National Grid

Half Year Results Presentation

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National Grid

Aarti Singhal, Director of Investor Relations

John Pettigrew, Chief Executive

Andy Agg, Interim Chief Financial Officer

Questions from

Christopher Laybutt, JP Morgan

Iain Turner, Exane BNP Paribas

Deepa Venkateswaran, Bernstein

James Brand, Deutsche Bank

Fraser McLaren, Bank of America Merrill Lynch

Verity Mitchell, HSBC

Nick Ashworth, Morgan Stanley

Mark Freshney, Credit Suisse

Introduction

Aarti Singhal, Director of Investor Relations
Good morning everyone and welcome to the National Grid Half Year Results Presentation. A warm welcome also to those of you who are watching this on the web.

As usual we will start with safety. No planned fire alarm test this morning, so if you hear an alarm you do need to leave this room and go towards reception downstairs. Also the cautionary statement which is here behind me, I'll draw your attention to that.

And with that I'd like to hand you over to John Pettigrew. Thank you.

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Highlights

John Pettigrew, Chief Executive
Thank you Aarti and good morning everyone. I'm joined this morning by Andy Agg our Interim CFO and Nicola Shaw our UK Executive Director who'll be on hand to assist with any questions at the end of the presentation.

Unfortunately Dean Seavers our US Executive Director is not able to join us today. As usual I'll start the review of our performance for the period. And once Andy's been through the financials I'll come back and talk about second half priorities and outlook.

So let me begin with our financial performance for the period. On an underlying basis, that is excluding the impact of timing and major storms our operating profit was down £79m of constant currency to £1.3bn.

This mainly reflects the return of UK gas transmission allowances associated with Avonmouth, lower profits in the US due to minor storm costs and the impact of US tax reform.

This was partly offset by increased revenue from our new US rates and income from legal settlements.

Underlying earnings per share was 19.7 pence for the period, up by 6% at constant currency, benefiting from a lower tax rate in the US and the reduced share count from the buyback programme relating to the return of gas distribution proceeds last year.

During the period we invested over £2.1bn in critical infrastructure representing an increase of 7% at constant currency.

And finally as you know our policy is to pay 35% of the prior year's total dividend at the half year, resulting in an interim dividend of 16.08 pence per share, an increase of 3.8% on 2017.

So as you can see it's been a solid first six months of financial performance with strong organic asset growth.

I'll now turn to our safety and reliability performance. The last six months have seen continuing strong levels of safety performance with a combined loss time injury frequency rate of under 0.1 which is comparable to world class safety performance.

Our reliability has also remained excellent; we have near 100% reliability for our UK electric and gas network. And despite a number of storms in the US during April and May we've maintained strong reliability across our US networks during the period.

Our system operator published its winter outlook in October with a forecast electricity margin on 11.7% which is up from 10.3% last winter. UK gas demand is forecast to be lower this winter at 46.6 billion cubic metres versus actual demand of over 54 billion cubic metres last winter. And bearing in mind the major storms we experienced in the US last year and the extremely cold temperatures in the UK we have, as we always do, reviewed our procedures and are well prepared for the coming period.

Now before I turn to the detail let me outline four strategic highlights for this half. Firstly we've decided to exercise the options on our remaining share in Cadent.

Second we've completed the full refresh of rates for our US distribution businesses.

Third we started a significant cost efficiency programme in the UK to become a leaner, more agile business.

And lastly on the growth front we have taken the final investment decision on our Viking interconnector to Denmark.

All of these are significant milestones and I'm really pleased with the progress that we've made. I'll provide you with more detail on each of these achievements over the course of this morning.

On Cadent this morning we announced that we've decided to exercise our option on our remaining 39% share which will be complete at the end of June 2019. This will complete the process of exiting gas distribution in the UK, we've realised significant value for our shareholders with £4bn returned last year and reshaped our portfolio towards higher growth.

In May we said that the cash proceeds of £2m would be reinvested in the business to support the strong organic growth we expect over the medium term. As a result the performance of Cadent has been classified as discontinued and is no longer included in our underlying numbers.

Now to our operational performance and the significant investments we're making. In the US we've invested $1.5bn so far this year. In the US this is made up of a large number of small projects. But we also continue to develop larger ones such as the almost $80m asset replacement substation in Providence, Rhode Island. We're in the final month of this project which involves transferring and energising circuits from the old substation to the new one.

The new substation is one of a number of works that we're extremely proud of. Not only does this increase the reliability for our customers but it also supports further economic development in Providence, it enhances safety and it helps to keep customer bills low.

Moving to our regulatory progress in the US. As I've just mentioned we've also completed the full refresh of rates for all of our distribution businesses. With Rhode Island Gas and Electric and Massachusetts Gas being agreed in the last two months and I'll expand on these shortly.

This full refresh is a significant milestone and provides us with a solid foundation from which we deliver strong returns and earnings as well as fund the increasing capital investment plans that we have.

We've also progressed regulatory discussions on the phasing of bill reductions for the lower US tax rate as well as for the return of the deferred tax credit. Andy will cover both of these in more detail in a moment.

Looking at the new rates in Rhode Island we agreed a three year rate plan from September 2018. This allowed a 9.3% return on equity with an annual capex of $240m. We also have new performance incentive mechanisms which will provide the opportunity to earn between 7 and 20 basis points of additional returns.

And for Massachusetts Gas the order provides a base return on equity of 9.5%, and annual capex of $413m. This will be invested in modernising our network to ensure the highest levels of safety and reliability and connecting new gas customers. New rates were effective from the 1st of October.

Now let me update you on our union negotiations in Massachusetts. Many of you will be aware that we're currently in dispute over two of our gas unions over terms and conditions. These two unions represent 1,250 workers from our US workforce of over 16,000. Particular issues around employee healthcare contributions as well as proposals to bring future employees into a defined contribution pension scheme rather than the defined benefits plan. Over the last few years we've agreed very similar terms with 16 other unions and therefore we're that we can reach an agreement with these two unions very soon.

