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National Grid

Half Year Results Presentation

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NATIONAL GRID

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Introduction

Aarti Singhal, Director - Investor Relations
Good morning, I'm Aarti Singhal, the Director of Investor Relations for National Grid. Welcome to our Half Year Results presentation and welcome to those who are watching this via webcast as well.

So this morning we're going to start as always with safety, there are no planned fire alarm tests, if you hear an alarm please make your way through these exits to the end of the hall. In your packs there is the cautionary statement, please take note of that as well.

As usual this morning after John and Andrew's presentations there will be time for Q&A and everything is available on the website and on the National Grid Investor Relations app and obviously the team and I are here if you've got questions later on today. So with that I'd like to hand you over to John. Thank you.

Presentation

John Pettigrew, Chief Executive
Thank you Aarti and good morning everyone. So before I start I'd like to introduce Nicola Shaw who is with us today who joined National Grid in July as our Executive Director for our UK business. So Nicola has extensive background in running infrastructure businesses and also brings strong regulatory experience and I'm delighted she's part of the team.

So now to the results. So when we were together in May I outlined both our short term priorities for the coming year, as well as the key drivers for our long term success. So today I'd like to update you on the progress we've made on both these areas. But first let me turn to our financial performance over the first six months.

As you can see it's been a good start to the year. Headline operating profit of £1.9bn and an earnings per share of 28.2 pence are in line with last year, which as you will recall benefitted from an unusually strong contribution from our other activities.

In line with our dividend policy the interim dividend will increase by 15.17 pence per share, representing 35% of last year's total dividend.

We continued to make significant investment in critical energy infrastructure across the Group. In the first half of this year investment increased by 12% to £2.2bn with a change in the foreign exchange rate accounting for around half of the increase.

As always our top priority is providing safe and reliable service to our customers and I'm pleased to say we've had a strong first six months. Across the Group our injury frequency rate of 0.1 represents world class safety performance. Of course this doesn't mean that we can be complacent and our teams will continue to work hard to further improve this performance in the second half of the year.

Across both our US and UK networks reliability has remained strong, demonstrating the benefits and significant investment made in recent years. For example this summer in the US we had a severe storm that interrupted service to more than 50,000 customers in Upstate New York. Through the investments that we've made and together with quick mobilisation of resources we were able to restore power to customers in less than 24 hours.

Looking towards the winter in the US we're well prepared for the challenges it may bring. And in the UK despite concerns over tight electricity margins, our system operator is also well prepared and has the tools in place to balance the system.

So let me now review the key achievements and developments across the Group starting with the US. As you know updating old rate plans and being able to file on a more regular basis is a key priority for us. And I'm pleased to say that this is progressing well and we're now starting to see positive outcomes.

In September for the first time since 2010 we secured a rate order for our Massachusetts Electric business, increasing revenues by just over $100m. This included a 9.9% allowed return on equity and over 90% of our requested increase to operating expenses. The new rates also increase the level of allowed capital investment by $79m to $249m per annum, whilst also updating the rate base to include all previously unremunerated capital expenditure.

With the new rates effective from the 1st of October this plan will allow us to significantly improve our returns for Massachusetts Electric.

Also in September we filed a joint proposal for our Gas businesses in Downstate New York, called KEDNY and KEDLI. The proposal was developed with the Public Services Commission and whilst we don't expect the final decision until December or January, we believe the terms put forward represent a fair outcome for our customers and for National Grid.

The proposal is for a three year plan that includes phased revenue increases across calendar years '17, '18 and '19. The plan proposes a 9% return on equity and gives us 85% of the requested increase in operating costs and KEDLI and 87% for KEDNY. It also includes a series of incentive mechanisms that will allow us to earn incremental revenue for exceeding performance targets.

Importantly the joint proposal provides for a $3bn capital programme over three years, reflecting the continued high levels of gas mains replacement and providing a clear opportunity for us to grow our asset base through organic investment. The level of capex will grow the rate base by around 9% per annum.

In addition it also allows us to progress four gas demonstration projects under the New York Reforming the Energy Vision plan, known as REV, and these projects will help to assess the viability of new technologies on the network, which is key to ensure that we remain at the forefront of new developments.

And in all our service territories it's absolutely critical that we work collaboratively with our regulators to explore, and where appropriate, implement new technologies that provide benefits to our customers.

So with three major filings substantially complete and representing 40% of our US business we made good progress on our regulatory strategy. And this progress also demonstrates that we now have the right systems and the right processes in place that enable us to file on a more regular basis across our US entities.

Next year we plan to file for the Niagara Mohawk businesses and the Massachusetts Gas business. We're also considering the timing of the filing for Rhode Island, potentially in last 2017 or early 2018.

Once these are complete around 90% of our US business will be operating under new agreements, supporting us in our drive to achieve returns as close as possible to the allowed level. And of course whilst we progress these filings and await new rates to come into effect, the US business will continue with its drive for efficiency to keep costs down and help to offset the impact of inflation.

