National Grid

Full Year Results Presentation

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National Grid

Aarti Singhal, Director of Investor Relations

John Pettigrew, Chief Executive

Andrew Bonfield, Finance Director

Questions From

Mark Freshney, Credit Suisse

Iain Turner, Exane BNP Paribas

Deepa Venkateswaran, Bernstein

Dominic Nash, Macquarie

Nick Ashworth, Morgan Stanley

Christopher Laybutt, JP Morgan

James Brand, Deutsche Bank

Fraser McLaren, Bank of America Merrill Lynch

Maurice Choy, Royal Bank of Canada

Verity Mitchell, HSBC

Introduction

Aarti Singhal, Director of Investor Relations
Good morning everyone, and welcome to the National Grid full year results presentation. As always, we're going to start with safety. There are no planned fire alarm tests this morning, so if you hear an alarm, you do need to leave the building and gather outside at Paternoster Square.

Second important thing is the cautionary statement. I would like to draw your attention to that, which is included in your packs.

Warm welcome also to those of you who are watching online. All the material is available on our website, and, as usual, there will be a Q&A after this presentation by John and Andrew, so, with that, I'd now like to hand you over to John Pettigrew. Thank you.

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Highlights

John Pettigrew, Chief Executive
So thank you, Aarti, and good morning, everyone. As usual, Andrew and I are joined this morning with Nicola Shaw and Dean Seavers, who will be on hand to assist us with any questions.

I want to start with a review of outperformance in '17/'18. It's been a busy time for the Group, and I'm pleased to report we had a good year. Let me start with our financial highlights, where we have included Cadent on a like for like basis to help with the comparisons with the prior year.

On an underlying basis - that is, excluding the impact of timing and major storms - operating profit increased by 6% at constant currency to £3.5bn mainly reflecting the strong performance of our US business.

During the year, we made significant investment at £4.3bn in critical infrastructure, representing an increase of 14% at constant currency. When combined with year end inflation, this capital spend drove core asset growth of 6%, in the middle of our stated range of 5-7%, and importantly, we achieved that whilst delivering strong returns on equity, at 12.3% for the Group.

Finally, in line with our dividend policy, the Board has recommended a final dividend of 30.44p per share, bringing the proposed full-year dividend to 45.93p. This represents an increase of 3.75%, reflecting last year's average UK inflation. So, as you can see, it's been a good year of financial performance, with strong organic growth.

Turning now to our safety and reliability performance. Last year we continued our relentless focus on safety, with our ambition to ensure that all our employees and contractors go home safely at the end of each day. To achieve this, I believe the most important thing is to have a culture where safety underpins everything that we do, not just at operational sites but right across the organisation. And it's delivering consistently on that culture that has enabled us to achieve an employee lost time injury frequency rate of 0.1, which is consistent with world-class safety performance.

Across both our US and UK networks, reliability has also remained strong. We achieved excellent performance for both our gas and electric networks, with near 100% reliability in the UK.

In the US, we faced a unique winter, with major storms across all our jurisdictions. In October, we restored over 530,000 electric customers following one of the most severe storms in recent years, and in March, we were challenged again with three back-to-back northeasters, which was unprecedented. As always, our crews worked around the clock, restoring the vast majority of affected customers within 72 hours, and almost all of the restoration cost of around £140m will be recovered through our existing regulatory mechanisms.

Now, moving to the key achievements and developments during the year, starting with the US, where we've made significant progress. We now have around 80% of our distribution businesses operating under new rates. This was following the successful filing in Massachusetts Electric, our KEDLI and KEDNY businesses, and most recently Niagara Mohawk. The NiMo agreement, which was completed in March, allows return on equity of 9% and $2.5bn dollars of capital investment over three years. With the KEDLI and KEDNY settlement, that means over the next three years total investment in New York will be more than $5bn.

In addition, in November we submitted rate cases for our Massachusetts Gas and Rhode Island business, and expect to have updated rates in place by October. Combined, we've asked for $81m of additional revenue and $800m of annual capital allowances, with a 10.5% return on equity for Massachusetts Gas and a 10.1% return on equity for Rhode Island.

Both filings are progressing well, with the hearings for Massachusetts due to conclude later this month, and there are hearings for Rhode Island starting in June.

With the completion of these rate filings, we'll have new rates for our entire US Distribution business, which will contribute to improvements in performance and allow us to achieve returns as close to the allowed level as possible.

One of the commitments we made last year was to continue our recent trend of improved returns, with a goal to deliver 90% of allowed return on equity. I'm delighted to say we achieved more than this, delivering 95% with strong asset growth of over 7%.

Operationally, we've also continued to make good progress. With a significant increase in the levels of capital investment, we've now established a capital delivery function similar to that that we have in the UK, and this function is already helping us to deliver projects much more efficiently.

A good example of this is the Metropolitan Reliability Infrastructure Project. It's a five-year, $280m gas project running through the heart of Brooklyn. When complete, this project will significantly improve the reliability of our network, and I'm pleased to say we're on budget and ahead of the initial construction schedule.

And finally, we responded quickly to the US tax reform that was announced in December, adjusting our rate filings for NiMo, Massachusetts Gas and Rhode Island to reflect the lower tax rates, and reducing our total revenue requests, including FERC, by $180m. And Andrew will discuss this in more detail shortly.

So, turning now to the UK regulated businesses and starting with our Cadent investment. As you know, we entered into an option agreement with Quad Gas for the potential sale of the remaining 25% stake. We're expecting the cash proceeds from the potential sale to be approximately £1.2bn. And for these proceeds to be retained for reinvestment in the business and to deliver on our growth strategy.

Operationally, both our electricity and gas transmission businesses have continued to deliver high levels of performance. In the five years since RIIO was introduced, we've now generated approximately £540m of customer savings, which will help to reduce bills over a number of years.

Last year, we were able to deliver 200 basis points of outperformance through efficiency and performance optimisation. For example, we completed the first phase of the London Power Tunnels, generating more than £80m of efficiency savings. In addition, we have progressed a number of important regulatory topics in the UK, which I'll cover in more detail later in the presentation.