The negotiations have been ongoing for several months and as no agreement was reached before the existing contracts expired we implemented our contingency workforce plans from the end of June.

This includes the employment of fully trained contractors; these are workers from other parts of our business, increase supervision to ensure safe operation and the establishment of the temporary work sites. These activities have ensured that doing the work stoppage we continue to successfully provide the service our customers expect including completing almost 40,000 individual jobs.

As a consequence of the work stoppage we incurred additional costs of £97m which were classified as exceptional

Now to the UK. Operationally both our electricity and gas transmission business has continued to deliver good levels of performance. For example in our electricity transmission business RIIO-T1 includes allowances and targets from maintaining the health of our assets. This involves the replacement and replenishment of our primary assets to improve their condition and decrease the level of network risk.

I'm pleased that we're forecast to meet all of our targets; we've done this at a cost below our allowances, which is delivering real value for our customers and our shareholders.

And in gas transmission we're making good progress on Feeder 9 with the tunnelling under the Humber Estuary. This is an important project to safeguard the security of the supply for a pipeline that transports 20% of the UK's annual gas needs. To date the tunnel boring machine has completed over 1700 metres of the almost 5000 metre tunnel and we remain on track for commissioning in the Autumn of 2020.

Now as many of you heard at our Investor Day in September we're also responding to the rapid changes we're seeing in our industry. Embracing new opportunities and technologies to better meet the needs of our customers and also create value for all of our stakeholders.

In this context we've focused very hard on our cost base to ensure that our UK business is as efficient as possible and well positioned for the future.

An extensive programme is underway that is expected to deliver four key outcomes. A flatter, leaner organisation, further economies of scale, simplified processes and ways of working and more efficient use of IT and back office activities.

It's these outcomes that will ensure that we become a more agile organisation equipped to be even more responsive to our customers. We expect to deliver £100m of opex savings from 2021 and Andy will take you through the financial impact of this in more detail shortly.

Now to the regulatory developments in the UK. There have been three areas of focus in the period, Hinkley Seabank, RIIO-T1 reopeners and most importantly the RIIO-T2 framework which I'll cover later.

On Hinkley we previously communicated Ofgem's final decision was broadly consistent with its initial view. As a consequence we'll consider all options; we'll have to introduce changes to our licence at the end of this year or the beginning of 2019.

Secondly in September Ofgem reached a final decision on funding for certain projects and programmes of work which were subject to reopeners as we entered into RIIO-T1. These included additional allowances for physical and cyber security, investment in our gas transmission compressor fleet to meet European emission standards, asset health costs for the Feeder 9 pipeline and funding for a visual impact provision scheme in Dorset. We were pleased that Ofgem allowed the necessary funding for the investments that we need to make on physical and cyber security.

However, we were disappointed not to get the funding for the compressor works. As a consequence we're now reviewing our approach to meeting the required emission standards including its progress with the second unit at Peterborough and Huntington in RIIO-T1. And deferring entirely the work of St Fergus and Hatton.

On Feeder 9 Ofgem changed their initial decision on the needs case awarding us £111m to continue this project. And the funding for the Dorset project of £116m is a great example of listening to what stakeholders want and designing solutions to meet that in the most efficient way.

And finally turning to National Grid Ventures and our property business. We continue to make good progress on the three interconnectors we have under construction. All three, Nemo to Belgium, North Sea Link to Norway and IFA 2 to France remain on track with some important milestones over the last few months.

North Sea Link has completed its first two cable laying campaigns with 260 kilometres buried under the sea so far. We made good progress in IFA 2. And on Nemo energisation station testing is underway with full testing starting in December and with the expected commissioning being before the end of March next year.

Our property business has also continued to perform well. I'm pleased that in October Hammersmith and Fulham Council gave initial planning approval for our Fulham development. Fulham is a 17 acre site with over 1800 residential units, 35% of which will be affordable homes.   This was an important step in the transfer of the site in to the St William joint venture and this year subject to final approval by the Mayor of London.

So in summary I'm pleased to report we've made solid progress in the period and we're well set for the remainder of this year. We've delivered against the priorities we set and I expect further progress in the second half as we continue to evolve the Group to the changing needs of our industry.

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 Performance

Andy Agg, Interim Chief Financial Officer
Thank you John and good morning everybody. Before I start I'd like to highlight that we're presenting this morning the underlying results for our continuing business excluding timing and excluding also the results of Cadent in both 2017/'18 and 2018/'19.

As John mentioned underlying operating profits reduced by £79m at constant currency to £1.3bn.

Operating profit benefited from additional revenue with new rates in our New York jurisdiction and from the settlement of legal proceedings in other activities.

However, this was more than offset by the expected return of Avonmouth revenues in gas transmission, the impact of US tax reform and higher storm costs.

As you know the impact of tax reform of the operating profit level is offset through a lower tax charge. This together with a lower interest charge and a reduced share count due to the return of the gas distribution proceeds last year contributed to a 6% increase in earnings per share to 19.7 pence.

This performance excludes two exceptional charges that we've taken during the first half related to the contingency workforce in Massachusetts and the efficiency programme in our UK business which John has covered.

Capital investment was £2.1bn, 7% higher at constant currency, this reflects increased investment in our US regulated business as well the ramp up of investment on our interconnector projects.

Our balance sheet allows us to efficiently fund this growth and overall we're on track to deliver good returns and value added for the year with the interim dividend increased in line with our policy.

Now let me walk you through the performance of each of our segments. Underlying operating profit for the electricity transmission business was £556m up 3% compared with the first six months of last year reflecting higher regulator revenues.