So turning to the UK, starting with the progress that we've made on the separation of the Gas Distribution business ahead of the sale of the majority stake. I'm pleased to say that our work to separate Gas Distribution from the rest of the UK is nearing completion. This process has been complex given the scale of the business, and has covered a wide range of areas, including HR, IT, pensions, regulation and finance.

One major achievement has been securing attractive financing arrangements for the new entity. In September we raised the larger ever sterling bond for a non-financial institution of £3bn, as well as a 750 million Eurobond at an average rate of 2.2%.

We're also pleased to have reached agreement with the pension trustees to split the pension scheme into three sections. As part of reaching this agreement we'll bring forward some future contributions to the non-regulated section of the scheme in the form of a £250m cash payment to be made in early 2017.

The sale transaction itself is now at the advanced stage of the bidding process. We're pleased with the level of buyer interest and the process is on track to complete in early 2017. And as we indicated when we first announced our plans we expect to return substantially all of the net proceeds to our shareholders following completion of the sale.

So this will put the portfolio in a strong position to support higher growth and to continue to deliver attractive dividends whilst maintaining a healthy balance sheet.

So moving on to the main regulatory developments in the UK. We continue to work closely with the Department for Business Energy Industrial Strategy and with Ofgem to consider how to evolve our role as the system operator to meet the needs of the changing energy market.

We understand that there must be confidence that the role is performed independently of our TO activities, such that any perceived conflicts of interest are mitigated. And in doing so we believe it is vital that there is no disruption to the pivotal role that National Grid plays as the system operator in balancing the system. And we'll hope to hear from the government shortly.

Turning now to the mid period review where in August Ofgem its minded to position for the RIIO-T1 price control. National Grid welcomes Ofgem's continued commitment to the clarity and the certainty offered by the RIIO framework which is delivering important benefits for our customers. As expected the scope of the review was narrow and there were no changes to the financial parameters. It related to specific outputs in gas and electricity transmission with the changes expected to be implemented from April 2018.

And finally on regulatory developments I wanted to mention onshore competition. We remain supportive of competition where it's in the interests of the consumers. And we will do all that we can to ensure that the costs, the benefits, and the risks of competition are properly understood. We will continue to play an active role in helping Ofgem develop the regime and we're currently chairing a working group to develop and early tendering model as part of our overall contribution to the process.

One project that's likely to be considered for competition is the connection of the nuclear station on the Northwest Coast. Ofgem intend to run a consultation later this year to explore whether this project meets the criteria for contestability.

I believe if it is put out to competition our track record of delivery, our expertise, and our understanding of the needs of local communities, together with our customer commitment means we'll be well placed to be successful in competing for this project and for other projects.

So overall I'm pleased to report good first half results and significant progress on our key priorities for this year. I'll now hand over to Andrew who'll discuss the financial performance in more detail.

Financial Review

Andrew Bonfield, Finance Director
Thank you John and good morning everyone. As John highlighted our financial performance was good, particularly as we were running against a very strong first half of last year. Our businesses delivered solid performance with operating profit benefitting from sterling weakness and favourable timing.

Total operating profit of £1.9bn and earnings per share of 28.2 pence per share are in line with last year. Capital investment was £2.2bn a 6% increase in constant currency.

Our balance sheet and credit metrics remain strong and we're on track to deliver good overall returns and value added for the year.

So let me start by giving you an update on each business segment and an indication of where we expect returns to be at the end of the year. Starting with Electricity Transmission operating profit was £697m, up 14% compared with the first six months of last year. Excluding timing operating profit was £33m, or 6% higher due to additional allowances reflecting the increase in the REV. Capital investment of £586m was £72m higher as non-load related spend increased to ensure the business meets its RIIO outputs.

Overall we expect returns to be slightly down to last year's very strong performance. We expect to deliver another strong year of totex, albeit down on last year. And the business is on track to deliver slightly more from other incentives and a similar contribution from legacy allowances.

For Gas Transmission, operating profit was flat on a headline basis at £159m, which included £7m lower timing benefits. Gas Transmission stepped up capital investment to £116m in the first half, an increase of 27% over last year. This included spend on a large pipeline replacement project under the Humber Estuary and accelerated investment in asset health. As a result we expect a marginal overspend on totex.

Good performance in other incentives will continue but will be slightly lower in the prior year. And as I have discussed previously our legacy allowances will continue to decrease. This year they will fall by about 100 basis points and conclude by the end of next year, we therefore expect overall Gas Transmission returns to be lower.

Operating profit for UK Gas Distribution was £403m, down 6% and this included adverse timing of £19m. Operating profit, pre timing, was 1% lower due to increased depreciation. Capital investment was £268m, down £18m on last year.

Moving to totex the business expects to deliver a consistent level of performance reflecting continued efficiency in the repex programme. We expect a good outturn under annual revenue incentive schemes and our additional allowances are expected to be similar to last year. As a result we expect a slight improvement in overall returns.

Now moving to the US. Headline operating profit of £435m was up 12% at constant currency, including favourable timing. Excluding timing and foreign exchange movements operating profit was down £61m. This reflects higher healthcare costs and operating taxes and the write off of some old construction work in progress balances.

