIIO T1. And as I said in November we were pleased that Ofgem allowed the necessary funding for physical and cyber security. However, we were disappointed not to get the full funding for our compressor works.

In addition, we also reached another milestone on operational performance, with the legal separation of the Electricity System Operator from 1 April 2019.

And finally, as you will have seen in the press recently, both the NuGen and the Horizon nuclear projects have been cancelled, along with the proposed connection agreements with us. Under IFRS, we've recognised an exceptional charge of £137m for the development costs. However, the regulatory arrangements we have in place have substantially mitigated the economic impact of these cancellations.

So let me now turn to National Grid Ventures, where we continue to make significant progress on our interconnected portfolio.

The Nemo project, which is £265m investment in a 1GW, 140km link with Belgium, was commissioned two months early and under budget. Process on our new interconnectors to France and Norway, which is IFA2 and NSL, has continued on track. The construction of the convertor stations on IFA2 is going well, and we've now laid over 270km of the cable for our link to Norway.

During the year, we made final investment decision on Viking, our interconnector to Denmark, and we already have all the planning approvals needed and will start construction early next year.

In March, we also announced our proposed acquisition of Geronimo Energy, in a joint venture with the Washington State Investment Board, and we expect to complete on this in June, subject to the usual approvals.

This is our first meaningful step into renewable generation in the US, providing us with a pipeline of over 6GW of solar and wind projects at different stages of development. On the joint venture, we'll hold the renewable assets that are developed by Geronimo.

I'll now turn to the property business and in particular the sale of the Fulham Gasworks. Having completed significant infrastructure work, including demolishing the redundant gas holders, we successfully transferred the 17-acre site to St William.

The site will now be developed over the next decade, and we'll recognise further profit on the land, as well as our share of the development profits as the apartments are sold. And I'm pleased that, of the 1850 apartments, 650 of them will be affordable homes in the Centre of London.

So, in summary, I'm pleased to report that we made good progress over the last year, with high levels of organic growth across the Group. We have delivered against our priorities to date, and we are well set for the coming year. More on this shortly, but first let me hand over to Andy, to discuss the financial performance in more detail.

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Financial Review

Andy Agg, Chief Financial Officer
Thank you, John, and good morning, everyone. As we go through this morning's presentation, you will see we've refreshed the slides and we're providing additional granularity on our performance measures.

Turning to the results, at constant currency, underlying operating profit was down 4%, reflecting the expected return of Avonmouth revenues, the impact of US tax reform, partly offset by higher property profits and favourable US legal settlements.

EPS was up 5%, reflecting a lower interest charge and tax rate, as well as a reduced share count. Our good operational performance was reflected in the 11.8% Return on Equity, and a 6% improvement in value added per share.

Our asset base grew strongly by 7.2%, reflecting higher capital investment and the benefit of tax reform in the US. The dividend of 47.34p per share is 3% higher, in line with our policy.

Let's look at the performance of each of our segments.

UK electricity transmission delivered another year of strong operational performance, achieving a 13.7% Return on Equity. This included totex outperformance of 230 basis points, an improvement on the prior year.

Our totex outperformance was due to continued focus on innovation and efficiency, as well as the additional cyber and physical security allowances from September's reopener filings.

Other incentive performance at 50 basis points was also higher than last year, due to improved customer, stakeholder, reliability, and system operator performance. Additional allowances contributed 70 basis points, in line with last year.

Underlying operating profit of £1.1bn was up 4%, largely due to higher net revenues. This was partially offset by costs associated with ESO separation, high depreciation, and other costs.

Capital investment at £925m was lower than last year, primarily due to lower load-related spend. This investment, along with the inflation-linked growth in the RAV, increased year end regulated asset value by 3.8% to £13.5bn.

As John mentioned earlier, we've recognised the one-off charge of £137m associated with the NuGen and Horizon nuclear projects. Existing price control arrangements covered the substantial majority of these costs.

As you know, we also recognised an exceptional charge relating to our UK efficiency programme. We are already seeing early benefits from this work, and excluding the ESO separation costs I mentioned earlier, there are almost no cost increases in the underlying business.

Moving now to UK gas transmission, which delivered a Return on Equity of 9.5%, slightly lower than last year. This reflects the lower compressor allowances from the reopeners.

Other incentive performance was strong, as our network continues to benefit from our investment programme. Operating profit was down, primarily due to the expected return of Avonmouth allowances. Controllable costs were slightly lower as we began to see the benefits of the UK cost efficiency programme, and depreciation decreased.

However, these were more than offset by an increase in other costs relating to the non-recurrence of one-off provision releases last year. Capital investment was £308m, in line with last year, and the regulated asset value grew by 3.3% to £6.2bn.

Turning now to our US business, where the Return on Equity was 8.8%, 93% of the allowed.

Underlying operating profit decreased 10% to £1.6bn at constant currency. Net revenues were up £99m, reflecting significant rate increases partially offset by tax reform and the impact of adopting IFRS 15. As you know, the effect of tax reforms reverses at the net income level, and is economically neutral for utilities over the longer term.

Controllable costs increased due to the Rhode Island Gas interruption, and additional safety compliance work in New York. Depreciation increased due to growth in the rate base, and other cost increases included higher minor storm activity, additional decommissioning costs in New York, and bad debts.

Of the cost increases I've mentioned, around £80m are not expected to recur next year.

We increased investment in our US networks to £2.7bn, or $3.5bn. This meant rate base grew by 9% to $22.9bn. Assets outside rate base were $2.5bn, and these largely relate to capital work in progress.