We invested £462m on the reinforcement of our networks and our new connections. This was £53m lower than last half year reflecting the completion of a number of larger non-load related projects.

Looking ahead investment will increase next year as we begin work on undergrounding of overhead lines in Dorset and on delivering increased network output measures.

For the full year we expect to deliver strong totex out performance in part due to the increased allowances available to us for data centres and for cyber security for the September reopener fillings.

The contribution from other incentives and legacy allowances will be broadly consistent with the prior year and as a result we expect outperformance above the 200 to 300 basis point range.

In gas transmission where operational performance remains on track, underlying operating profit was £91m, this is £53m lower, primarily reflecting the expected return of Avonmouth pipeline revenues.

As a reminder this is one of the vagaries of the way the RIIO framework flows through our IFRS results. These adjustments will have no impact on our returns as the allowances have already been excluded from these calculations.

Gas transmission capital investment was £153m broadly in line with the prior period. This included investment in Feeder 9, the Humber pipeline replacement project and continued investment in our asset health programme.

The September Reopener filings resulted in reduced allowances for the upgrade of our compressor fleets and for Feeder 9. These lower allowances will be reflected in the current year return on equity which we now expect to be slightly lower than the allowed level of 10%. The allowance updates will flow through next year's IFRS performance with a 2019/'20 full year negative MOD adjustment of approximately £80m

Turning now to our UK cost efficiency programme. We continue to look hard at our cost base to ensure it's appropriate for the remainder of RIIO-T1 and for the future. We've recognised exceptional costs of £127m in the first half, approximately half of this will be cash outflow this year with the remainder over the next two years.

This programme is designed to generate opex savings of around £50m next year and at least £100m per year from fiscal 2021 onwards with cash flow benefits in each of the next few years.

We continue to expect to deliver outperformance of 200 to 300 basis points this year and in each of the remaining years of RIIO-T1.

In our US regulated businesses underlying operating profit was £431m, £95m lower than last year. This reflects the benefit of new rate case outcomes offset by the impact of US tax reform, which as you know is offset on the tax line together with a £56m increase in storm costs. The majority of these will be recoverable for our existing regulatory mechanisms.

The higher than usual level of storm costs in the first half means that this year's profitability is more weighted towards the second half than usual.

We expect to offset any further headwinds of tax reform, cost inflation and IFRS 15 over the remainder of the year driven by the natural seasonality of the business and contribution from new rate coming into effect.

As John has already mentioned we had to implement contingency workforce plans from the end of June this year in our Massachusetts gas business. Incremental costs of £97m has been recognised as an exceptional item in the first half of this year.

Capital investment was $1.5bn, $100m higher; this included slightly lower capital investment in our Massachusetts gas business as we focussed on the implementation of our contingency workforce plans.

Excluding the Massachusetts work contingency costs, returns for the US are expected to be at a similar level to the prior year.

Turning now to the latest on US tax reform. As we've previously discussed the reduction in the federal tax rate from 35 to 21% will be significantly beneficial to our customers. It will be economically neutral for utilities but will reduce our cash flows in the near term.

There are three areas that I'd like to update you on this morning. Firstly, we now have clarity on bill reductions for all of our operating companies, including updates for KEDNY and KEDLI and Massachusetts Electric since we last updated you in May.

Secondly, the return of the $2.2bn deferred tax balance, this will now be returned over an average period of up to 50 years significantly longer than the initial view of 20 to 30 years.

And thirdly, rate based growth will increase due to the lower build up of deferred tax into the future largely as a result of bonus depreciation ending for utilities. Over time this will be beneficial to both operating profit and cash flow.

So now let me discuss how these items collectively flow through the income statement over the next couple of years. 2018/'19 will see a partial impact on operating profits of $210m, this is more than offset by the full year effects of the lower tax charge which will therefore represent a small benefit to earnings.

2019/'20 will have an additional impact to operating profit of around $110m, there will not be a significant impact on the year on earnings as the overall operating profit impacts will then be offset by the lower tax rate.

In National Grid Ventures our existing interconnectors, Grain LNG and metering businesses continue to perform well delivering similar levels of profitability to the prior year.

Capital investment increased to £212m compared to £180m last year. As John mentioned we've ramped up cable laying and onshore construction on North Sea Link and IFA 2, this was partially offset by lower investment in Nemo as the cable laying has now been completed.

Other activities include our St William joint venture with Berkeley Homes, our residual property business and certain central costs. At the half year operating profit from the property business was £38m, £15m lower than last year.

For the full year the majority of the expected property profits relate to the Fulham transaction which is forecast to take place in the second half.

Corporate centre and other contributed £38m at the half year point including £94m of benefit from legal settlements to recover costs associated with the US systems implementation.

Finance costs were £494m down 9%. We benefited by nearly £50bn including lower pension interest and a higher rate of capitalised interest offsetting the underlying increase from the growth in net debt.

The second half interest charge will be higher as some of the benefits will lessen in the second half. Our effective interest rate decreased by 30 basis points to 4.4%.

The underlying effective tax rate before joint ventures was 19.3% down 360 basis points from last year primarily due to the lower US tax rates.

As I mentioned earlier the lower tax charge interest benefit and reduced share counts helped EPS increase to 19.7 pence, 1.2 pence higher than last year.

Operating cash flow was £1.9bn broadly in line with last year.

Net debt increased by £2.6bn to £25.6bn. The increase includes ongoing business requirements of £1.2bn and £1.4bn of exchange rate impacts as the dollar has strengthened since the year end, it was $1.4 to the pound at 31st of March.

As we indicated in May for the full year, and excluding the impact of exchange rates, we continue to expect ongoing business requirements to increase net debt for the year by approximately £2.5bn.

In the first half of the year we raised over £1bn of new long term financing, all for our US business. This included the $350m bond in our Rhode Island business which priced with a coupon of 3.9% securing funding ahead of the new rate case coming into effect in September.