The benefit of the new rates in Massachusetts and New York will start in the second half, so expect underlying profit, excluding timing and the strengthening dollar to be slightly higher for the full year.

Capital investment was just over £1bn, up £39m in constant currency. This was primarily driven by increased spend on mains replacement. As we've previously indicated our overall return for the US is expected to be around 8% for the full year and from this year we will report our US returns on a fiscal basis to align with the rest of the Group.

We're often asked about US regulation and why we are happy to accept a 9% allowed return in the US when returns in the UK are in the low teens. So I want to take a few minutes to explain the differences in the cash and economic returns that we earn from our UK and US businesses.

Let me start by looking at the regulatory frameworks on each side of the Atlantic. In both the UK and the US there is need for significant investment in aging infrastructure to repair, replace and modernise the networks.

Our regulators understand this and in both geographies the objectives of regulation are aligned, first to act in the consumer interest and second to balance the regulatory risk and reward framework to encourage investment.

However, the UK and US methods for delivering this are - these objectives are different. Nominal regulation in the US benefits cash flow and real regulation in the UK benefits growth, both of which are important to value creation. This can be looked at by looking at a simple example.

This slide compares both the economic return and the cash return on the notional £1,000 of investment in our regulated UK businesses to the returns proposed in the new rate plans for KEDNY and KEDLI.

You can see that the 48% equity ratio in the US helps provide a greater cash return than the 38% equity in the UK. In this example we would receive £43 of cash in the US, compared to £35m in the UK. When added to post tax debt allowances in total the US returns £13 more cash than the UK. This difference is important for us as we need to maintain strong cash flow metrics to fund growth in our business.

Obviously in the US we do not have the benefit of inflation protection, which is a key feature of the UK regulatory system. In the UK inflation is returned through an uplift to the RAV and returned over the life of the assets, which keeps the company whole. For reporting purposes we use the long term average 3% RPI, even though actual inflation rates have been below this for the past few years. By adding the UK inflation to the total you can see that this tips the total return on an economic basis in favour of the UK, as shareholders are being compensated for accepting less cash from customers today.

As a reminder many of the UK incentives benefit the customer through sharing mechanism, and these have helped us generate £330m of savings for customers in the first three years of RIIO. Again, this is a very high level example of the economic impact of the key differences of our UK and US regulatory frameworks. Of course the key is to make sure that we deliver against these Downstate New York rate plans and we are confident we can do this.

I also appreciate that there are other differences, for example deferrals in the US and fast/slow money in the UK which I've ignored for purposes of this example. However, the fundamentals remain, the mix of cash and growth within each geography enables us to deliver both growth and yield which is important for delivering shareholders value.

UK customers defer some of the bill payments through indexation, which also supports the higher regulatory gearing ratio. In the US nominal regulation is attractive because it provides National Grid with a faster cash return. We believe this mix of cash and economic returns supports the balance in the portfolio between the UK and the US.

Looking at our other activities, I'm pleased that so many of you were able to join the seminar in September where we provided greater insights into these businesses.

As expected, half year operating profit of £157m was lower, reflecting decreased revenues from our French interconnector business and last year's gain on Iroquois gas pipeline.

Our metering and Grain LNG businesses continue to provide a good steady level of profit and we expect this to continue for the remainder of the year.

Operating profit in our traditional property business is down year on year as we had some significant site disposals in the first half last year. We expect overall profitability to be similar for the full year. And as discussed at the seminar, St William, our joint venture with Berkeley Homes continues as planned.

Finance costs of £523m were up 6%, mostly due to exchange rates. Excluding foreign exchange finance costs were down £4m. Our effective interest rate increased by 20 basis points to 3.9% including higher RPI. The effective tax rate was 21.7%, down 30 basis points from last year due to the lower proportion of US profits and earnings per share were flat at 28.2 pence per share.

Operating cash flow for the half year was £2.3bn; this was lower than last year as warmer winter weather in the US led to a lower receivable balance for collection in the first half of the year. As a reminder we typically see greater levels of cash generation in the second half, and we expect cash flow, excluding foreign exchange and Gas Distribution related activities, to be broadly flat for the reminder of the year.

Net debt increased by £3.9bn to £29.2bn, the stronger US dollar increased net debt by £1.8bn, which is offset by the revaluation of US dollar denominated assets. Net debt also increased by £0.7bn from debt buybacks which I'll talk more about in a moment.

In the first year we've raised over £4.5bn of new long term financing. In August our US operating companies KEDLI and Massachusetts Electric issued new debt of $700m and $500m respectively. And we continue to find innovative ways to fund our business. For example we have agreed around $750m in the form of credit loans for the Norwegian interconnector with the Italian and Swedish export credit agencies.

Our Treasury team has also been active in making sure that the financing for the new Gas Distribution company is substantially complete. As John mentioned we completed the record £3bn sterling bond and a further 750 million bond at an average cost of 2.2%.