Turning next to National Grid Ventures, where the major area of activity has been our interconnectors, where again we've made good progress. All three of the interconnectors we currently have under construction - that's Nemo, North Sea Link, and IFA 2 - are on track, and we reached a significant milestone on Nemo, with the completion of initial cable laying, quite recently. These three interconnectors represent £1.3bn of investment, and will contribute over £150m of EBITDA when operational.

And our property business also continues to make good progress: in particular, our site at Battersea, which will deliver almost 1000 new homes in London when it's completed. And next year will be an important year for our property business. When we expect to transfer into our joint venture, our 17-acre Fulham site, subject to the relevant planning approvals.

So, in summary, I'm pleased to report another year where we've made good strategic progress whilst delivering strong operational and financial performance for the Group. National Grid is in good shape, and I expect further progress next year, as we continue to evolve the Group for the changing needs of the industry.

So, more on that shortly, but first, just before I hand over to Andrew to discuss the financial performance in more detail, I want to say thank you to him. As you'll have read, this will be his last results presentation. Andrew has brought strong leadership and financial discipline in his eight years at National Grid, and I've personally valued the guidance and support he has given me since I became CEO.

Andrew leaves with National Grid having a very strong foundation for the future, and with all our best wishes. And I'm really pleased that Andy Agg, who is the Group Treasury and Tax Director, will be taking over as Interim CFO. Andy, who is here today, is highly experienced and has been with National Grid for well over 10 years. So, with that, I'll hand over to Andrew.

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Financial Review
Andrew Bonfield, Finance Director

Thank you, John, and good morning, everybody. As John has highlighted, our financial performance was strong. All of our key metrics show progression. At constant currency, underlying operating profit was up 6%, and pro forma earnings per share up 4%.

Our strong operational performance was reflected in the 12% growth in value added and a 60-basis-point improvement in return on equity. Asset growth is now at the middle of the range, driving by increased capital investment and the reshaping of the portfolio.

The dividend of 45.93p per share is 3.75% higher, in line with our policy. Now let me walk you through each of the segments.

UK Electricity Transmission delivered another year of strong operational performance, achieving a 13.1% return on equity. We continue to focus on innovation and efficiency to deliver totex outperformance of 180 basis points, which is broadly consistent with the prior year.

Other incentive performance, at 40 basis points, was lower, mostly driven by the reduced BSIS incentive opportunity under the arrangements for 2017/18. Additional allowances added 70 basis points of performance.

Underlying operating profit of £1.1bn was down 15%, largely due to higher MOD adjustments, increased depreciation, and lower BSIS income.

Capital investment was £1bn, which is broadly in line with the prior year. This investment, along with inflation-linked growth in RAV, increased the year end regulated asset value by 4.5% to £13bn.

Moving to Gas Transmission, which delivered a return on equity of 10%. As I highlighted at the half-year, returns were lower. This reflects the increased spend on asset health, which is required to deliver our RIIO T1 outputs and the end of legacy allowances. Other incentive performance remained strong as a result of the investment we had made to ensure the reliability and integrity of the network.

Operating profit was up 12% on an underlying basis, primarily due to increases in base revenues, including £47m for Avonmouth. Again, as I mentioned at the half year, we will be returning approximately £85m of Avonmouth allowances in the current financial year.

Capital investment increased by £96m to £310m. This increase is a result of our investment in the feeder 9 and compressor projects, and the step up in asset health spend. And the regulated asset value grew by 4.5% to £6bn.

In the US, our return on equity was up 70 basis points, to 8.9%, which is 95% of the allowed return, due to the new rate filings. In New York, performance was 60 basis points better, at 9%. Our Downstate gas businesses benefited from the recent filings, and we also saw improved performance in our Upstate business.

As expected, performance in Massachusetts improved significantly. This was driven by the first full year of rates in the electric business, where we achieved a return on equity of 9%. We expect new rates in our gas business to be effective from October.

Our Rhode Island business saw a reduction of 80 basis points due to inflation, and have new rates which are expected in September. And our FERC returns have remained strong.

Underlying operating profit increased significantly to £1.7bn, up 20% at constant currency, driven by higher revenues from the rate filings as well as the absence of one-off write-offs in the prior year.

We increased investment in our US networks to £2.4bn, or $3.3bn, driven by the expansion of main's replacement programs and reliability and reinforcement investments. This meant rate base grew by 7.4% at $20.7bn.

National Grid Ventures performed well, making a £287m contribution to the group, including the post tax share of JVs and associates. As expected, the metering business continues to see a decline in revenue driven by a lower meter population.

Our Grain LNG business delivered consistent levels of operating profit last year, and profits at IFA have reduced due to lower auction revenues and the impact of the sharing mechanism.

Profits at BritNed were also lower, as the benefit we've seen from the levy exemption certificates last year, which drove higher price arbitrage and auction revenues, was not repeated.

Capital investment has increased significantly to £363m, reflecting the start-up of construction on IFA2, the second French interconnector, and increased spend on Nemo, which is on track to be operational next year.

Moving to other activities - total Group contribution was £111m, up £34m from the prior year. Operating profit in the property business increased to £84m as a result of asset disposals, including sites in Staines and York.

Corporate centre and other costs decreased year-on-year as a result of lower business change costs.

The remaining 39% stake in Cadent made £123m post tax contribution, down £21m compared to last year's pro forma number. This was driven by a reduction in base revenues and adverse year-on-year timing.

Financing costs increased by 2% at constant currency to £974m. This was primarily due to higher UK RPI and increased debt. These factors were partially offset by the crystallisation of gains on investments in our Captive Insurance company and the sale of our shares in Dominion.

The effective interest rate increased from 3.9% to 4.6%, reflecting the higher RPI.

The effective tax rate was 23.7%. This was 50 basis points lower, as a result of lower UK and US tax rates, partially offset by higher profit mix towards the US. This gave rise to a charge of £589m.

Earnings increased to £2.1bn, and as you've heard, underlying earnings per share increased to 60.4p per share.