Consistent with our policy we will pay an interim dividend 16.08 pence per share representing 35% of last year's total. Scrip uptake on the full year dividend was 31% and we'll again be offering the Scrip option at the half year. As we stated in May we don't plan to buy back the Scrip shares this year given the very strong asset growth levels we are seeing.

Turning now to our focus on the efficient funding of our growth. Over the last five years our asset portfolio has grown by 5% on average adjusting for the gas distribution disposal. We've maintained an A- credit rating for the Group and with gearing steady at around 65% at constant currency. This has enabled us to raise debt cost effectively with
access to a wide range of debt sources.

As you know with the combination of US organic growth and interconnector investment our portfolio is enjoying particularly strong asset growth. We are efficiently funding this growth through a mix of debt, internally generated cash flow and by utilising the Scrip option.

In addition we'll be retaining the proceeds from the disposal of our remaining 39% share in Cadent for reinvestment in our business.

Putting this all together with the strong capex visibility that we have, we expect gearing to be around the 65% level by 2021 on a constant currency basis. For this coming year at the year end we expect gearing to be a couple of percentage points higher as we won't be receiving the Cadent proceeds until around June 2019.

From 2022 onwards the majority of our inflight interconnector capex will be complete and the EBITDA generated from these business will benefit the group from that point forward.

Turning now to look at our expectations for the full year. Compared to our year end technical guidance there are three main updates.

Firstly, in the US regulated business we've incurred higher than anticipated storm costs in the first half so the full year US profitability is now likely to be slightly lower than last year. This will have no significant impact on ROE as the majority of these costs are recoverable under our regulatory mechanisms.

Secondly, we recognised legal settlements of £94m in our other activities segment which will benefit our full year performance.

And finally, we expect the interest charge for the second half of the year to be slightly higher as some of the benefits in the first half are not repeated.

So in summary our performance remains on track and we expect a net benefit at the full year from the items I've just described. Our capital investment has increased supporting asset growth of at least 7% in the near term and our financial position remains strong. And with that I'll hand you back to John.

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Priorities and Outlook

John Pettigrew, Chief Executive
Thank you Andy. As you know National Grid is a long term business, each step we take in the near term is focused on creating long term value for all of our stakeholders.

So let me now turn to our major priorities for the second half looking at them through the lens of the four long term drivers of success for National Grid.

To remind you these are putting our customers first, optimising the performance of our core business, seeking out growth opportunities in a disciplined way and evolving the business for the future.

National Grid has a vital role to play in enabling customers to benefit from the changes in our industry. The energy transition and wider technology advancements mean that we're better able to give our customers a more cost effective service.

I strongly believe that performance optimisation is central to our role to meet the changing needs of our customers.

For a regulated utility like National Grid a key element to maximise value for customers is stable and predictable regulatory frameworks that incentivise optimisation both through innovation and efficiency.

And regulatory frameworks are of course a major area of focus for us in the UK. We're in discussion with Ofgem on the RIIO control and on competition.

On RIIO-T2 the framework decision document that was published at the end of July provides a solid foundation for this. Ofgem confirmed the key principles of RIIO-T1 will remain, that is incentives, innovation and outward based regulation.

There are however many areas that we'll continue to discuss with Ofgem including achieving a fair return on equity that's reflective of the level of risk in transmission networks.

Ofgem will publish their sector specific consultation in December which will provide further detail on the cost to capital, incentives, outputs and other financial parameters for our transmission businesses. This consultation will conclude in the second quarter of calendar 2019.

In the meantime we'll continue to work with our new stakeholder panels to better understand customer expectations, which will help frame our response to Ofgem's consultation early next year.

We'll of course provide you with updates on this consultation and the wider RIIO-T2 process as it progresses to 2021.

The second area of UK regulatory focus for us is the proposed introduction of increased competition. We support the principle of onshore competition and will work with Ofgem to develop a framework that delivers value both for customers and shareholders.

We're responding to the consultation on the special purpose vehicle model shortly, where together with a competition proxy model Ofgem plan to introduce license modifications in the next six months.

In our view these are complex models that don't present a clear customer benefit case and we'll continue to engage with Ofgem on these. We believe that our long term track record of efficient delivery puts us in a strong position to win in a competitive environment.

We competitively tender around 90% of our costs including both equipment and construction works.

However, this doesn't mean that we're complacent. We'll continue to look for new ways to reduce our costs overall as we're doing with the cost efficiency programme that we described earlier today.

Let me now turn to the regulatory frameworks in the US where we have a number of near term priorities. With the completion of the refresh of rates for our distribution companies we now have rates that allow us to invest appropriately to meet safety and reliability targets.

For our next filings we're proposing to evolve the regulatory frameworks. We'll do this whilst providing more options for regulators to meet policy outcomes of decarbonisation and changing customer needs.

An example of this will be Massachusetts Electric where we'll be filing later this month. As part of this filing we'll be proposing a five year, forward looking incentive based framework.

In addition, although currently small I'm pleased that incentivisation is now a regulatory feature of many of our rate plans and one we aim to expand further into the future.

We're also continuing to adapt our investment response to our customer's requirements and to anticipate their future needs, this focus is increasingly at the heart of every filling that we make.

And our forthcoming Massachusetts Electric filing will include a request to significantly expand the rollout of electric vehicle charging infrastructure. This can provide over 17,000 new charging points across the state.

We're also looking at filing in New York for advanced metering infrastructure implementation which follows a collaborative stakeholder process. If approved we'll replace approximately 1.7 million existing electric and 640,000 gas metering points. This will represent a significant investment of over $650m over six years and we're planning to submit this filing later this month.

And finally, on US regulatory priorities, we've also started reviewing the next steps for KEDNY and KEDLI with a current three year plan concludes at the end of calendar 2019.