Alongside funding the Gas Distribution entity we are also focused on managing leverage in the retained National Grid businesses. We have bought back debt with a book value of £2.1bn including swaps, for a total consideration of £2.8bn. This early repayment has resulted in a £718m exceptional charge, reflecting the acceleration of future interest payments. This is NPV positive, with the economic cost of the buyback being offset by avoiding the costs to carry on excess cash and expected proceeds from the sale of the majority stake in the UK Gas Distribution business.

Consistent with our policy the Board is recommending an interim dividend of 15.17 pence, representing 35% of our prior year full year dividend.

Scrip take up in August was approximately 14% and we will again offer a scrip option for the interim dividend. We will continue to manage dilution whilst keeping a close eye on the need to finance growth within our current credit metrics.

As normal we have included technical guidance to support you with modelling assumptions. The key points are we expect the UK to deliver 200 to 300 basis points of outperformance, with reduction in totex and legacy incentives in UK Gas Transmission.

In the US returns are expected to be around 8% for this year, ahead of the full year benefit of new rates in Massachusetts and New York.

And we expect our other activities for the year to return to more normal levels of performance.

So let me summarise, the financial performance across the Group has been good. Our capital investment has increased again. Funding for the new Gas Distribution business is almost complete and our financial strategy remains robust.

With that I'll hand you back to John.

Priorities & Outlook

John Pettigrew, Chief Executive
Thank you Andrew. So turning now to the priorities and the outlook. In May you might recall I shared with you four drivers that I believe are absolutely critical to the continued long term success of National Grid.

First our customers, every action we take must consider their interests as this will enable us to create value over the longer term. This is particularly important now when customers' needs are evolving and I'm focused on ensuring our customer first approach underpins everything that we do at National Grid.

Turning to performance optimisation in the business let me give you a good example from the UK. At the full year results presentation I shared with you an example of how we're optimising performance through our circuit breaker replacement programme, saving over £100m. Over the last few months we've applied the same principles to our transformers by reviewing our end to end replacement process. This has included challenging our approach to engineering design, how we undertake procurement, our contracting strategy and installation methodology.

This has resulted in opportunities to lower the unit cost by up to 30% and to reduce the timescales for replacement from over 20 weeks to just 12. Over the remaining RIIO period this is expected to save £140m with around 50% of it being shared with our customers.

In addition this approach has the added benefit of reducing the number of outages on the network and therefore also improving reliability for our customers.

Moving on to our near term growth opportunities as you know our aim is to grow our asset base by 5 to 7% per annum, assuming UK inflation of 3%. To meet this aspiration we're focusing on two key areas. Firstly, we'll continue to invest in our core regulated assets where we have strong growth potential. Over the past three years we've invested more than £10bn in these networks. And this year we expect to invest around £4bn.

The investment is needed to deliver asset health, network expansion and modernisation and we expect the current levels of spend to continue over the medium term. Ultimately all of these investments will enable us to deliver safe, reliable and affordable service to our customers.

And secondly, we're also looking for opportunities to increase the level of investment in our other activities segment. As we outlined to investors in September we see a number of opportunities, such as the additional 2.4 gigawatts of interconnector capacity, with two new interconnectors to France and to Denmark. A pipeline of commercial transmission opportunities at various stages of development associated with connecting renewable energy. And developing our surplus property portfolio, including the St William JV, where we expect to complete the sale of Fulham in 2018 which will significantly boost the profitability of our property division.

In addition we're also considering further investments to smart meters, solar and storage. It's clear to me we must take incremental steps today to maximise value for the long term. And whilst we have several opportunities outside our regulated asset base we'll only allocate capital to those opportunities that drive the most shareholder value.

Finally let me update you on the evolving role of networks and the steps that we're taking to best positon National Grid for the long term. As you know over the last decade the drive for cleaner energy has led to significant investment in renewables. And this has resulted in much improved economies for distributor generation and more recently for storage. As the International Energy Agency has reported, renewables have now overtaken coal as the world's largest source of installed power capacity.

In addition, as I said earlier the needs of our customers are also changing. They are much more engaged and at the heart of our energy system, not at the end of the value chain.

So what does all this mean for our networks? Well I believe it creates clear opportunities. Just taking Electricity for example where change if most prevalent, significant investment will be needed to reinforce and modernise the distribution networks to cope with dynamic power flows and also to add intelligence to the network which is critical for enabling much of the innovation at the customer end.

And similarly in Electricity Transmission will also require investments with new sources of grid scale renewable power being connected and further interconnection is established between markets.

National Grid is responding to all of these changes, for example in our role as the system operator in the UK we're always seeking to find new ways to optimise the system and adapt to changing demands, whilst delivering savings for our customers.

In August we entered into contracts to supply split second power to the electricity system using battery storage. These were the largest contracts of their kind in Europe, helping to address the challenges created by the growth of renewables.

The contracts provide about 200 megawatts of enhanced frequency response at less than half the cost of the alternatives and are expected to generate significant savings of around £200m.

We're also at the forefront of developments in the US where we have a large distribution business that’s close to the end customer. One example is our growing distributor generation connections programme in Massachusetts which has made us one of the top ten utilities in the US for facilitating solar connections.