Operating cash flow was £4.7bn, £250m higher than last year. This mainly reflects one-off pension contributions that were made in the UK and US last year.

Closing net debt was £23bn. This reflects £1.8bn of business-as-usual cash outflow, the return of the £4bn from the gas distribution sale, and the benefit of £2.1bn from the strengthening sterling versus the dollar.

We raised over £1.8bn of new long-term financing. This includes a £400m bond in our New England power transmission business, which at a coupon of 3.8% is the lowest rate we've ever achieved for a 30-year bond in the US. Our RCF-to-debt ratio was 10.6% on a continuing basis, and FFO-to-debt was 16.4%.

Value added was £2bn, or 57.9p per share. This comprised the growth in group assets of £2.3bn driven by increased capex and higher UK RPI, cash dividends and repurchase of scrip shares, which total £1.5bn, this year's underlying growth and net debt of around £1.8bn, which I mentioned a moment ago.

One of the benefits of Value Added as a measure is that it includes the movements in all regulatory assets and liabilities, including our assets outside RAV and rate base. As we have discussed previously, IFRS earnings can be adversely impacted by regulatory adjustments such as the revenue mechanisms under RIIO. A great example of this is the recognition of allowances for Avonmouth in 2017/'18 in our IFRS profits, which will reverse in the current financial year. The Value added measures takes into account these sorts of regulatory adjustments, and therefore is a more effective way of capturing the real underlying performance of the business.

We are seeing a step up in the rate of organic growth. This is driven by the sale of gas distribution, which has reshaped the portfolio towards higher-growth businesses, the visibility of our US growth profile due to the successful rate filings, and the investment in interconnectors in National Grid Ventures. We therefore expect asset growth to be sustained at the top end of the 5-7% range for the medium term, and at least 7% in the near term.

Now let's look at the organic growth opportunities in each of the businesses. In the US, the business is well advanced in its rate filing strategy. Each rate filing outcome has provided for increased investment to replace and reinforce aging infrastructure, as well as provide funding to support each state's decarbonisation agenda. We expect to invest at least $10bn over the next three years in our US business. We can also expect that the vast majority of this investment will be fully remunerated benefitting earnings from the point the investment is made.

These higher levels of investment are already impacting our rate base growth, which increased to 7.4% this year. This, plus the beneficial impact of US tax reform on rate based growth, means that we can expect the growth rate to remain at least 7% through 2021, and even higher in the near term.

In the UK, we have significant clarity over the investment profile, particularly now that we are five years into the RIIO T1 price control. We spent £1.3bn this year and expect to continue to spend around this amount through to March 2021. Assuming 3% RPI, this would deliver average asset growth of just under 5% per year over the remainder of the price control.

In National Grid Ventures, we have made very good progress on our interconnector projects. The capex on the three interconnector projects under construction totals approximately £1.3bn. These projects are expected to complete in the early 2020s, and once operating should generate EBITDA of over £150m per annum. The proposed Viking project could add a further £850m of capex and an incremental £100m of EBITDA.

So, bringing it all together, we expect to spend around £13bn of capex across the Group over the next three years.

Moving into US tax reform, as you know, tax is a pass through cost for utilities. The reduction in the corporate tax rate from 35% to 21% will be significantly beneficial to consumers and economically neutral to utilities.

However, there are some implications on cash flow. The lower bill collections have little or no offset in tax cash paid, as we are currently in the net operating loss position in the US. We have already reduced our revenue requests by $130m, relating to the three operating companies undergoing rate filings, and $50m for our FERC businesses, which operate under formula rates.

In our remaining distribution businesses, we may be able to partially offset the bill reductions with faster recovery of regulatory assets, or use the headroom created to fund further investment. We have filed Massachusetts Electric proposals earlier in the month and plan to file KEDNY and KEDLI over the summer.

We will also return $2bn of existing deferred tax liabilities, which represents historic tax collections at the higher rate of 35% over 20 to 30 years as required by the legislation.

Under US GAAP there is no impact at the operating company level on earnings or US RoEs. Under IFRS, there will be a small impact associated with the return of the deferred tax balance, as the release of the $2bn liability is reflected as an exceptional item in this year's accounts.

Finally, rate base growth will increase due to the lower build up of deferred taxes in the future, as a result of bonus depreciation ending for utilities. Over time, this will be beneficial to cash flow, marginally offsetting the lower tax collections.

National Grid has a strong balance sheet and efficient capital structure, which underpins the effective financing of the company's capex program. The Group is now entering a period of stronger growth. We expect to fund this investment through a combination of internally generated capital, delivered through continued strong returns and cost efficiencies, capital arising from the disposal of the remaining 39% shareholding in Cadent, and additional capital generated through the scrip dividend.

As I have always said, we put in place the scrip to support the business in periods of higher growth. At this stage, we do not expect to buy back the shares in 2019 and 2020 unless we have higher-than-anticipated balance sheet capacity.

We are confident in the strength of the balance sheet to finance this attractive level of growth, upon which we expect to earn strong returns. We are well positioned to deliver asset growth of 7% over the medium term and grow the dividend per share at least in line with RPI.

As normal I'd like to summarise our technical guidance for 2018/'19, and as ever you can find more details in the statement.

Overall, we expect our UK regulated businesses to continue to deliver 200-300 basis points of outperformance, driven by traditional incentives in both businesses, and totex outperformance in electricity transmission.

In the US, returns are expected to be a similar level to the current year. Revenues will benefit from new rates, but there will be a partial offset resulting from the adoption of IFRS 15 and the impact of tax return.

Other activities are expected to benefit from the transfer of Fulham site into the JV with Berkeley Group, which is subject to completion of site works and appropriate planning consents.

Our interest charge will increase, reflecting the growth in net debt, and no investment gains, partially offset by lower inflation. The tax rate will be lower, offsetting the bill adjustments to customers from US tax reform.

So let me summarise. The financial performance across the Group has been strong. Our asset growth rate has increased, and we expect 7% growth over the medium term. We have grown the dividend in line with UK RPI, and our financial strategy remains robust.