Now let me spend a few moments on another key priority for us, our interconnectors projects. As I said at the start of the presentation one of the strategic highlights for us in the last six months was the final investment decision on Viking Link subject to the resolution of a number of minor issues.

As a reminder this link is a 760 kilometres, 1.4 gigawatt joint venture with the Danish transmission owner. Our investment will be £850m and when it goes live in 2023 it's expected to eventually contribute around £100m of EBITDA as well as import over 80% clean energy.

In the next six months our priority will be to progress with Viking as well as the continued efficient delivery of our other three interconnector projects under construction. These represent a combined investment of £2.1bn through to 2023. This is a valuable growth driver for the group contributing an expected £250m of EBITDA when they're fully operational by the mid 2020s.

For our core regulated networks, given the age of our assets in both the US and in the UK asset health investment for safety and reliability remains a key growth driver.

In the US new customer focused investment drivers such as the electric vehicle and metering opportunities I've just discussed provides us with further potential in the medium term.

And in the UK, as I mentioned a few moments ago, we'll been working closely with the stakeholder panels as part of the RIIO-T2 process to make sure that we're planning the right investments to meet the customer needs from 2021. And this will be a key part of our work over the next six months.

So our committed interconnector capex, clarity on investment under RIIO-T1 and the completion of our rate filing refresh in the US provides significant visibility for Group capital investment through to 2021 and beyond.

These all combine to give us high quality asset growth of at least 7% for the next two years and at the top end of our 5 to 7% range in the medium term. And with the final divestment of UK gas distribution we now have a portfolio of businesses with high quality growth for the future, supporting our investment proposition of growth and income for shareholders.

Looking across the Group one of our key priorities is to deliver the capital plans we've been funded for as efficiently as possible. And we'll continue to do this in the second half of this year.

Beyond our core regulated networks and interconnector investments we're also developing other opportunities. In particular we're investing in opportunities arising from the growth in large scale renewable generation. We have a small but growing portfolio of renewables with almost 30 megawatts of installed solar and storage in the US and more under construction.

As I mentioned at the year end results the long term contracted nature of regulatory underpinning makes renewables well suited to the risk reward profile of our portfolio. This is because they leverage many of our core capabilities in engineering, in project development, asset management and financing.

For these reasons in the coming months we'll continue to look for opportunities in the rapidly expanding US renewable space. We're also progressing wind generation opportunities and these include Deepwater Wind, a National Grid Ventures partner that was awarded contracts to install 400 megawatts by Rhode Island and 200 megawatts by Connecticut. We'll be advising Deepwater on the subsea cable construction and have options to purchase the subsea links when commissioned.

So overall we're well positions to take advantage of the opportunities that arise from the ongoing energy transition.

So in summary we've delivered solid financial performance in first half with strong strategic progress whilst continuing to grow the portfolio. We're influencing the evolution of our regulatory frameworks in both the US and in the UK and significant activity is underway to make us a more agile organisation.

We'll continue to develop a disciplined approach to the many growth opportunities we have across the Group and coupled with efficiency delivery this will create long term value for customers and shareholders. Now Andy, Nicola and I will be happy to take any of your questions.

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Questions and Answers

Christopher Laybutt, JP Morgan
Good morning. Two questions, please. The first, there were some headlines on Bloomberg about your dividend this morning. Just wondering whether you could provide some clarification around the dividend and RIIO-2, and has there been any change to the policy or is the policy unchanged?

And, secondly, just in terms of government consultations that are currently underway in relation to UK regulation and regulated assets, one recently launched by the Chancellor, how do you think this might impact your business, and is there any relevance for RII0-2?

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John Pettigrew, Chief Executive
So, thanks, Chris. I mean, in terms of dividend policy, the policy remains absolutely the same, which is, you know, we look to grow the dividend by at least RPI for the foreseeable future.

We've always recognised the importance of sustainability of dividend to our shareholders and, as a business, we always look to try and work through rate filings and price controls in delivering that dividend.

As I said in May, it's clearly underpinned by, you know, a sensible set of regulatory assumptions, and that remains the same as I said in May.

In terms of the consultations, actually there are two consultations open at the moment on regulation more broadly. So there was the one announced by the Chancellor last week at the Budget, which was looking specifically at innovation, and then there was the one launched that's been undertaken by the NIC looking more broadly at regulation.

And I think our position is that we welcome those consultations and reviews from an innovation prospective. You know, I think there is an opportunity, potentially, to better align regulatory frameworks to innovation, particularly where it's very long-term, you know, so we have a five-year price control going forward. Quite often innovation takes much longer to deliver value for customers, so then there's an opportunity there.

And, in the broader regulatory consultation, you know, we'll be looking to see how we can contribute to that. As I said, we welcome it, and I think that, potentially, our opportunity is to think about the duties that the economic regulators have in the context of a changing energy landscape going forward, particularly around things like encouraging infrastructure and investments to meet energy policy targets.

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Iain Turner, Exane BNP Paribas
Yes, if I can ask three questions. On Nemo, is there any scope and do you have any incentives to make that available sooner rather than later and help the Belgians out?

Secondly, on US tax reform, you've given us some helpful views on earnings. Can you just give us an idea of what the means for cash flow on the same sort of basis?

And then, finally, and I think I asked this question six months' ago, just a quick update on your thinking on Brexit and the impact that will have on your business?

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John Pettigrew, Chief Executive
Okay, why don't I take the first and the third and I'll let Andy take the second.

So, in terms of Nemo, in simple terms, we're incentivised to complete as quickly as possible. Actually, we're in the last phases of the construction of Nemo, so, as I said in my speech, you know, we're just about starting the testing process. That will continue with vigour to December, and we're looking to commission by March.

So, there's a very sort of set playbook you have to go through to commission an interconnector. We're very used to that given the work that we've done in the past, and we'll be doing it as quickly as possible. But, at the moment, our view is that it will be done by March.