In addition our proposed New York and Massachusetts modernisation plans, which are designed for investment in technology upgrades ranging from smart meters to system automation, could result in over a billion dollars of investment.

So overall as you've heard we’re actively engaged in responding to these changes but we need to do more in order to keep pace with developments. To achieve this we’re enhancing our innovation and technology developments and capabilities through direct initiatives and partnerships such as our investment in Energy Impact Partners, a utility backed venture capital fund which brings us closer to entrepreneurs at the leading edge of the industry. So with our focus on the key drivers for long term success of putting the customer first, performance optimisation and growth, we’re taking the necessary steps across the Group to ensure that National Grid is strongly positioned to evolve for the future.

So in summary we delivered good financial performance and we made significant progress with our near term priorities. In the second half we will continue to focus on these priorities as we work to finalise KEDNY and KEDLI rate filings, to complete the sale of a majority stake in our Gas Distribution business of course subject to value, whilst we continue to seek new opportunities to grow the business.

So thank you very much ladies and gentlemen for your attention and Andrew and I will be happy to take any questions.

Questions and Answers

Iain Turner, Exane BNP Paribas
Can I just ask what the capital structure of the Gas Distribution business will actually look like when it comes to sale? You may have given us enough detail in what you've said but can you just summarise what it will look like and does the business have a name yet?

Andrew Bonfield, Finance Director
At the moment it is National Grid Gas Distribution so a very creative name. At the moment the entity itself will have a 65% structure because that's what the regulatory gearing is. Obviously some buyers will look at different gearing options but they will be at a higher level within the ownership structure and that would depend on the individuals who may or may not be interested. So at this stage the entity itself will be geared around the regulatory level.

Iain Turner, Exane BNP Paribas
Is that an external debt ...?

Andrew Bonfield, Finance Director
In the entity itself that is where we've raised most of the £3.6bn and there is other debt being transferred in as we speak and going through that process. So most of that will be externally funded. There will be some bank debt in there as well.

Mark Freshney, Credit Suisse
I have two questions. Firstly on the bond buyback which post tax net proceeds or net cost is half a billion pounds. The benefit will mostly I guess appear in the sale price for the Gas Distribution business so when you get a higher price, all else equal, will you return those net equity proceeds, i.e. are you keeping the half billion benefit - cost on balance sheet and returning the proceeds to shareholders?

Andrew Bonfield, Finance Director
Let me explain the first part. So obviously because we're only selling a majority stake first of all the £500m you're referring to, some of that actually is within the entity itself so a portion of that will be reflected in the sale price for the 51%, but we're not selling 100%, you won't get full reflection because some of that will flow through in the 49% minority stake we continue to hold Mark.

There is also some of the buyback was in National Grid Electricity Transmission so some of that will be reflected in lower interest payments going forward rather than purely in the prices.

When we look at what we will do obviously we will take into account the costs incurred in the transaction, effectively doing the debt buyback is a part of the cost so we will reflect some of that but it will be the proportion relating to the 51%.

Mark Freshney, Credit Suisse
Okay thank you. And secondly on the electricity system operator, negotiations with the government or discussions should I say seem to be prolonged, can you give us any colour as to what the preferred options are for increased system operator independence and what you think will happen in the outturn?

John Pettigrew, Chief Executive
So let me pick that out Mark. So the process is continuing Mark, so as we talked about previously, as the role of the system operator has evolved and developed there has been a recognition that we have to demonstrate independence in the market. But we've always taken putting the control - we've always taken seriously having the right controls in place. Over the last few months we've had discussions with the regulator and Ofgem. I've personally made it very clear that I don't think moving to an independent system operator is the right thing at this stage in terms of the evolution of the energy sector with so much going on but we'll continue those discussions and I'm hopeful, as I said in my speech, that we'll come to a conclusion relatively soon.

Mark Freshney, Credit Suisse
Thank you.

Deepa Venkateswaran, Bernstein
I have two questions. The first one is on the foreign exchange devaluation. Just wanted to understand what percentage of your UK capex is euro based or dollar based to the extent that you're - I guess nothing much is manufactured in the UK, and how hedged are you and should we then start seeing that dip into totex performance, I don't know, three years hence?

And the second question which is more broad for the UK in your role as the SO, so this winter we're obviously seeing big spikes partly because of some plans being in SPR and the French situation. Looking forward if these SPR plans partly come back to the market because of capacity markets but then there'll be equally be some diesel peakers and gas peakers as well which you'll include in your firm capacity, so what kind of a system are we look a year out? Again would these diesel peakers be actually selling prices in a few hours or how do you think about that?

John Pettigrew, Chief Executive
So let me pick up briefly on the first and Andrew can add to it. So in terms of our capital investment plans, so first of all with the exchange rate reduction that we've seen we've not seen any increases in prices coming through yet. We generally don't hedge our capital investment plan apart from our major projects. So where we've got some of our major projects such as interconnectors quite often we do hedge that exchange rate risk, but we're not seeing that price effect coming through at this stage.