Before I hand back to John, I would just like to say the decision to leave was very difficult, as I have thoroughly enjoyed the last eight years, and I am proud to have National Grid on my CV. I will continue to support the company, and expect John and the team to take the business from strength to strength in the future. 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
So, thank you, Andrew. As I said at the start, we've had a full agenda in the last year, so let me now turn to our priorities for the year ahead, and also the steps that we're taking for the longer term.

As we just highlighted, we see significant capital investment and growth over the medium term, and I believe that by focussing on four drivers that I've spoken about previously, we'll deliver this growth efficiently and earn attractive returns.

To remind you, these drivers are - putting our customer first, optimising the performance of our core business, seeking out growth opportunities in a disciplined way, and evolving the business for the future. And as I look to the year ahead, these will continue to guide our overarching strategic focus.

So, starting with our customers, whose needs to continue to evolve, and they expect more from us. Affordability remains top of the agenda, but we need to go beyond this to ensure that customers are receiving a world-class experience.

In the year ahead, our teams in the US and in the UK will be undertaking new initiatives to enhance customer engagement and drive a stronger customer-centric culture in National Grid.

For example, in the coming year, we'll be integrating our contact centres and customer portals into a single platform for a seamless experience no matter how customers contact us.

In the UK, we'll be seeing different customer types, such as storage operators, so we are making changes in how we interact with them. A recent example of this is the connections process, where through listening to feedback and eliminating process inefficiency, we've reduced the time it takes to provide connections by 30%.

Turning now to performance optimisation, where the starting point as always is a strong focus on maximising the performance of our core business. In the UK, we expect to invest £1.2bn of capex this year, primarily to maintain the health of our networks, and we'll be progressing with major projects such as the Richborough to Canterbury overhead line and some station upgrade and the replacement of feeder 9 under the Humber Estuary.

We're also not losing sight of the efficiency we can create from within the business, driving a sharper focus on our cost base. We are completing a review of our operating costs and considering our options to simplify our organisational structure, to speed up decision-making and be more responsive to our customers.

Ultimately, all these steps will help to generate customer savings and enable us to meet our commitment of achieving UK outperformance in the 200-300 basis points range.

So, moving on to UK regulation, which will be right at the top of our agenda. As I said at the half-year results, we are operating in a dynamic external environment. This is especially the case in the UK, with the ongoing debate about the current regulatory framework and the political narrative on the ownership model.

As you would expect, we have been actively engaged with all our stakeholders to ensure that our track record of significant investment and strong operational performance is recognised and understood.

In May, we submitted our response to the RIIO T2 consultation document. It's important to remember that these are still early days in the RIIO T2 timeline, which won't take effect until April 2021. This consultation presented a wide range of possible options across multiple areas. We fully support Ofgem's proposals on giving customers a stronger voice. Their thinking is closely aligned with ours, namely to put stakeholder engagement at the heart of the approach for RIIO T2.

Our focus over the next three years is to ensure that the final package does three things. It provides an appropriate balance between risk and reward, it drives innovation and efficiency through incentivisation, and it ensures financibility of our networks and ultimately benefits all parties.

The next steps on the road to 2021 will be Ofgem's decision on the framework this summer and the publication in the autumn of the methodology for the sector-specific price controls. And we will of course keep everybody updated as we see significant developments.

The second area of regulatory focus for us will be Hinkley Seabank. In January, we expressed our disappointment with the financial parameters for the project that were proposed by Ofgem, and whilst the annualised capex for this project is relatively small, we do not view Ofgem's position as one that fairly balances the risk and reward for this complex project. Ofgem is expected to announce its decision on this consultation in the summer, and depending on the final decision will then consider all the options available to us.

The third area of regulatory focus will be agreeing funding for certain projects that were uncertain at the time of RIIO T2, in particular, projects in our gas business. We have made our submission for these projects to Ofgem and are expecting a decision in September.

So, moving now to performance optimisation in the US, where we have the challenge of ensuring that we continue the high levels of reliability we've seen recently whilst delivering on the major capital investment program. Given our large distribution presence in the US, this means delivering on thousands of small to medium-sized projects in addition to the larger projects to modernise and expand our networks.

To deliver this work, we are reviewing all our end to end processes to remove inefficiency, and we are strengthening the jurisdictions with greater operational support, to enable the organisation to deliver this significant capex in the most effective way.

As you heard from Andrew, we expect to invest $10bn over the next three years, 90% of which is already reflected in our rate plans, and this growth is driven by a number of factors. Mandated spend to remove all the gas mains that are prone to leaks, storm hardening for our electric networks, and other initiatives to modernise our networks and to provide new connections with gas and electric customers.

And whilst we continue to deliver these capital projects, we must work hard to make sure that the regulatory environment and the returns we get are attractive.

Looking beyond the current rate filings, our strategy is to focus on efficiency so that we can deliver as close to the allowed returns as possible and help keep customer bills down. By doing so, we optimise the frequency of rate filings. Currently, the next rate case to be filed will be Massachusetts Electric, which we expect to do towards the end of this calendar year.

So, having considered performance optimisation, I'd now like to discuss growth in the context of the portfolio as a whole. Over the last two years, we have been on a journey migrating the portfolio towards higher growth, and today Andrew and I have talked in detail about the significant capex we are set to deliver. This capex enables us to deliver growth at the top end of our 5-7% range, leaving a core asset base that is over 20% larger in 2021 compared to last year.

The growth that we are delivering is of high quality. It's growth driven by customer needs that is funded through regulatory arrangements, with a risk/reward balance that is consistent with our investor proposition, and that will generate attractive returns for our stakeholders. It's this quality growth, combined with efficient balance sheet, that underpins our long-term investment proposition of sustainable asset and dividend growth for our shareholders.

And as I look to next year and beyond, I believe we have a great opportunity to deliver much more for our customers whilst creating significant value for our shareholders.

So, finally, I want to cover the fourth driver - evolving National Grid for the future. As we know, the US and the UK both continue to decarbonise at pace. 2017 was the greenest year ever for the UK, with over half electricity generation coming from low-carbon sources, and similarly many states in the US remain committed to aggressive CO_2 targets.