Finally, as John mentioned, we've recognised an $88m exceptional charge relating to our efficiency programme. In the context of a fast-growing business, we expect to generate savings of $30m in FY'20 and $50m of annual savings from FY'21 onwards.

Today, I am pleased to provide additional US GAAP disclosure, to better aid comparison with other US utilities, who report under this standard. I'll start with a bridge between the IFRS performance I've just discussed and US GAAP.

As you know, IFRS accounting rules don't always fully reflect the regulatory performance of the US business. US GAAP tends to be a better measure of this performance. For us, the largest adjustments between IFRS and US GAAP are from the accounting treatment of the regulatory recovery for environmental and storm costs. Under US GAAP, these costs are deferred to the balance sheet until we've received the associated revenue, whereas under IFRS costs are immediately expensed.

Other adjustments include differences in treatment for items such as depreciation and asset decommissioning costs. You can see on the slide how we go from IFRS profit this year to US GAAP profit.

The final item relates to levelisation. This is simply a regulatory mechanism to defer agreed regulatory revenues, so that bill increases for customers can be phased in over time.

Now let's look at how our US business performs under US GAAP. We already provide asset growth and Return on Equity numbers for each regulated business, so you can track how our capital investments translate into asset growth and ultimately into returns for shareholders.

To supplement this from today, we're reporting adjusted US GAAP earnings for the US business. This represents the achieved Return on Equity, multiplied by the equity portion of the rate base, capturing performance against rate plans and rate based growth. For FY'19, adjusted US GAAP earnings on rate base were $967m, assuming a 50/50 regulatory capital structure.

To aid comparison to earnings of other US utilities, you would need to also take into account the $75m of non-cash interest on assets currently outside of rate base, which would increase earnings to around £1.04bn, and, as the Group is geared at around 65%, if we were to apply the Group gearing to the US business, this would increase post-tax interest costs by around $100m.

Let's turn to the recent performance of our adjusted US GAAP earnings. Over the last two years, they've increased by 12.5% per year on average. This was driven by average asset growth of 8%, plus the 60 basis points increase in our achieved Return on Equity since FY'17.

Looking ahead, adjusted US GAAP earnings growth is supported by future rate based growth and the achieved Return on Equity, which next year we expect will be at least 95% of the allowed return. Over the medium term, we can expect adjusted US GAAP earnings to increase broadly in line with our rate based growth.

Turning now to National Grid Ventures, which contributed £316m to the Group. This is an increase of 10% on last year, mainly due to reduced business development costs. Metering, Grain LNG, and interconnector profits were broadly consistent with last year. Capital investment increased again, to £444m, with the first of our four new interconnector projects, Nemo, completing towards the end of the year. As we said before, we expect around £250m of EBITDA contribution from our new interconnectors from FY'25 onwards.

Moving to our Other activities, where the total contribution to Group profit was £124m, compared to a small net charge in the prior year. This reflects the sale of the Fulham site and the £95m in legal settlements partially offset by a one-off pension charge.

Our venture capital business, National Grid Partners, increased its investments in innovative technology start-ups, which will provide benefits in future to the core business.

Financing costs decreased by 1% to £993m despite an increase in average net debt. This was primarily due to lower UK RPI.

The effective interest rate also decreased, from 4.6% to 4.3%.

The underlying effective tax rate was 19.6%. This is 420 basis points lower, primarily as a result of a full year impact from US tax reform.

Underlying earnings increased to £2bn, and as you've heard, underlying earnings per share increased to 58.9p per share.

Operating cash flow was £4.5bn, $238m lower than last year. Higher underlying operating cash flows were more than offset by the cash costs of the exceptional charges we discussed earlier. During the year, we raised nearly £3bn of new long term financing, largely in the US.

Closing net debt was £26.5bn, with a £1.5bn adverse movement in exchange rates, and a further £2bn underlying increase. This was slightly below our expectations of £2.5bn, partly due to timing of recoveries in the US, helping to offset the cash impact of the exceptional items.

Our credit metric benefited from the over-recoveries in the US. The RCF to debt ratio was 9.4%, or 10.8% excluding exceptional items. SNP's FFO to debt metric was at 12.6%, or 14.7% excluding exceptionals.

During the year, we also reduced the level of the balance sheet hedge of our US assets to around 80%. This better aligns our debt portfolio with the currency mix of our retained cash flow. As a result, our US dollar denominated currency balance stood at $21bn, down from $25bn last year.

As we look ahead to next year, we expect capital investment to increase close to £5bn, and to remain at around that level in FY'21. In our US regulated business, we continue to invest, to update, and to modernise our networks. This is supported by our recent regulatory filings for Massachusetts Electric and Downstate New York Gas.

Investment in the UK regulated business will increase, primarily driven by asset health spend, comprising around two-thirds of the capital programme, and by undergrounding of transmission lines in Dorset.

In our National Grid Ventures and Other activities segment, we expect to see a significant increase in our interconnector capital spend, together with the initial investment in Geronimo Energy. As a result, we expect continued high quality asset growth of around 7% in FY'20 and FY'21.

Our objective is to maintain an efficient balance sheet. For our current rating, this means regulated gearing in the mid-60% range. We do this by maintaining a balance between cash generation and capital investment while delivering dividend growth.

As expected, our regulated gearing at March 2019 was 66%, which will reduce in June when we receive the final Cadent sale proceeds.