Andrew do you want to …?

Andrew Bonfield, Finance Director

Well also I mean obviously some of this will flow through into higher inflation which will effectively we get real price effects anyway so we will have to wait and see, but obviously depending on what we can do from a procurement angle as well.

John Pettigrew, Chief Executive
So in terms of the system operator role, so the current position is, as we set out in our winter outlook report, is the expected margins across this winter are 6.6%, that compares with 5.1% last year. So we've described that as tight but manageable. We have we believe the right tools to be able to balance the system. Clearly we've seen some volatility recently, that's partly explained by I think the events that are going on in France, so we're very aware and I've talked to our counterparties in France about their plans to do the safety checks on the nuclear plant.

They've told us that their intention is to phase that so there's no more than three to four gigawatts of French plant out at any one time, so we've looked at that in terms of the impact in the winter and we would expect the French interconnector to flow broadly over the course of the winter in normal weather. There may be circumstances when it's cold here and cold in France where actually we see a reduction in flows on the interconnector, but actually that's where SPR does come in. So SPR is effectively an insurance policy and we've got 3.5 gigawatts of strategic balance reserve for this winter that we can call upon if we see either a reduction in the flow on the interconnectors or indeed we see a reduction in availability of domestic generation.

Looking forward to 2017/18 I think the answer to your question is really dependent on what's the outcome of the capacity market auction in January. So obviously the government has announced that there is going to be a capacity auction for '17/'18. National Grid in its role of system operator will facilitate that but as yet we don't know what the outcome of that will look like and exactly what generation will make itself available.

Given that though we shouldn't be expecting to see strategic balancing reserve in '17/'18 winter. You know it was always intended to be an interim product and with the capacity market coming forward in '17/'18 we shouldn't need it.

Ashley Thomas, Societe Generale
Two questions, one on EFR and the other one on capped market demand. On EFR John you highlighted and you suggested the cost is half of the alternative. Simplistically it looks like sort of £9 per kilowatt and I assume the alternative is FFR at about £40 per kilowatt, so to me that sort of seems materially below half. Is there another alternative or is there another way to think of it and could battery storage basically replace FFR in the future, i.e. could that £40 go down in the future?

John Pettigrew, Chief Executive
So let me just give a bit of the background to the fast frequency response. So as the network has evolved and we've seen more intimate generation the system operator is continuously looking for new products to be able to balance the system efficiently. We identified a need for a really fast acting frequency response service so we put a tender out. We received about 1.2 gigawatts of responses to that tender against a need for around about 200 megawatts. So what we've ended up doing is contracting for about nine different parties for the 200 megawatts.

The price that was bidded, so it was very competitive, was a very strong price that means we identified the opportunity to save about 200 million for customers. How we calculated that saving is really to look at what would be the alternative if we needed to provide it from other than the battery storage. And the reality is it's not a one for one, so actually because it's fast frequency response, in order to have the same capability from traditional frequency response you probably need to buy about four times as much, and therefore that drives the value for us as well as the unit prices were quite competitive as well.

Ashley Thomas, Societe Generale
Great thank you. And the second question is just on capped market targeted demand. You recommended a 900 megawatt sort of reduction to the earlier demand level and the government decided on just a 300 megawatt reduction for the 2020/'21 T-4. What was the main sort of difference in view? I think it's down to embedded generation not in the capacity market and is that difference in view just sort of one off for 2020/'21 or is there a sort of more sustained difference in view?

John Pettigrew, Chief Executive
No nothing was sustained; I think it was just an update reflecting better information. I don't think it was anything more complicated than that so we'd done our analysis, we'd submitted the information, there was some new information that came in that was updated and they reflected that. So I don't think there was anything fundamental to it.

Ashley Thomas, Societe Generale
But you're just taking a more - they're taking a more conservative view than you are?

John Pettigrew, Chief Executive
No I think they just had some additional information that they then reflected in the same analysis that we'd done. So I don't think there's any difference in view.

Jenny Ping, Citi
Two questions. I know it's early days yet but I was just wondering whether you can give a sort of feel of where your thoughts are post the US elections? Clearly there's a lot of moving parts and not all of us know what actually the new President-elect actually thinks about various policies but just to give us a feel what level of the capex and the RAV growth are set within the federal levels presumably mostly versus at the top level? And also on the - from a big picture corporate level whether there's any tax, corporate tax changes which you would expect that to come through?

And then secondly Andrew just for clarification, so when you come through to give us a RAV premium number on the day you announce your disposals for the Gas Distribution assets, will that include or exclude the 700 million buyback? Thanks.

John Pettigrew, Chief Executive
Shall I start with the question on the new President, President-elect in the US? So I think, to be fair it's early days I think we'd say in terms of doing our assessment of what exactly it means. I mean it was interesting yesterday I think that there was quite a positive statement that came out from the Trump administration in terms of infrastructure in the US and the need for infrastructure in the US so that's positive for us as well as other sectors as well. But I think we need to see what the detailed policies are to get a really good understanding of exactly what it means. It's worth remembering that the vast majority of our business in the US is Electricity Distribution and Gas Distribution. Gas

Transmission makes up about 10% I think. And therefore state regulation and state political relationships are really important and I'm going to ask Dean to possibly say a few words on that.