The economics for solar, wind, and storage are becoming increasingly attractive, with further demand for clean energy coming directly from US corporates through PPAs. There is no doubt that the ongoing significant growth in large-scale renewables is set to continue into the long term.

So, for all those reasons, National Grid is actively engaged in the renewable space, which is creating new opportunities for us. In the UK, for example, we currently have around 100 connections in the pipeline from a range of new solar and storage customers. Similarly, in the US, at the distribution level, we continue to connect renewables for our customers.

In addition, utility-scale renewables also offer attractive opportunities. For examples, we connected the first offshore wind farm in the US, off Block Island, and we are in the process of installing a 6 megawatt battery on the island of Nantucket.

The strong ongoing growth in large-scale renewables is likely to generate further opportunities for incremental investment. The long-term contracted nature of regulatory underpinning makes them well-suited to the risk/reward profile of our portfolio, and they leverage many of our core capabilities, in engineering, product development, asset management, and finance.

The transition to renewables is likely to be closely followed by the electrification of transport, with many forecasters now predicting price parity with petrol and diesel cars by the early to mid 2020s. This brings with it some fantastic opportunities for National Grid.

For example, we've been in discussions with the government in the UK about how network investment will help address consumer's concerns about range anxiety, and I'll look forward to updating you on the progress on this in the near future. We are also active in the debate in the US, with more than 150 public charging stations already installed, and submissions made to our regulators in each of our states for EV investments.

National Grid Ventures has also set up a Technology and Innovation team based in Silicon Valley, that is assessing new technologies across the energy sector as it migrates towards more decentralised and digitised solutions.

So, overall, I believe the trend to decarbonisation provides multiple and exciting opportunities for National Grid.

So, in summary, last year we delivered strong financial and operational performance. We delivered 95% of our allowed return in the US, with significant regulatory progress, and we achieved outperformance of 200 basis points in the UK.

National Grid is in great shape and we are well positioned to capitalise on the significant growth that we see in the medium term. We continue to focus on efficient delivery and on creating value for our customers and our shareholders whilst being a leader in the energy transition.

Now, just before I move on to questions, I am pleased to announce that we will be hosting an investor seminar on the UK business in September, where Nicola and her leadership team will review the business and also update you on the latest developments in the RIIO T2 process.

The event will take place on 21 September in London and on 24 September in Boston for our US-based investors.

Thank you very much for your attention, ladies and gentlemen. Now Andrew, Dean, Nicola, and I will be happy to take any questions.

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Questions and Answers

Mark Freshney, Credit Suisse
Thank you. Just two questions. Firstly, on the US tax reform, what is the impact expected to be on operating cash flows? Because that's where the real adverse benefit is. And on the other side, what is the impact on overall asset-based growth? Because that's where the value generation is.

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Andrew Bonfield, Finance Director
Mark, on the inflows, cash flows, effectively at the moment it's about $180m we highlighted, which is the bill reduction, because effectively there's no offset. There are other filings still to come through, so we'd need to wait and see what those are, and then there's also to deal with the $2bn, because none of that has been dealt with yet.

At the moment, that $180m is about 50 bps on the RCF to debt metric which, as we said, was 10.6%, so still comfortably above that.

And then as far as actually rate base growth, the bonus depreciation over the years has probably reduced, we've had this conversation before, by about 0.5% a year on US rate base growth, by a build-up of deferred tax liabilities. So it could add about 50 bps to the US growth rate.

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Mark Freshney, Credit Suisse
And just to be clear, that's included within your slightly above 7% guidance for rate base growth for the Group?

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Andrew Bonfield, Finance Director
Yes. Yes, it is.

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Iain Turner, Exane BNP Paribas
Does that make you think again about how you financed the US business? Because obviously you do it all with debt at the moment and you don't pay much tax.

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Andrew Bonfield, Finance Director
Iain, there's a couple of things. Obviously, one which is around HoldCo interest deductibility, there is a question mark in the US, and that's still to be determined. Again, about that, ultimately at the end of the day we tend to look at debt as whole, and so what you tend to look at is, across the Group and the gearing at the Group level, where it sits within the individual entities is dependent upon what optimises, and also where you actually get the best financing rates.

You may see, over time, more funding move more to a Group level, because that may be a more attractive place for us to fund, but nothing's been determined on that yet.

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Deepa Venkateswaran, Bernstein
Thank you. I have three questions. So on the US, I think a year back you had said that the IFRS EBIT growth from '17 was around 7% to 2021. Could you clarify, maybe, from 2018, what you expect the EBIT growth to be, taking into account the tax ranges?

Second question is on the decision to discontinue the scrip dilution through buybacks. I was wondering, are there any factors which might lead you to reconsider it? I don't know, FID decisions on interconnectors, or otherwise, which might mean that you have more balance sheet capacity? So, just any movements around that?

And the third question is, are you thinking of doing utility-scale renewables in the US even when it's not part of the rate base? So are you thinking about solar or onshore wind, for instance, and are you slightly late to the game, at least, in onshore wind if that's the case? Thank you.

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Andrew Bonfield, Finance Director
Do you want me to do...

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John Pettigrew, Chief Executive
The first two.

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Andrew Bonfield, Finance Director
The first two. First of all, on operating profit growth, I mean the underlying operating profit growth will remain in line with the 7% we talked about before. The impact of tax reform is just - that's a bit of a wild card at the moment, because although we've already done some reduction, effectively we don't know where it's going to end up

through the rest of the rate filings, Deepa, so it's going to be, if we could just ask, actually probably by November we will probably be in a better position to indicate what those individual growth rates are. But the problem is, because we haven't done all the filings, it's a little bit early and we'll need those rate filings to be put in place to indicate where it is.

Effectively, excluding tax reform, the growth rate will remain at the 7% level, so that doesn't change. The fundamentals don't change. And don't forget, any reduction in billing is offset by a reduction in the tax rate, so effectively it's all one-for-one in the P&L.