With capital investment expected to rise to close to £5bn in FY'20, we'll continue to fund the Group through issuing new debt at attractive rates, internally generated capital delivered through strong financial performance, and additional capital from the scrip dividend option, which was put in place to support the business during higher growth periods.

We therefore expect to continue to utilise the scrip dividend in FY'20 and FY'21. As a result, we expect gearing to remain around the mid-60% level through to FY'21.

Value added was £2.1bn, or 61.2p per share. This comprised the growth in Group assets of £3bn driven by increased capex, cash dividends paid of £1.2bn, and this year's underlying growth in net debt of £2.1bn.

Finally, in line with our dividend policy, the board has recommended a final dividend of 31.26p per share, bringing the proposed full year dividend to 47.34p.

I'd now like to summarise our technical guidance for FY'20, and as ever, you can find more details in our full year results statement.

Overall, we expect our combined UK regulated businesses to continue to deliver 200-300 basis points of outperformance, including the benefit of the £50m of efficiency savings. In the US, returns are expected to increase to at least 95% of the allowed return, benefiting from updated rates, the non-repeat of this year's cost headwinds, as well as the cost efficiencies we expect to deliver.

National Grid Ventures and Other activities will reflect the non-recurrence of the significant Fulham transaction and the legal settlements that benefited FY'19. We will see a first full year of Nemo in operation and a first year of development profits in our property joint venture. Our interest charge will increase, reflecting an increase in average net debt and a non-repeat of one-off gains, and we expect a tax rate of around 21%.

In FY'20, net debt is expected to increase by around £1bn, including the benefit of the £2bn of Cadent proceeds expected in June, and £0.4bn increase from the impact of IFRS 16.

So, to summarise: we have efficiently delivered on our £4.5bn capital programme; we have maintained good returns performance; and the balance sheet remains strong, funding 7% asset growth in the near term and reflecting our continued commitment to our progressive dividend policy.

Now, John will take you through the priorities and outlook for the coming year.

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Priorities and Outlook

John Pettigrew, Chief Executive Officer
Thank you, Andy. So let me now turn to our longer term objectives and priorities for the year ahead. I strongly believe that National Grid has a critical role to play in enabling the energy transition to a low carbon future. Power and heat networks sit right at the heart of the energy system.

Therefore it's our responsibility to continue to create value for our customers and society more broadly, whilst anticipating and responding to their changing needs.

To deliver a service that meets those changing requirements, we need to build and maintain world-class networks that are safe, reliable, resilient, and smart. And whilst we are already investing in these areas today, we recognise that we need to go further, innovating, evolving, and developing new tools and systems.

We also recognise that we have a role to play in helping to drive the decarbonisation of the economy. This role includes enabling the connection of renewables, ensuring we're taking a whole system approach, facilitating the growth in the electrification of transport, and developing solutions to decarbonised heat.

By undertaking this role, we will deliver stronger returns for our shareholders over the long term. And it's with this in mind that I now turn to look at our priorities and outlook for the year ahead.

I'll start with the US, where we have three key focus areas. Firstly, a continued focus on improving our customer experience. Secondly, the efficient and safe delivery of our services. And thirdly, reaching fair and progressive regulatory settlements.

On customer experience, we've already invested significantly in digital solutions, such as our customer e-billing portal, and will continue to invest this year, working towards our longer term ambition of paperless billing for everyone.

And in terms of the efficient and safe delivery of our services, we're making significant investments in our IT systems for our gas business. These systems will enable a more efficient management of our field force, a more responsive service for our customers, and further cost improvements.

On regulation, we filed for new rates for Massachusetts Electric in November last year, and for KEDNY and KEDLI this April. Our regulatory strategy across the US is to move rates to be more forward-looking, incentive based, and multi-year, and this will allow us to plan our works in the most cost effective way. By introducing more incentive opportunities, regulation will drive more efficient outcomes, which will benefit customers and drive higher returns for shareholders.

For Massachusetts Electric, we submitted proposals that will allow for up to a five-year settlement. This will give us good visibility on the funding for our investment plans and allow for annual inflationary cost increases offset by efficiency savings.

As part of this filing, we've also taken the opportunity to advance the state's decarbonisation goals. This included a request for funding for over 17,000 electric vehicle charging points, and the installation of a 14MW battery storage system. Separately, we are asking for a Return on Equity of 10.5%.

This filing will support annual investment of $300m, an increase of $50m on the existing rate plan, and we expect to hear the outcome for this filing in September.

For KEDNY and KEDLI, we submitted a request for a combined annual capex allowance of £1.5bn. This is a 50% step up from our existing allowances. This increase in capex has been driving by a number of factors, including; the need for increased pipeline replacement; enhancements to pipeline safety; improved system resilience; and modernisation of our LNG facilities.

Importantly, the filing also includes proposals to support a low carbon energy future. This includes developing a green gas tariff and projects to facilitate the increased use of renewable natural gas. Our four-year proposal includes a Return on Equity of 9.65% and we expect rates to come into effect from April 2020.

I'll now turn to the UK outlook, where we also have three focus areas. Firstly, embedding the cost efficiency programme. Secondly, delivering our capital investment as efficiently as possible. And thirdly, continuing to help to shape the regulatory framework for the benefit of customers and all stakeholders.

Starting with the cost efficiency programme, where this year we'll be going live with new IT systems, which will provide better data to improve decision making and simplify our processes further across the organisation.