In terms of Brexit, I think you asked and I don't think our position has changed particularly Iain, in that, you know, as you'd expect with a company like National Grid, we work very closely with Government and with regulators to make sure that we're considering all possible scenarios around Brexit.

Our focus has been, as the system operator, you know, considering circuitous supply, and we, you know, our position is we don't see any significant issues at this point.

We obviously look at it from an interconnector perspective and, you know, we believe the fundamentals of interconnection don't change in the Brexit.

The internal energy market is the gold standard, but if it's not the internal energy market we know that we can trade on that interconnector effectively going forward.

And then, the third area, like any business, we're considering our supply chain and making sure that we've got the appropriate strategic spares in place. So I think we're well set in terms of considering the scenarios, but we continue to work both with Government and Ofgem to make sure we understand the fuller landscape.

Andy.

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Andy Agg, Interim Chief Financial Officer
Yeah, thanks. So, on tax reform, the figures I mentioned in my speech, the $210m this year, the additional $110m to make the $320m next year, will impact cash, we've always said, in the short-term because of the net operating loss position from a tax position. Those impacts flow through to cash.

Only when we get to being in a cash tax paying position in the early to mid '20s would you expect the cash to neutralise out.

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Deepa Venkateswaran, Bernstein
Thank you. I have three questions. So, firstly, on your UK cost programme that you've launched, it's very close to RIIO-T2, so isn't it possible that all the benefits of this will be entirely clawed back as you start RII0-T2? So, I was just wondering about the timing.

Secondly, following from the previous question actually on the Viking FID that you've just taken, what are your assumptions about the CO_2 differentials between the Continent and the UK and the £100m of EBITDA that you've given, you know. Is that kind of robust even if the UK had, I don't know, a total carbon price of maybe £24 and the Continent has something maybe substantially different from that? And so, what's that?

And the third one is just on the Massachusetts issue that you have with the unions. It seems like you're paying around 33m per month for this temporary disruption. How long do you expect this to go on and, you know, is there something in the second half as well that you're expecting? Thanks.

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John Pettigrew, Chief Executive
So let me start with the UK efficiency programme. So, I think, you know, if you go back to 2013, we've always set out as National Grid to deliver as efficiently as possible, you know, recognising the importance of affordability and value for money for our customers. And, in the first five years of RIIO, I think we've be very successful in that.

As you know, we've returned £540m to customers and, currently, transmission represents about least than 3% of the bill. But, in the context of you can never rest of your laurels, we're not complacent and, with the changes that have gone on in the external environment, and the change in demands that we see of our customers, we think it's perfect timing, actually, to make sure that we have an organisation that, not only can deliver over the next couple of years that remains in RIIO-T1, but also that it positions us really well us for RII0-T2.

So that's what we're doing. It's really a reflection of - We're seeing very different needs from our customers from what they were back in 2013, and we think it's important to address that, but we also think we've got a duty to make sure that we're driving value for our customers.

As Andy said, the programme itself will deliver about £50m of opex reductions next year and £100m in 2021. We think that'll position us very nicely in our engagement with stakeholders as we think about RIIO-T2 as well.

In terms of Viking, I mean, in Viking, we do a whole host of scenarios in terms of what the market might look like, so it's not just tax in terms of CO_2, we also have to model for things like the arbitrage and what's the generation background's going to be looking like in Europe as well as in the UK.

So, we're comfortable that the estimate we provided today is a central estimate based on all those different modelling and scenarios that we've done. So, we do take into account that there could be changes in tax, but, similarly, there are going to be changes in the generation background both in the UK and the US and, therefore, the arbitrage, which really drives the value for the interconnectors, will also, could potentially, vary.

So, we do a whole host of scenario testing, and what we present today is a central range which we think it's probably not our best view.

In terms of Massachusetts and the work stoppage, let me just take you back and then I'll talk about the costs. So, in terms of the work stoppage, we had been in negotiations with these two unions for a while. When we got to the end of the contract in June, we were in a position, we were unfortunate, we hadn't agreed terms and conditions.

It impacts on about 12 [audio jumps] thousand people in our US business, and we've agreed these terms with probably 16 other unions.

The two areas of dispute are healthcare, and paying a small excess on initial healthcare claims, and pensions, and, fundamentally, that's about for future employees moving from a DB scheme to a DC scheme.

The position is, in order to be able to deliver a safe and reliable network, we needed to bring contractors in, we need to ensure we had the right supervision so we can deliver a safe and reliant network to our customers and, as I said, in the speech, we've done about 40,000 jobs so far.

The cost of that in the half year is the £97m that we've set out. We are hopeful that we will get to a resolution, you know, in a reasonably short timescale. We are in active dialogue with the unions as we speak today.

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James Brown, Deutsche Bank
I also have three questions. The first is also on the cost-cutting and the context there but within the context against your outperformance targets in the UK of 2% to 3% for the rest of this regulatory period. And, obviously, at the moment, you're around the 2% mark, so not to ask you for clear guidance on kind of specific numbers but if there's any context you can give us around the cost-cutting now, whether that's to hold at the 2% level so we can be within that range or maybe, hopefully, push up the level of outperformance over the last couple of years in the period?

And then the second question is also linked to that, is whether, when you calculate the totex outperformance, do you take into account the restructuring costs or do you strip those out as exceptionals?

And then, thirdly, also, again, on Massachusetts, you've suggested from your comments that you'd gone through this process in many states already, but I was just wondering whether there were many unions where you, in the future we're you're in similar kinds of discussions or whether you're most of the way through that process across the US? Thanks.

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John Pettigrew, Chief Executive
So, I'll take the first and the third, and then I'll let Andy take the second.