Secondly, on scrip. As we said, effectively, given the level of growth, given the funding particularly of things like interconnectors, we are in a position where we're at the top high end of that growth rate and expect to be actually above the 7% for the next couple of years. That probably means that we are in a situation where the scrip is needed. We've always said, consistently, that 5-7% asset growth, you would need the scrip at the top end. The last few years we've actually been at the real bottom end. That's given us the capacity.

So a couple of things would need to happen. One, the growth rate would need to be lower. I don't think that's going to happen. And actually, the growth we're investing in, in things like interconnectors, is really positive for the long term. Remind you that interconnectors start to produce EBITDA in the 2020s onwards, which is at a point in time where we're coming through RIIO 2, so effectively that will help mitigate any reduction in returns in the UK at that time.

And then it's about performance, and it's really about do we generate incremental performance over the next couple of years, which gives us incremental cash flow opportunities. So those would be the biggest factors.

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John Pettigrew, Chief Executive
In terms of renewables, you know if you look over the last couple of years, we've been increasingly involved in investment, both on the regulatory perspective and the non-regulatory perspective, so we've got about 35 megawatts of solar in Massachusetts, or will do at the end of the year, which is connected to the network. We've been doing some joint ventures with an exterior on Long Island for network connected solar, and we're also looking at batteries as well, on, as I said, Block Island, but also in Long Island. So we've been looking at those types of investments.

From our perspective, what we look to do is to invest in assets that have got a strong regulatory underpinning or regulatory characteristics that allow us to take advantage of capabilities, as I mentioned the space around project management, engineering, financing, and so on. And we think large-scale renewables have a lot of those characteristics.

When you look at the US market, it looks like a very large-scale market over the next few years, so I don't think we're late to the game, but if there is the right opportunity we'll certainly look at it very carefully, but with the discipline in terms of investment that we always apply to all our investments.

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Dominic Nash, Macquarie
Hi, two questions, please. Firstly, on the Hinkley Point Seabank decision, you say you're exploring all options. Am I correct in believing that really you've only got three options, which are either you accept it, you go down a judicial review, or you go down a CMA referral? Or are there any others? And can you just give us what the pros and cons would be of the CMA versus the judicial review or others?

And secondly, I'm sorry, I kind of may have missed a bit but US GAAP numbers, you've alluded in the past that you might be prepared to come up with a Group US GAAP EPS number to add to the other EPS numbers, either for the Group or maybe as a stand-alone US division. Is that something you still have plans to do later this year?

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John Pettigrew, Chief Executive
Let me start with Hinkley Seabank. You would have seen in the response, because it's been published, that we felt very strongly that the returns that were being proposed through what Ofgem calls proxy competition were not commensurate with the level of risk associated with a significant transmission project connecting a nuclear power station.

So we have responded quite strongly to that. I think it's quite interesting that other parties in the industry, including the supply chain, have also responded quite strongly to that. So we're now in the process of, as usual, the consultation with Ofgem in dialogue and discussions. We are hopefully that Ofgem will shift their view in terms of what's an appropriate return.

Fundamentally, given where we are with the project, I think we feel the strategic wider works is the right route. We received planning consent for Hinkley back in January 2016, so the project is under construction. So, from our perspective, we're hoping that Ofgem will shift in terms of where their opening position was at the consultation.

If they don't, you're right, there are three options, and we will consider those options depending where we get to in terms of the discussion and consultation. At the moment, we're in that dialogue, so we're not at the point where we've made a decision, but the options that are available to us are to progress, we have a license obligation to do that, but we do have the option of going to the CMA and taking it for judicial review. I'm not going to get into the pros and cons of that, because I don't think that we're at that point yet. That's a way down the line. But those would be the options available to us.

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Andrew Bonfield, Finance Director
On the US GAAP numbers, I mean, I think first of all my team would probably lynch me if I promised that today, particularly given that I won't be here to have to deliver it.

Laughter

So yes, I promised it, Dominic. But I think the challenge there is actually around timing, and the problem, as I think I've indicated to you before, is - if we do produce the EPS number at the same time as we're trying to do the audit of the Group accounts, that just is a little bit complex.

We are looking still about how we can actually give you more transparency into the US. I think Andy and the team will be looking at that, and hopefully they will be coming back to you, giving you more indications later this year.

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Nick Ashworth, Morgan Stanley
Thank you. Good morning. Two from me. Firstly, just on the US, it's been a good year. RoEs have gone up, 95% of your allowances, which was I think a little bit ahead of the 90% that you were guiding for or hoping for. Is there any reason why, going forward, that number should change, and why it shouldn't get even a little bit better, given that we seem to be now in a process where all cases are being filed, you have new plans in place, and presumably you can keep refiling as and when you want? So can you be a little bit more colour around that, and what we should be really thinking about for RoEs in the US in the medium term?

And then your comment on the UK, and I don't know if this is something new or not. You were talking about the outperformance in the UK, and looking at operating costs, and what you're doing there to drive further outperformance. Is this something new? Is this something that was already baked in? I just wanted to get a bit more colour around that as well, please.

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John Pettigrew, Chief Executive
Yes, I'll start with the US. You're right. We've had a good strong year. I think it reflects, really, the strategy that we put in place a few years ago, to start to do what I call the drumbeat of regulatory filings. Through those filings, we've been able to get agreement in terms of an appropriate cost base as well as the strong investment that's been agreed with regulators. So on that side, that regulatory drumbeat is working for us. We've still got another couple of rate filings to conclude this year, in Massachusetts and Rhode Island.

But on the other side of it, I guess, has been driving the operation performance of the business as well. So, as you hear, we've established a capital delivery function, so we're spending $3.3bn of capex in the US, so we need to make sure that we're delivering it as efficiently as possible. So it's really about having the right regulatory framework together with driving the efficiency that allows us to earn those returns, to get us as close to that as possible. We're delighted to get to 95% this year. It was ahead of our expectations.