On capital investment, our key priorities will include completing the tunnelling for Feeder 9, starting work on the second London power tunnel, which will provide additional capacity and resilience to our networks across South London, and initiating the works on the undergrounding of our power lines through Dorset as part of our visual impact programme.

With regards to the regulatory frameworks, it's critical that we continue to enable the necessary investments to maintain the excellent safety and reliability we've all come to expect from our networks.

It's also important that we continue to ensure the rapid decarbonisation of the UK energy system, and encourage innovation to the benefit of all customers.

More specifically, as you're aware, Ofgem's RIIO T2 sector specific consultation was published last December. As you'll have seen in our response in March, whilst the initial proposals are a step in the right direction, we don't think they bring about the right changes for consumers in the long term.

We provided feedback on three areas of concern, the level of allowed returns, the outperformance wedge, and the approach to incentivisation. As you know, the overall financial package is key, balancing both a fair return and appropriate cash flows. Taking a balanced approach to risk and correcting for the errors in the calculation that we see, we believe a fair, real RPI Return on Equity is 5.5%.

With regards to the process, we expect Ofgem to publish its decision on the consultation next week. We'll be submitting our initial business plans in July for further stakeholder comments before sharing our final plans in December. And we'll continue to work constructively with Ofgem to seek a framework that puts consumers at the centre of this price control, enables the energy networks of the future, and that allows for a fair return for our investors.

So, staying with regulatory matters, let me now turn to Hinkley. As you know, we've already started the construction of the project in accordance with our contract with EDF. Ofgem continued to develop the necessary licence modifications to introduce the competition proxy model, and as we set out previously, we continue to believe this mechanism is not in the long term interest of customers. We'll wait to see what the final modification to our licence looks like later this summer, before taking a decision on the appropriate next steps.

So finally, turning to National Grid Ventures, where the major focus will be the continued investment we're making in our European interconnectors. We continue to see interconnectors as a very cost effective way of widening the sources of electricity for the UK, as well as connecting to low carbon and renewable options. In fact, when the three interconnectors we have under construction are completed, our total interconnector capacity to Europe will be 7.8GW, and almost 90% of that will come from low carbon sources.

And by the end of this year, we'll have made real progress on the completion of most of the construction works on IFA2, we're aiming to be halfway through the cable laying on our Norwegian link, and on Viking we'll have started the manufacture of the cable and the convertor stations.

With regards to Geronimo, the deal should close next month, and we plan to complete the construction of the Crocker Wind Farm in South Dakota this autumn.

So, having set out our priorities for the coming year, I now want to focus on how these priorities continue to integrate and reflect our environmental and sustainability goals. And we're making good progress here. For example, in UK electricity transmission, in our trial project at Sandwich in Kent, we were the first utility in the world to use low carbon emissions, insulating gas at 400,000 volts.

On climate change, we've set ourselves ambitious decarbonisation targets, and I'm proud to say that we've already reduced our emissions by 68%, and of course we'll be reviewing our existing target of 80% by 2050, following the recent recommendation from the Committee on Climate Change to reach net zero emissions by 2050.

And on sustainability, our business activities enable us to make significant contributions to a number of the UN Sustainable Development Goals, in particular, the affordable and clean energy and climate action goals. But we also want to contribute to others.

We've taken action on life on land, where we set ourselves a target to recognise and enhance the value of the natural environment on at least 50 of our sites. We've worked with multiple partners and community organisations across the UK to deliver enhancements to 38 sites so far. These cover more than 400 hectares of land, and consist of a wide variety of habitats and species.

And we're also addressing good health and well-being. This commitment includes access for all our employees to health and well-being services, including mental health services such as counselling and psychological therapies.

We're also one of a small number of organisations that supports the government's Inclusive Economy Partnership. This has included us playing a key role in developing a framework that supports employers to voluntarily report on disability, mental health, and well-being in the workplace. This is a long term priority, and we'll continue to update you on our future progress.

So, as you can see, we have a large number of priorities across the Group this year, including continuing to focus on our customers, embedding cost savings, and efficiently delivering investment plans. And as Andy has outlined earlier, based on our current investment plans, we expect to see another step up this year, to nearly £5bn, and this elevated level of investment is expected to continue into 2021, delivering many benefits for our customers. In total, our asset base is expected to grow strongly by around 7% in 19'/'20 and 20'/'21, and the vast majority of this critical investment is covered by existing regulatory arrangements, and it's our responsibility to deliver that investment efficiently, which in turn generates long term value for our shareholders.

So, in summary, as I mentioned, power and heat networks sit at the heart of the energy system, and we create value for our customers by delivering world-class networks and driving decarbonisation.

In the last year, we've invested £4.5bn in an efficient and disciplined way, delivering strong organic growth. We made good progress on our strategic priorities, helping to underpin our total return proposition, and we've delivered significant customer benefit so far.

We've also taken positive steps in evolving our regulatory frameworks in the US, and contributed to the shape of RIIO T2 in the UK, and all of this has been achieved whilst maintaining a strong balance sheet and a continuing commitment to our progressive dividend policy.

Now, just before we move on to your questions, I'm pleased to announce that we'll be hosting an investor seminar on our US business in September, where Dean and his leadership team will provide a deep dive into the business and our outlook for the future. The event will take place on 20th September in London, and on 23rd September in New York.

So, thank you very much for your attention this morning. Now Andy, Dean, Nicola and I will be happy to answer any of your questions.

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Questions and Answers

Chris Laybutt, JP Morgan
Thank you very much. Two questions from me. Slide 20, Andy, could you please step through the bridge from the asset level gap to the $1.04bn figure again, just for my

benefit? And are we to assume that that figure is a pretty decent representation of your GAAP earnings for the Hold Co? So I guess that's question one.