In terms of the efficiency programme, you know, our intention is to really underpin the 200 to 300 basis points of outperformance that we committed to. So that's what our guidance says, so I'm not going to point any more specifically than that. What we have set out is we're expecting it to deliver around £50m of benefit next week and £100m per annum from 2021.

Obviously, that gets shared with customers, quite rightly, as part of our totex mechanism, but it will help to underpin that 200 to 300 basis points of commitment that we've made. And, as I said earlier, it will also put us in a great position to move forward into RIIO-T2 as well.

In terms of the unions, as I said, the vast majority the unions that we deal with in the US, over the last few years, we have moved to these terms and conditions. There are a few local unions left that we will, as those contracts expire, come to address the similar issues, but the vast majority have actually been dealt with, and the specific focus is on these two unions in Massachusetts at the moment.

Andy.

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Andy Agg, Interim Chief Financial Officer
Yeah, thanks. And, on the restructuring costs, as John said, in the same way that the benefits of the efficiency programme will flow through, totex can be shared with consumers, the cash spend, in terms of achieving those efficiencies, will also go through the totex mechanism and be shared. So not the £127m, the accounting entry, but as we spend the cash against that, that flows through totex.

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Fraser McLaren, Bank of America Merrill Lynch
Good morning. I also have three questions. So, first of all, the 94m US legal recoveries, is there any risk that the US regulators try to nab any of that?

Secondly, could you give us a bit more context, please, on the US renewables ambition? What might that look it? Is it likely to be incremental investments or larger acquisitions?

And then, just finally, again, on the Massachusetts union issue, could you help us, please, to get the £97m cost so far into perspective in terms of what these items are worth to you in Massachusetts?

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John Pettigrew, Chief Executive
Thank you. I'll start with the legal settlement. So it's related to our systems in the past, as you know, which we incurred these costs, and a large part of those costs were incurred by shareholders. So there is no expectation that regulators will claw back another 94m. It will stay with National Grid.

In terms of the renewables ambition, as I said back in May, I mean, and as I've said today, we do see the rapid growth in the renewables in the US as an opportunity. It allows us to use a lot of the capabilities that we have in National Grid, and, over the last few years, we've built up a small portfolio of both solar and storage, and we continue to. So we have about 40-odd megawatts in construction with a battery, a large battery on Nantucket Island as well as some developments with NextEra on Long Island. So we've been building up our capacity.

Our approach to it will be exactly the same as our approach to all investments, which is we take a disciplined approached, and if we see an opportunity on a risk-adjusted basis that delivers good returns for our investors, then we will look at very carefully and take it forward.

In terms of acquisitions, our position's always been the same which is, you know, there may well be small or modest acquisitions but our position on acquisitions is we've got very strong growth organically, we, of course, we look at that opportunity but only if it was compelling to our shareholders and customers would we take it forward.

But, in terms of the £97m, so I wasn't quite sure what the context of the question was.

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Fraser McLaren, Bank of America Merrill Lynch
Yeah. I was just wondering, if you were to give the unions what they want, how much would it actually cost you?

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John Pettigrew, Chief Executive
Yeah, so I think the most important point to bear in mind here is that – So, the dispute is very narrow in terms of terms and conditions, but it is important, from a US regulatory perspective, that we're mindful of the fact that customers ultimately pay for the costs of the work that we do, including pensions and healthcare. And the fact that we have agreed this with 16 unions, it's important that we protect that value as well, but protecting that value and ensuring that we're fulfilling our duties to make sure that we're delivering value for money for customers, is the reason why this is really important.

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Verity Mitchell, HSBC
I've also got three questions. The first one is on gas transmission. You've got an extra £18m MOD payment for 2020, do we know about that already or is that in addition to the MOD adjustments we'd already seen?

And, secondly, sorry, going back to Massachusetts, can you just confirm, I mean there's been lots of press speculation, are you actually not doing any work at the moment except emergency work? And, in terms of your Mass Electric filing, is there not going to be some reputational damage from this irrespective of the costs involved?

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John Pettigrew, Chief Executive
So, why don't I take the second two now, and I'll ask Andy to do the first one?

So, just say the second one again, I just want to make sure I get the context right.

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Verity Mitchell, HSBC
The second one was I understand that you're only doing emergency work at the moment, you're not actually fulfilling your normal business. Is that actually true? And what kind of reputational risks do you face with that given that you're just about to go into rates with Mass Electric?

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John Pettigrew, Chief Executive
Yeah, so, let me just put that into context. So, some of you would be aware, actually, that just around a month ago there was quite a significant safety incident in Massachusetts with Columbia Gas, it wasn't part of National Grid, that resulted in a number of explosions and injuries and a single fatality as well, so a very serious incident in Massachusetts.

That, quite rightly, resulted in the DPU, the regulator in Massachusetts, indicating they're going to do a safety audit across Massachusetts, and we welcomed that and we'll be working with them on that.

Subsequently to that, we had a relatively minor effect in Woburn in Massachusetts which impacted about 300 customers. The pipeline wasn't damaged, there was no damage to customer property and we restored the customers within 24 hours.

But, in that context, the Massachusetts DPU suggested to National Grid that our focus should be, in the short-term, on emergency work and mandatory work and compliance work, and, effectively, placing a moratorium on work outside of that.

In Massachusetts, actually, there are always moratoriums during the winter. So towns, themselves, place moratoriums to avoid too much disruption, particularly given the harsh nature of it. So, effectively, that moratorium's been brought forward.

We are continuing to work with the DPU. As you know, our focus as a company has always been on delivering world class safety, and it continues to be, and our performance during the work stoppage has been exceptional in that regard. But we will work with the DPU to understand what their concerns and issues are.

The overall impact in terms of the capital investment plan. As you've seen in the first half, we're about $100m up. Our expectation for the capital investment plan for the US is that we're going to be similar to last year; it's allowed us about $3.3bn, maybe slightly lower.