Dean Seavers, President, National Grid US
Good morning. One, I agree that the infrastructure comments are encouraging but I'd echo the piece that John said about the local business. I mean our business model is basically non-partisan, so our business model starts with the customers. So for us it really, while we've got the federal relationships and they're strong, this really is at the state level in terms of policies and we think about what's going on Massachusetts with the clean energy RFP coming out as well as New York with the reforming the energy vision that John talked about, we've got great relationships there. So we're still encouraged about what we're doing for our customers.

Andrew Bonfield, Finance Director
As far as the RAV premium is concerned I think we will give you information which will enable you - whether it's allocated as a cost or part of the reduction in premium. I don't think it really matters, it's what's the net proceeds is ultimately what shareholders are going to be interested in, but it will be part of the - it will be reducing part of the net proceeds so that will be part of how we would look at it.

Dominic Nash, Macquarie
Two questions please. Firstly going back to the exchange rate and sterling, that obviously will impact RPI at some point and it should also impact your COPI I think you alluded that with an earlier question. Is there any protection in place if the two numbers start to diverge where you either have like high RPI low COPI or high COPI low RPI that you can either claw back from customers or customers can claw back from you?

And secondly going back to this debt refinancing and also wrapping it into the iBoxx index, do you think the ten year iBoxx index is actually fit for purpose within your structure? As we go to the end of the review I think we're going to get a negative iBoxx number, it's starting to looking increasingly likely. And if you're having to refinance debt in order to try and keep up with it or is that a strategy that you should do or should you be pushing for a longer iBoxx index along the lines of say the water sector is moving down?

John Pettigrew, Chief Executive
Do you want to do iBoxx first?

Andrew Bonfield, Finance Director
I was going to say on the iBoxx what we try to do Dominic and we've said consistently is actually measure against the spot, that's really what we've got to measure against on the issuance date you can actually measure it, so over time that should then give you performance which is at least in line or better than the index. So if you issue under the spot, even though at points in time the average may be above or below where you are, over time you should equalise up against that. So I think it's more - we're very focused on that.

As to whether the iBoxx is fit for purpose I think that's a decision that Ofgem will need to make and think about whether it does track correctly. I mean there are some differences obviously between our rating, the rating in the index, the length of tenure of our debt, the length of tenure of the index itself. So I think anything that just encourages companies to try and actually manage the liabilities better across - is good, so if it was - I would probably agree with longer term financing if we can because ultimately that does drive stability in the business over time which is what we're trying to get because this is a long term business model. But that will be an Ofgem decision.

John Pettigrew, Chief Executive
And in terms of your first question Dominic, I mean RIIO is designed to provide clarity and certainty over that eight year period. So there are certain elements that do adjust and RPI is one of them. There are certain ones that were a part of the overall package effectively that we're signed onto in terms of this is the cost and these are the outputs, so there isn't an adjustment for exchange rates or import inflation through construction and things like that. You know there are real price effects assumed in the real model and that was part of the eight year price control that we accepted back in 2013.

Dominic Nash, Macquarie
What proportion roughly could you give us - quantify of your capex is imported?

John Pettigrew, Chief Executive
I haven't got the number to hand, I don't know if you've got the number to hand?

Andrew Bonfield, Finance Director
No.

John Pettigrew, Chief Executive
We can come back to you on that Dominic, exactly what it is. But as I said we're not seeing evidence of increasing costs coming through to date.

Andrew Bonfield, Finance Director
And there still are other things we can do then ultimately at the end of the day around for procurement which can help you create innovation, and back to the things that John was talking about as far as the transformer is a great example of that where it's a mixture of both performance from a procurement perspective and also looking at the engineering and leaning out the processes much better.

Ed Reid, Lazarus
I think in the past Grid has talked about potentially a doubling of BSUoS costs over the next five years. I was wondering whether the outcome of the EFR has changed your view or you still think that is likely?

John Pettigrew, Chief Executive
I mean it links back to what I was talking about in terms of what's going on in terms of balancing the system. So it's clear, I mean I quite often quote that 2015 was the last year that we operated the system in the way that we've operated over the last 50, and that just reflects the amount of

intermittent generation we're seeing, the amount of solar we're seeing on the network. And therefore the products and services that we're having to develop to make sure that we can maintain frequency and voltage are shifting, we're having to develop new products and services. And also as we've seen in the last year the generation market is also looking to balancing services as a source of revenue as well.

So our expectation is that it will continue to increase. Things like the tender are good news, you know they're good news for customers because they came in at a price that I think was very competitive and perhaps a little bit surprising. We have a process with Ofgem where we have to assess those costs on an either annual or every other year basis and we will do an update in the next few months actually in preparation for the next BEIS scheme. But we are seeing increased BSIS costs, there's no doubt about it.

Ed Reid, Lazarus
Thank you.