And then question two, in terms of the 65% gearing level given RIIO-2 brings with it some uncertainties, is that still the right level for National Grid and is the Board and are you as a management team still comfortable with that level?

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Andy Agg, Chief Financial Officer
Thank you. So on the first one, so our - I'm hastily finding Slide 20. So yes, what the chart's presenting is in addition to the US GAAP earnings of the rate base business, which is the US operating segment. The additional $75m that we've called out there and added in, which is the accrued earnings on assets outside of rate base includes things that are either you know Serve Co or Hold Co level, as well as some of the capital working progress that hasn't yet gone into the rate base. So, it's trying to represent the overall earnings - GAAP earnings from the US business.

The second piece on gearing I think, you know, we guided this morning through to the balance sheet leverage through to FY'21 and the set out again, the key tools that we use to manage the balance sheet. I think it's very early when we think about what 2021 onwards or 2022 onwards might look like with RIIO-2 still working through, you know, the rate cases we filed in the US working through what those will look like. But we're confident today the leverage is in the right place. We have the right tools and we're confident with the way the balance sheet is.

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Jenny Ping, Citi
Hi, just following on from Chris' question, back to Page 20, Andy. Just to confirm the interest costs that you've got there, $457m, does that include the intercompany loan charges of the $1.7bn that you've got, and what would that number look with that intercompany loan and therefore impact on earnings?

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Andy Agg, Chief Financial Officer
Yeah, so what we've tried doing there is effectively a notional regulatory interest charge, so based on an allowed cost of debt on an assumed 50/50 regulatory capital structure. As with our UK op cos exactly how we fund and how we move cash around, you know, is an integral part of how we manage our debt book.

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Jenny Ping, Citi
So that would come in in the $100m additional that you talked about if assuming a gearing of 65%?

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Andy Agg, Chief Financial Officer
So the $100m on the left is purely going from the 50/50 to take the gearing up to 65%, the additional cost of that debt, yeah.

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Jenny Ping, Citi
Fine. And also, just on that can you give us the year end net debt number for the US business, with or without that $1.7bn intercompany loan?

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Andy Agg, Chief Financial Officer
I think we'll go to what I said that how we think about gearing from a Group level and then we have opportunities to raise debt both as an op co, a hold co level, UK and US. So what we've to guide here is if you took Group gearing and applied it at a US level the actual level of gearing within our US hold co will be slightly higher as you said, there's intercompany debt involved in that but we've tried to give you on an external view of our US business would look like.

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Jenny Ping, Citi
Okay and one last one big picture wise in terms of energy transition. I just wondered what your latest thoughts are on your gas transmission networks in the UK specifically given that there is the push for decarbonisation, given the works have been done or started at least on hydrogen and what your thoughts are on that asset whether they should belong to the Group longer term? Thanks.

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John Pettigrew, Chief Executive
In terms of gas transmission I think everybody recognises that gas has got an incredibly important role to play as part of the decarbonisation journey. 80% Of UK heat comes from natural gas and 40% UK electricity generation currently comes natural gas.

I think, you know, there's a lot of work to be done over the next few years in really understanding what's the optimum to look to decarbonise the gas network. We have a number of projects underway looking at one, you know, how much hydrogen could you inject into the network without having to require people to change their appliances?

We're also looking at whether the network could be converted to hydrogen for example, in the long term and what's the interaction team, hydrogen molecules and the steel networks that we've got? And we are also looking at opportunities around sort of how you inject more green gas into the network as well.

So, you know, there's a lot of work to be done I think over the next few years to find out what's the optimum route. What is clear is the gas networks have an important to play for many, many years to come and you'll see in our draft business plans that we'll be submitting to Ofgem quite soon that actually the levels of investment that are needed in the gas networks will continue for many years to come as well.

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Argent Seni, Credit Suisse
Thank you. Good morning, I have two questions please. The firstly with Labour's policy to create a national energy agency would you consider splitting the business into two in the UK and US to protect the value in the US?

And secondly, would you also consider adopting measures in the Labour document such as putting Civil Society members on the Board to reach Labour's objectives without getting asset expropriated?

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John Pettigrew, Chief Executive
Sorry, the second one, I didn't quite catch it. It was put --

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Argent Seni, Credit Suisse
Sure. So, would you consider adopting measures in the Labour document to reach Labour's objectives without getting asset expropriated?

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John Pettigrew, Chief Executive
So I think let me just talk about nationalisation as it's the topic of the day so to make sure that people understand where we're coming from. So, you know, our position very clearly is that we don't believe that the proposal that Labour have set out are in the interest of consumers in the UK.

The key question I think to be asked is, well what's the problem that state ownership is trying to solve? And from our perspective when we look at the proposals it's not clear to us. So, the UK has one of the world's most reliable and safe networks as you know. We're investing massively in the networks and the National Grid's invested £10bn over the last six years as I said this morning.

We're very conscious of the affordability agenda as well and we've returned £640m to customers over the first six years RIIO T2. When you look at the decarbonisation agenda, you know, there needs to be a recognition that actually there's a huge amount of progress for this already happened and National Grid is a key enabler of that. So last year 49.6% all the generation in the UK came from zero carbon sources.

We all celebrated last week the week where it was the first time we had our electricity generation without any coals, the first time since Queen Victoria was on the throne. And National Grid is investing things like Interconnect, as I said this morning which will be 90% clean energy.