Massachusetts Gas represents less than 20% of our capex plans.

So we're working with the DPU and making sure that we address any issues.

In terms of the filings, I think, you know, we have a very constructive relationship with the DPU more broadly. I think you've seen that with the most recent Massachusetts Gas rate case where we settled on a three year rate case with 9.5% return, and an increase in the capital investment.

So I think we continue to work very closely with the DPU and we have a very constructive relationship.

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Andy Agg, Interim Chief Financial Officer
Yeah, and in terms of the proposed MOD adjustment for gas transmission, I mentioned the £80m in my speech, that's our latest estimate that we expect to go through the MOD adjustment for '19/'20, and it includes a number of things. It includes our estimate, initially, from the reopener impact. And that will get confirmed when the MOD adjustment process runs but by the end of this month.

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Nick Ashworth, Morgan Stanley
Hi. Just a couple of numbers questions just to check. On the cost efficiency programme in the UK, you said it's £127m in the first half, I think it also says in the statement that it will be a little bit higher in the full year. Do you know where that will go to for the full year?

Secondly, can I just get an update on how much is actually invested so far in the interconnectors?

And then, finally, thinking about growth in the future, and we talked a little bit about renewables, in the US as well, I know there's, potentially, a lot going on with transmission and Fit (?) 1,000 and all, and some of the projects which have come up for bidding there, can you talk a little bit about that landscape and all the focus grid - it feels like all the focus has been on distribution over the last few years, but I know there are more opportunities coming for transmission, and give them the business over here, and the small business you have other there, what sort of opportunities are there for transmission accrual over the next few years in the US?

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John Pettigrew, Chief Executive
Okay. So, again, I'll give Andy the numbers one, the first one.

In terms of investment in interconnectors, we've got four under construction, so Nemo's nearly finished. We've spent, to date, around about £500m of the £2.1bn that I've set out. So we've still got significant investments to go between now and 2023.

In terms of the US landscape, it continues to be an area that we look at very closely. The opportunities for competitive transmission in the US tend to be quite lumpy and sporadic. I think last time we were together we talked about an opportunity with Granite State which was to bring clean energy down from Canada and Upstate New York into the North East. We had a proposal that would use some of our rights of way, but it was a wind solution, and, ultimately, Massachusetts chose a hydro solution.

There continues to be opportunities, you know, in early forms of development with different states issuing RFPs, most recently Connecticut have issued one, and we continue to look at that and to look to partner with people to see if there are opportunities.

So, nothing specific at the moment. It's quite sporadic, but there is definitely a lot of opportunity and, similarly, on the offshore wind side as well. So, as we've mentioned, with Deepwater. We see a lot of activity in the North East for offshore wind.

Andy.

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Andy Agg, Interim Chief Financial Officer
Yeah. Just in terms of the UK costs, as you said, £127m was the cost recorded at half year. Because that programme's underway as we speak, the final costs will be trued up as we go through the second half and we know what they eventually end up with. The total will then be in exceptionals at the full year as it is at the half.

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Nick Ashworth, Morgan Stanley
Have you done a lot of it already or is the incremental bit meant to –

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Andy Agg, Interim Chief Financial Officer
I think all incremental rather than a - So the £127m is the majority of it.

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Nick Ashworth, Morgan Stanley
Okay. Thank you.

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Mark Freshney, Credit Suisse
Hi. Two questions. On the impact of the US tax reform, the $328m near-term adverse impact, is there anything you're having to do within the subsidiary level to move capital around to ensure that the subsidiaries continue to be appropriately capitalised?

And my other point is, or other question is, at Group level, you mentioned that gearing would rise from 64%, you mentioned a couple of percent by year end before getting the proceeds in from the sale of Cadent, but is there anything else that you would need to do at the Group level in terms of rotation of capital to get that gearing down, because it seems that, given, you know, you've just sanctioned Viking, it looks set to remain higher for a sustained period of time?

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John Pettigrew, Chief Executive

Okay, I'll hand you over to Andy. I'll just reiterate that I think we're in a much better position now in terms of clarity and visibility on the impact of tax reform. I think, when we last met, we were still waiting to get some clarity from a number of our regulators in terms of the impact of the 35% reduction to 21, and how the deferred Tax Credit was going to work. I think we now have that clarity and, as we said, $210m impact this year, increasing to $320m next.

So, I think, with that visibility, we have a good sense of, you know, how we've managed it, but I'll hand you to Andy to go over the specifics.

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Andy Agg, Interim Chief Financial Officer
Yeah, thanks. So, to take the first one. In terms of the US operating companies, Mark, as you know, our policy broadly is to run all of our operating companies, UK and US, in line with their regulatory gearing levels. So, therefore, when there are changes like this, as we always do, we look to either raise debt or shift, you know, small equity injections or dividends to keep the actual gearing ratios in line.

So we'll just allow for this change of cash from the tax reform in the same way we do with everything else. So there's no sort of specific action required in the short-term.

At the Group level, as you said, I mentioned in my speech, you know, we do see a little tick up this year for a number of reasons. Some of that is some of the timing outflows that we're seeing in UK and US this year, some of it will be FX related. The Cadent proceeds coming in just after the year end is just a timing difference when that cash comes in.

But, to reiterate, as we've said previously, some of the other measures that we will continue to look at, so the efficiency programmes, the rate filings, the scrip option, those are all about keeping the balance sheet in the right place. And, in my speech, again, we guided to being around the 65% gearing level by '21 as well.

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John Pettigrew, Chief Executive
Okay. If there no more questions, can I just thank everybody for coming today.

As I said in my speech, I think a solid set of results in the first six months with strong operational and strategic progress and, you know, we continue to be on track. It's good to grow the business in the 5% range and, actually, for the next few years, we're right at the top of that range, so thank you very much, and safe journey home.

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