Our focus now is to get as close to the allowed returns as possible, so we will continue to make sure we've got the right drumbeat of regulatory filings, and that will continue at the end of the year with Massachusetts Electric, so we'll see the benefits this year of the filings we did last year, and partial benefit from Massachusetts Gas and Rhode Island, but some of the other ones will start to tail off. So you've always got that challenge of how can you drive efficiency to maintain those overall returns, and that will be the focus for us going forward.

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Nick Ashworth, Morgan Stanley

But there's no issues with going back and refiling? You're happy with how the process has been from this first iteration?

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John Pettigrew, Chief Executive
We're very happy with how the process has gone, and as I said in the speech, our aim is to drive the efficiency of the business that allows you to then get as close to the allowed returns for as long as possible. At the point at which we feel we need to increase investment, or the cost base is not being covered, we then go back in and do a rate filing, and that's the drumbeat that we now have in the US, and we have all the mechanics and processes to be able to do that.

In terms of the UK, the point I was making was, we do want to - we are looking at our operating costs, and we are looking into our processes and how we can use innovation to drive some of the system changes to drive efficiency. We're very conscious in the UK that affordability remains right on the top of the agenda from a political perspective, so everything that we can do to drive costs down for customers is helpful, and it also helps to deliver that 200-300 basis points. In the first five years of RIIO, we've delivered on that 200-300 basis points, and we want to make sure we continue to do that right out to the end of RIIO T1.

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Christopher Laybutt, JP Morgan
Thank you. Good morning. Just one quick follow-on from Nick's question. Is 95% the new 90% in terms of the aspirational target?

And Viking, Andrew, just a question in terms of the assumptions that you mentioned earlier. Is that capex included in the capex projections that you've already got internally? If that project goes ahead, will that be incremental to the growth that you've set out today, and just some more colour around that, please?

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Andrew Bonfield, Finance Director
As far as the £13bn I mentioned, it will be incremental of the spend over the period of time, over the next three years. What we do incur over that period of time will be incremental.

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John Pettigrew, Chief Executive
In terms of the percent you're allowed, I'm going to make Dean smile here. The challenge is to get as close, if not at, the allowed. We're not satisfied by 95% or 90%. Our goal is to get as close to the allowed as possible.

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James Brand, Deutsche Bank
Three questions, please. The first is just on the achieved RoE number you've given for the US, whether that includes tax reform benefit in that or not, and if so, what it is?

Secondly, on the guidance that you've given for outperformance for the UK business, or that you've reiterated at 2-3%, you've given that for a long time as a range looking through the period and looking at your portfolio of assets in the UK. But obviously, the gas distribution business being sold off, you're averaging closer to two for the transmission business in the UK at the moment. So, should we still see that range as it used to be, as an average over the period and across the whole portfolio, or should we see it as something more saying that you can at least achieve that 2% for the business that's remaining over the remaining years of the price control?

And then thirdly, given it's up to about 64% net debt to asset base here, and obviously you're flagging the scrip and you're retaining some of the proceeds from the remaining stake sale in Cadent, should we see this kind of level of gearing, of mid-60s, as being a ceiling or close to a ceiling for you? And are there other metrics you look at as well other than gearing? But any comments on that would be of interest.

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John Pettigrew, Chief Executive
I'll let Andrew do the first and the third. Let me take the middle one. So, in terms of outperformance, our focus is to continue to deliver 200-300 basis points of outperformance. That's always been there. Irrespective of when we sold the gas distribution business, we set out when we did that we would continue with that commitment of 200-300 basis points.

Within any particular year, you're always going to see variations on that. The opportunity to deliver that outperformance comes from delivering projects as efficiently as possible. There are more opportunities in some projects than others, depending on the engineering solutions, and therefore you're always going to get volatility within a year, but the commitment remains exactly the same, to focus on 200-300 basis points.

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Andrew Bonfield, Finance Director
On the first point, around the achieved RoE in the US, no, there is no benefit from tax reform. Tax, any change tax, is a deferral, so it's actually just put up in due regulatory, yes, it's a liability - IOUs, so therefore has no impact on the achieved return. So the reduction in the tax rate will actually be then hung up on the balance sheet as a reg liability. So US GAAP will have no impact.

Secondly, on gearing, probably as we've always said, mid-60s sort of percent gearing is probably the sort of high end of the gearing ratio range that fits our credit metrics. But it also depends on what the metrics are, and the cash flows associated with that, so the one we look at, as we always talk about, is RCF to debt. That's the most constrained metric that we normally have, which is the Moody's metric, so that's the one which will be the primary one. Gearing is secondary, but it does indicate whether there is balance sheet capacity as well.

As far as - you know again, just to reiterate, when we're looking at the balance sheet and the balance sheet capacity, this is about making sure that we have sufficient ability to fund the growth that we're going to see over the next few years. And just to remind you again, the value of the interconnector returns, they are very good high-returning businesses, but they don't have cash flows associated with them, so unlike regulatory investment, which has an immediate cash return, there is the lag. That is the bit that puts the pressure on the metrics over the next couple of years. But it's good investment.

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James Brand, Deutsche Bank
So there's no benefit from the fact that the tax rate has come down, but there's a lag in terms of revenue...

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Andrew Bonfield, Finance Director
It impacts IFRS accounts, but has no impact on US GAAP at all, because it straight goes into a reg asset and liability account.

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Fraser McLaren, Bank of America Merrill Lynch
Good morning. Just three questions, please. The first is about your relationship with Ofgem, and specifically if you think that a constructive dialogue on RIIO 2 might be hampered by the strong views which you both have on Hinkley?

Secondly, on the disposal of the remainder of Gas D, you've arguably struck the deal at a point of maximum uncertainty, both from a regulatory and a political perspective. Do you think you might have achieved a better price by waiting?

And then lastly, thinking about funding for growth, are you open to other disposals? Isle of Grain has been mentioned in the past as one that you might look at. Thank you.

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John Pettigrew, Chief Executive
Okay, so I'll start with the relationship with Ofgem. As we always have had, and we continue to have, we have a very constructive relationship with Ofgem. And I've directly had conversations with Dermot around making sure that, actually, they understand the rationale for why we're having a disagreement on Hinkley, but we need to continue to have constructive dialogue on RIIO T2, and that's exactly how it's playing out, so we feel very comfortable you can compartmentalise these things.