There's still a huge amount to do but when we look at the Labour proposals, you know, it's very clear that that will not either accelerate the decarbonisation agenda in the UK, nor will it result in lower costs for customers. Our view is it will be a huge distraction and that it will delay the decarbonisation in the UK and potentially increase costs to customers.

So, you know, our position at the moment is to make sure that people understand that, and we engage with Labour on a regular basis. And within the Labour Party there are people who, you know, have an ideology and, you know, to be blunt I'm never going to convince. And there are people who actually don't have a view that state ownership is the right route and we will continue to engage with them as we do more generally, you know, with the general public so they understand the role that National Grid is playing and actually where the UK economy is in terms of decarbonisation, which is we've made great progress.

There's a long way to go and, you know, the Committee on climate change has if anything said we need to accelerate. To deliver that you want companies like National Grid to be agile, to be embracing new technology and to be innovative and to meet the changing needs of customers. So that's the position we come from in terms of that.

In terms of splitting the company, you know, the Board has a duty to consider valuation of the business, and it does that, as you'd expect, on a regular basis. But we don't see splitting National Grid as a response to what is currently a proposal by the Labour Party.

In terms of broad - you know, more broadly actually National Grid and Section 172 of its obligations always wants to ensure that it's got a broad set of inputs in terms of the key stakeholders and any decision that the Board of National Grid makes it's always considering the broader stakeholders, whether it's customers, whether it's regulators or other broader key stakeholders.

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Argent Seni, Credit Suisse
Thank you.

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Fraser McLaren, Bank of America Merrill Lynch
Good morning. Just three questions from me please. First of all can you elaborate on the issues that you've had with the Western Link, please? Where is the problem now and is there any liability for National Grid or implications for the other links that you're working on?

The second question is about the £400m increase in net debt by virtue of IFRS adoption. To what extent does that put pressure on your actual credit metrics?

And then lastly the Hinkley Licence mods are just moving back farther and farther. Why is that and what's the revised, you know, scale of time for making a decision on any appeal? Thank you.

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John Pettigrew, Chief Executive
Thank you. Why don't I do the first and the third and I'll give Andy the second? So in terms of Western Link, I mean if we just step back, so Western Link as a project is going to deliver significant benefits for customers going forward. And when we've been going through the commissioning phase we've seen when it's operating that it's going to deliver those benefits to customers.

It is an innovative project in that this is the longest deep sea cable in the world that's operating at 600kv. And inevitably when you're doing innovative projects you sometimes see teething problems. It is clearly a frustration to us to have the latest fault. It was a cable fault. Our contractors, which are Siemens and Prism are working full pelt to get it resolved and we're hopefully actually that this fault will be fixed by around about the end of this month. So that's where we are with it.

In terms of liabilities, National Grid has very robust contracts around Western Link so for late delivery there will be penalties to our contractors. And we continue to engage with Ofgem as you would expect on a regular basis to make sure they're understanding all the activities and all the things that we're doing to make sure we commission it as quickly as possible.

In terms of Hinckley, you know, I agree it has slipped back. You know, our position is we're waiting to see the licence from Ofgem. Until we can see that licence it's difficult for us to make a decision how we move forward. We're hopeful that we'll see it in the next couple of months. We engage with Ofgem on a regular basis and we're encouraging them to give us the final licence so that we can make that decision, but at the moment we're waiting to see when Ofgem are going to do that.

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Andy Agg, Chief Financial Officer
And on the IFRS 16 question, lease accounting, although that adds into our net debt position it's already taken account of the credit metric calculations elsewhere so there'll be no overall impact on our credit metrics.

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Dominic Nash, Barclays
Hi, a couple of questions please on the US. So firstly, what's your guiding for Group asset growth at the high end at 7%? Can you just give me a quick breakdown again what your medium term US growth will be please?

And following on from that, so it's 1B rather my second question. You say that US net income will be rising in line with asset growth going forward. Is that basically the only way that can work is that you assume that your 9% RoE is sustainable going forward on those maths?

My second question is on KEDNY and KEDLI, a massive increase in potential earnings base there and capex on the repex programme there. Could you remind us what percentage of your network's going to get replaced in that four year period and so how many years of investment can we look forward to in that division please?

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John Pettigrew, Chief Executive
Okay, so why don't I start with KEDNY and KEDLI and I'll come back to the first question, 1A and 1B.

So with regards to KEDNY and KEDLI we've been in significant dialogue with the New York State regulator as we prepared to put this filing in. So as you know we're come into to the end of the three year filing where we're spending about $1bn a year. I set out this morning some of the key drivers as to why we think that needs to increase.

Importantly when we did the filing a few weeks ago the feedback from the regulator was it was as expected, now the utilities in the US have seen press releases from the regulator following a filing because they were surprised. So I'm quite pleased that at least it's in line with the expectations.

We now go through a very long process with KEDNY and KEDLI. As you know, it would be probably towards the end of this year if we get to a settlement before we get an outcome and that includes four months of discovery and Q&A.

What we've tried to do in the filing as we always do now with rate filings in the US is to create some optionality for the regulators. So we're very clear about what the things that we believe must be done from a safety perspective and what things there is opportunity to do either slightly longer or to defer depending what the impact is on customer bills.

We do have some opportunities I think in New York because with the tax reform and commodity prices there is some headroom effectively to be able to take forwards some of the policy agenda items in New York without having a significant impact on bills. But, you know, at this level of rate filing it will impact on customer bills. So we'll work through that.