Analyst - Mark
Two detailed questions. The first thing is on the 5% to 7% asset growth aspiration can you confirm if that still only applies to the regulated grids or whether it would also apply to some of the other non-regulated investments such as the interconnectors?

And secondly on the change in reporting date for US returns. I think previously you've reported as at December, now you're hoping to move to a fiscal yearend. What would the comparator have been for last year?

John Pettigrew, Chief Executive
So in terms of the first one, the 5% to 7% relates to our total growth so it does include our non-regulated businesses as well.

Andrew Bonfield, Finance Director
Yeah as far as we will give you both pieces of information Mark. The reason to do this actually is to save the CEO and CFO having to explain to every investor the difference between calendar and fiscal year every time we get into a meeting on what the ROEs are. It actually means we can actually do it now on a consistent basis, but we'll give you the information. We will probably - the point to note, and I know that some people are saying well is this is an issue about what happened in the fourth quarter of last year on a fiscal basis, we did see returns low in the US and that was because of the mild winter weather. So we did still have non-decoupled revenues in KEDLI and KEDNY, because of the mild winter we did see a lot tick down. So you will see it slightly lower than the 8% than we talked about on a calendar year for a fiscal year basis for 2015/16.

Maurice Choy, Royal Bank of Canada
Two questions from me. If I recall correctly two years ago there were some discussions about introducing a RIIO styled regime in the States, and if I recall correctly National Grid perhaps might have sent a team to help educate and discuss that with some of the PUCs in the States. I wonder whether if you could help us understand if that discussion is still ongoing, and given Andrew's discussion about a balance between growth and cash between UK and US regulation, if there is a

RIIO style regulation in the States would that be in the best interests of National Grid assuming it's value neutral to the customers?

Second question is just a quick question on the SO. If you could just help us understand what asset base if any this business has? Thank you.

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John Pettigrew, Chief Executive
So in terms of the price controls and rate filings in the US I mean our focus has been very much to get ourselves in a position where we can do them on a regular basis and have a drumbeat. So we have had conversations with the regulators both in Massachusetts and downstate New York as part of doing the rate filings. And although we're not in a RIIO style environment in the US, actually we have agreed with the regulator, particularly in downstate New York, some new incentives which are linked to outputs. So I mentioned in my speech that there are some incentives in KEDLI and KEDNY that actually give us some upside of potentially 0.3 to 0.4 basis points to outperform on our replacement programme or the unit costs and also to reduce the amount of leakage that we have on our networks.

So although there hasn't been a substantial shift in terms of the way that the US regulators think about it, they are actually putting in some incentives which are outputs based which is very much based on RIIO. From our perspective the principles of RIIO we feel are very strong because it aligns the utility and what we do with customers, and therefore we continue to promote the principles of RIIO both in the UK and the US.

The second question so it was on the SO.

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Maurice Choy, Royal Bank of Canada
Asset base of the SO.

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Andrew Bonfield, Finance Director
The asset base it's about £250m.

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Chris Laybutt, JP Morgan
Just one question on yesterday's asset sale process which we discovered SSE retained around 20% of the funds that they received in terms of equity funds. Could you give us a guide as to what you deem to be substantial at this stage in terms of the return of funds to investors please?

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Andrew Bonfield, Finance Director
Substantial means substantially, it means the vast majority. I think we haven't defined that. I mean one of the things we will be doing is actually engaging with shareholders through the next few weeks as to how we're going to do it. So there's a mechanism issue that we need to determine and also actually to get what they think because there are some shareholders for example that actually don't want us to distribute anything, so we will actually go through that dialogue process. But it will be substantially all.

Laughter

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Sam Arie, UBS
I just wanted to move to a question on I guess the UK political/policy background. And I think many of us would have the assessment that National Grid has done an amazing job in recent years of keeping out of the limelight in a period where the media and politicians have focused intensely on the supply part of the value chain. But going forward as you said systems getting more expensive to manage and consumption has been coming down so grid costs are increasing as a proportion of the bill. Do you have any sense of the sort of political environment for you in the UK becoming tougher or what more generally are your expectations in the next few years?

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John Pettigrew, Chief Executive
So I think one thing that's really important to remember is that the real principles that we've put in place and have worked on really do align the work that we do as a utility with customers' interests. So if you look over the first three years of RIIO then actually because of the way that that's structured we're able to return about £330m to customers through innovation and outperforming on the outputs. So I think in terms of the overall environment in which affordability is incredibly important, our focus to make sure that we're driving down the efficiency - driving the efficiency of our business to minimise the impact on customer bills is something that, as I said in my speech, is running through the DNA of the organisation.

So I think the fact that we're able to articulate that and explain that to people is important and we'll continue to do that. We've established very good relationships with BEIS, you know I was very pleased to see that they brought together energy with industrial strategy, I think that's the right thing to do and we've got good engagement with ministers and with civil servants on all aspects of the changing energy environment.

Okay if there are no more questions; okay in which case thank you very much for attending today. As I said in my speech a good first six months and we'll look forward to seeing you all in May.

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