So we're having a strong discussion on Hinkley, but actually I think it is a very constructive conversation we're having on RIIO T2.

Our response, which will be published in the next few weeks, will show that we are very supportive of a large number of the elements that are in the framework, so we are very pleased to see that they're building on a lot of the good things from RIIO T1. We're very pleased, and in fact you know we've been advocating for much more involvement from customers and consumers in the building of the business plans, so that aligns very much with our own thinking.

There are of course areas that we disagree, in terms of the RoE range, for example. So I'm very comfortable that the relationship is one in which we can continue to have a constructive relation to RIIO T2 whilst having a challenging discussion on Hinkley. The second question, was disposal struck at the right time. Do you want to take that one, Andrew?

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Andrew Bonfield, Finance Director
I think, you know, there's always - it's the billion dollar question. With the benefit of hindsight, next week you can find something very different. But I think, generally, we're very pleased with the outcome. We think it's comparable to what we saw in the initial deal.

There was a slight reduction relating to expectations of returns, and lower control premium, but actually when we look at the outcome, we're very pleased with it and it's very comparable to the round 1.

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John Pettigrew, Chief Executive
In terms of the portfolio, our investment proposition is to grow the asset base by 5-7%, and our policy on dividend is to aim to grow it by at least RPI for the foreseeable future. That's our investment proposition. We look at each business in the Group to see how it's supporting contributing to that. That was part of the rationale why we took the decision to sell the gas distribution business, but at this point in time we're very comfortable with the portfolio mix that we've got.

It's obviously something the Board will review on a regular basis, but it's always against that context of the investment proposition that we have.

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Maurice Choy, Royal Bank of Canada
Thank you and good morning. Two questions. The first is just the guidance of at least 7% asset growth. Does that include a) Viking, and b) in slide 34 you've mentioned US$10bn of capex for the US, but only 90% is in a rate plan, does that include, I guess, the remaining 10% in your at least 7% guidance?

And second question is just on messaging for the capital that you're retaining from the scrip dividend. You mentioned this is only for the next couple of years, and I'm wondering, why wouldn't you just go beyond those two years, especially given, that number 1, you have most likely returns coming down FY'20, two, you've got US tax reform cash flow coming down once you assess all of the other jurisdictions, and number three 3, obviously, I assume you have more growth coming, especially on National Grid Ventures. So why just two years and not just go beyond? Thank you.

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John Pettigrew, Chief Executive
I'll let Andrew pick up the third. In terms of the first thing, Andrew referenced already, so it's not including Viking at the moment, so that would be incremental. In terms of the 90% of rate base, it's just really reflecting the fact that we've still got two rate filings going on this year, and as we look over a three-year period, actually we've only got two years left of our KEDLI and KEDNY rate filing as well.

Our expectation is the investment will be a similar level at the time we get to year three. We may well have to do another rate filing for that, so it really reflects just the rhythm and the timing of all the rate filings that we've got in the US.

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Andrew Bonfield, Finance Director
And as regards why only for the next couple of years, have we highlighted for the next couple of years, firstly because, actually, that's where we have the peak capex, over the next two years, we're above the top end of that 5-7% range. Obviously we'll need to look out as we get closer to that time, if there is incremental investment in NGV, that may make decisions, but at this stage that's not part of our commitment from an asset growth perspective. Trying to make that as clear as possible.

Secondly, we also have, obviously, RIIO 2 coming through. We have no idea of what that will be and what that means from a cash flow perspective, so this stage, to say we need to retain scrip for that, we don't know yet. So I think that would be wrong for us to say definitely no buyback, because again, it depends on resourcing, and resources we have, and the cash flows associated with the core business.

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Verity Mitchell, HSBC
Thank you. I've just got two questions. One is about gas transmission in the UK. We continue to see totex overspend, and I just wonder what your thoughts were compared with a much more stellar performance in electricity transmission?

And just secondly, sorry, back to the US and the debt situation. You've got negative outlook on three areas: NiMo, KEDLI, and KEDNY. How do you think about it from a bottom-up, top-down basis, and will you be looking at the rate filings to try and fix the tax-related downgrade that you had from Moody's in KEDLI and KEDNY, and how should we think about that?

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John Pettigrew, Chief Executive
I'll take the first one and give Andrew the second. In terms of gas transmission, I think we've said consistently, actually, that when we entered into RIIO T1, we knew it was a tighter price control in terms of the work that we would need to do from an asset health perspective. So we've always undertaken the investment that we believe will deliver the regulatory outcomes in terms of the norms, but also ensuring that we're maintaining the integrity and the reliability of the network. So that has required us to invest more than was the original allowances, which is why it's dragging down the returns.

On the flip side, actually, the incentives in gas transmission outside of totex have performed very strongly, which is offsetting some of that overspend on asset health.

Clearly, as we go into RIIO T2, we will be working quite hard to make sure that we get the right capital investment plans approved by our customers and with Ofgem, to make sure that we've got the right levels of investment for asset health going forward.

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Andrew Bonfield, Finance Director
And, Verity, on the impact on the individual OpCos, firstly, KEDLI and KEDNY were downgraded one notch, which actually brings them in lines with the other companies, so effectively that brings them in line with all the other Group companies.

As far as actually negative watch - that slightly is helpful in your regulatory conversations, because what it does, means you can go in to the regulator and say, actually some of the headroom from the tax reform actually can be reinvested in the business, and deal with some of the other regulatory assets and liabilities which may be on the balance sheet.

The reason why NiMo, we gave it back straight away, is we actually were in an over-collected position. In KEDLI and KEDNY, we have some significant reg assets sitting on the balance sheet, which we can have a discussion about. So that's part of that regulatory conversation.

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John Pettigrew, Chief Executive
Any final questions? In which case, I'll say thank you very much, ladies and gentlemen. As you've seen, I think we're in good shape, National Grid, we've got strong organic growth going forward. And I look forward to seeing many of you at the September investor seminar with the UK business. Thank you very much, everybody.

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