What percentage? I'll come back to you. I can't remember what the percentage is. What I would say is we're at the early stages of what effectively is the, we call it the Leak Prone Pipe Replacement Programme in the US, and the Mains Replacement Programme is what you would call it in the UK, if you remember that programme. We're at the very early stages so this will be a multi-year programme.

How quickly we do it, we will work with the regulator to make sure we get the balance right between doing what's right from a safety perspective and recognising the impact on customers.

Now I've forgotten what your first question was.

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Dominic Nash, Barclays
Basically the split between the US and UK within that 7% asset growth and the implied, does that mean the RoE remains constant in the US?

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John Pettigrew, Chief Executive
Yeah, so in terms of the US, you know, we were up $3.5bn of spend of 9.2%. We're expecting for the next couple of years for it stay at that or slightly above that level. So we're expecting continued strong growth well above 7% in the US. And that, when you apply that to the Group with pretty constant investment in the UK, so we're expecting 1.2bn, 1.3bn for the next couple of years and with Interconnect this gets you to the top end of our 7% range.

So, in terms of returns we've guided today, so this year US outturn is 93% of the allowed returns. We're expecting to be above 95% next year.

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James Brand, Deutsche Bank
Three questions please. The first is on UK investment and obviously the initial proposals from Ofgem have been very tough in terms of the allowed rate of return, which you've obviously highlighted.

Often when utilities are going through challenging regulatory settlements they often say, look this could be a threat to investment. And you're obviously thinking pretty carefully about what you might want to propose in investment given that you've said you're going to be presenting your initial business plan in July. So I was just wondering how you approach that? Do you try and scale back investment or do you play it very straight and you work out exactly needs to be done and the return backdrop maybe doesn't affect that decision that much?

The second question is just on the US IT spend for the gas business. I was just wondering whether all of that was recoverable under the regulatory assessment, i.e., whether the investment there goes into the RAV or not?

And then thirdly, I think it was a year ago and it was Andrew Bonfield that kind of suggested that there may be changes implemented around the dollar hedging that you have in place that you'd always try to hedge both the equity and the debt value in the US by having dollar debt. So I was just wondering with Andy coming in whether there ended up being any changes around that or not or whether there are any changes planned? Thanks.

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John Pettigrew, Chief Executive
Just let me do the first two and Andy do the third.

So in terms of the regulatory process in the UK and where we're at on returns and investment, so everybody's aware in this room we've been very clear in our response in March that we don't think a 3% return provides a fair balance between the risk and reward that we perceive in RIIO T2.

And our response is set out very clearly where we think Ofgem have made some errors in their calculation but also what's an appropriate return based on where current interest rates are and our perception of the relative risk of a transmission business relative to the market. So we're setting that out. You know, we're hopeful that the arguments that we've made have been listened to and we'll see what Ofgem says next 23rd May, next Thursday I think that is, when their document comes out.

In terms of the investment profile, I mean, we're at a very early stage. You know, one of the things that we were pleased about in terms of Ofgem's proposal was this is a price control that's very much driven by the needs of customers and stakeholders.

So we're in quite intensive discussions with stakeholders about what are their needs going forward from us a utility and as a network. What will come out at the beginning of July is an early indication of what our stakeholders are telling us and we're taking that requirement and converting it into what that might mean for capex.

We've got a long process to go through that will run in parallel between getting the right return and the right overall financial package and making sure that we've got the right investments to meet our obligations, but also to support the decarbonisation agenda. So you'll see that evolve, I think, over the six to nine months as we go forward.

In terms of the IT spend, the vast majority is actually recovered through the rate base. Actually, it's a huge investment right across our US business to enable our gas workforce. It's been needed for some time. But we actually aligned the rollout of that investment to reflect the rate cases that we were doing so that we can maximise the recovery and make sure it's part of the rate base. Andy?

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Andy Agg, Chief Financial Officer
Yes, on the dollar hedge question, actually it's interesting you mentioned the speech last year so that's some work I'd started with Andrew in my previous role as Group Treasurer. I mentioned this morning in the speech that we brought the overall level of dollar hedging down to around 80% of the total US asset value. That's slightly lower than it was previously. It's about a $4bn reduction in the mix of dollar debt in the portfolio.

But the rationale for that is effectively when we looked at it, the top up was to do with goodwill and if you look at the currency flows you don't get cash coming out of the goodwill balance, so we've brought the level of hedge down to reflect more the rate base balance.

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James Brand, Deutsche Bank
Thank you.

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John Pettigrew, Chief Executive
A question over there.

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Sam Arie, UBS
Hi, thank you. I had a follow up question of Ofgem and the price control and then one, apologies again, on the nationalisation topic.

But on Ofgem, so you've mentioned your consultation response which was pretty directly worded and you think that Ofgem have got their math wrong. And I'm just wondering, can you remind us what are your options if Ofgem come back with no change? Can you appeal only sort of within the Ofgem tribunal under your licence condition or is this is something that ends up in the court system?

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John Pettigrew, Chief Executive
You're right, we were very clear I'd say in terms of our response to the consultation. But also, I think we were very helpful and we've had some feedback from Ofgem staff that we were. So not only did we say what we didn't like but we put forward some proposals

on what we thought was sensible to get the right regulatory regime going forward and we continue to have constructive dialogue with Ofgem.

This has still got a very long way to go. So although we're publishing effectively a draft business plan in July which will then be critiqued by the challenge group and stakeholder group, we don't actually submit our business find until December this year and then ultimately Ofgem won't make a decision until the of 2020.

In the event that the proposals and the final decision by Ofgem are not acceptable then National Grid as other networks has the option to refer it to the CMA. And in the energy sector you can refer the whole package, or you can refer single items within the package. So that is sort of the route that will be followed in the event that we couldn't get to a sensible outcome.

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Sam Arie, UBS
Okay, very helpful. And can I quickly ask my follow up on the nationalisation topic too? So I mean I think you set out your views on that policy very clearly. What I think was new in this week's document from the Labour Party was I suppose a confirmation in writing that although the nationalisation price that they think about would be set in parliament, it could include deductions relating to a whole list of other topics over pension deficit, asset sales, the state of the assets in the business and so on. I'm sure you've looked at this, but can you comment at all on what you think the legal protections might be against that kind of approach?

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John Pettigrew, Chief Executive
Yeah, so you know, as you'd expect we look very carefully at the Labour Party's proposals or go through, we still don't believe it's the right thing to actually go to state ownership. But the government has an obligation to pay fair value for the assets.

There is lots of debates and lots of narrative across the industry about how you define fair value. But in the event that the Labour Party go forward and try to pay less than fair value then there are several legal routes available including the European Courts in terms of human rights and a whole host of other areas in terms of treaties.

So we understand the legal mechanisms that would have to be employed by our investors in the event that was to happen.

Clearly, we continue to focus on making sure that people that we don't think state ownership will solve the problems that Labour have been setting out.

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Sam Arie, UBS
Thank you.

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John Pettigrew, Chief Executive
I've just got one at the back, Simon and then I'll come to you.

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Martin Young, Investec
Just one question continuing on this nationalisation debate. If we take a step back a number of years when Miliband came out with the idea for capping, you know, retail prices in the UK you can imagine it was sort of dismissed as a Labour policy at the time. Skip forward a number of years and parts of that were picked up by, you know, different political parties and we've ended up where we are today with a price gap on parts of the market.

If you, you know, look at what Labour, you know, put out and scrub out the bits that you think are a bit crazy and ideological you know, grounds, you can probably bits in it that resonate with the public. Is there clear risk that those are picked up by political parties of all, you know, colours and that going forward we have a considerably tighter regulatory settlement than we've ever, you know, had before?

And quite clearly there are differences between what you feel is fair and what Ofgem, you know, currently has on the table. And you can probably say that some of the things that Ofgem, you know, are trying to push through are indeed responding to some of the underlying, you know, points that are being picked up by various people out there. So I just wondered if you could give a few thoughts on how tight you feel regulation could land?

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John Pettigrew, Chief Executive
Well there's one thing we do agree with Labour on which is the aspiration to decarbonise the economy. The fundamental difference we have is the approach to achieve that, which will minimise costs for customers and will do it in a sensible and timely way.

In terms of regulation, you know, I think we've set out quite clearly what we believe is an appropriate regulatory framework to encourage and deliver the infrastructure investment that’s going to be needed over the next five years.

It is quite clear from Ofgem’s document, and actually we acknowledged this in our response, that it is going to be a tighter price control in RIIO T1. What we keep emphasising is we understand that, but you also need to make sure that you get the balance right between risk and reward but as importantly, I think, is that you continue to incentivise companies to drive innovation and efficiency.

So you’ll hear us talk all the time about it’s important that we get the overall package right, and that’s the focus for us is to make sure you get a sensible return and we've set out our views on 5.5%. But also that we do get incentivisation to drive innovation and technology change. And our concern with the current regulatory proposals is it tries to address many, I think, of the deficiencies that they saw in RIIO T1 but doesn’t yet create the framework for RIIO T2.

So I think it will be tighter. It will require, you know, a great performance to deliver the returns that we would want to deliver. But as a company we’re very confident about that. When National Grid has been incentivised in the past, we've been able to drive performance for the benefit of customers and for our investors. So we’ll continue on that line with our discussions with Ofgem. Simon, sorry.

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Simon Virley, KPMG
John, given the challenging regulatory and political environment in the UK, to what extent are you looking for opportunities beyond the UK and the US for future growth?

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John Pettigrew, Chief Executive
Yes, thanks Simon. So as you saw today I think, you know, when we look forward over the next couple of years we've got a very strong growth opportunity, you know, 7% is right at the top of our range. In the US our regulated businesses are growing by 9%+ so within our core businesses we've got strong growth and we will continue to work with the regulators to deliver that.

Outside of that we will look for opportunities which are in adjacent markets to allow us to use the capabilities and skills that we've got and have got sort of regulatory characteristics in terms of their revenue streams.

So the most significant one we've announced really is Geronimo Energy. So we do see large scale renewable generation as an opportunity for National Grid if it is in an adjacent market and allows us to use many of our capabilities. And over the last three years we've done some relatively modest investment in large scale renewable generation in our geography and we see that as a useful platform. So where there is opportunity and those investments pass the hurdle rates that we set then we will take that forward.

If you look at Geronimo Energy in particular, they've developed about 400 megawatts a year. Over the last few years they've successfully developed about 2.2 gigawatts and they've got a pipeline of 6 gigawatts of solar and wind.

If we were to continue to develop it at that rate it would be an incremental investment of about $150m per annum, so not huge in the scheme of the Group, but an opportunity for us that we can take forward.

Any other questions? Okay, in which case I'm going to say thank you for attending today. I appreciate all your questions and we'll see you all very soon. Thank you.

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