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## National Grid

Full Year Results Presentation
19th May 2016

## NATIONAL GRID

**Aarti Singhal, Director of Investor Relations**

**Sir Peter Gershon, Chairman**

**John Pettigrew, Chief Executive**

**Andrew Bonfield, Finance Director**

## QUESTIONS FROM

**Mark Freshney, Credit Suisse**

**Bobby Chada, Morgan Stanley**

**Dominic Nash, Macquarie**

**Deepa Venkateswaran, Bernstein**

**Edmund Reid, Lazarus Partners**

**Iain Turner, Exane BNP Paribas**

**Lakis Athanasiou, Agency Partners**

**Verity Mitchell, HSBC**

**James Brown, Deutsche Bank**

**Peter Atherton, Jefferies**

**Analyst, Bloomberg Intelligence**

***Introduction***

**Aarti Singhal, Director of Investor Relations**
Good morning everyone. I'm Aarti Singhal, the Head of Investor Relations for National Grid. It is my pleasure to welcome you to our full year results presentation. As always we're going to start with safety. If you hear a fire alarm it's not a test, it's for real. In case of emergency please use the front exits, turn left and go to the end of the hall. The other important thing to take note of is the cautionary statement which is included in your packs.

For those of you who are joining on the web thank you for watching the webcast. All the material is available on the website or the Investor Relations app.

So thank you very much for your attention. I'd now like to hand you over to our first speaker, our Chairman, Sir Peter Gershon. Thank you.

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**Sir Peter Gershon, Chairman**
Thank you, Aarti. At the half year results presentation last November I said a few words about CEO succession, and said that Steve isn't going yet and still has the second half to deliver.

The results we are announcing today mark a strong finish to Steve's leadership of National Grid. Steve stepped down at the end of March as CEO and handed the baton on to John Pettigrew. Steve has made an outstanding contribution to the Group over his fifteen year career with National Grid, including over nine years as its Chief Executive. The Group composition has changed significantly over that time with outstanding total shareholder return delivered during his tenure as Chief Executive.

To my mind the real test of a CEO is the quality of the team and the business that they leave behind. The results today should give you confidence that the business is in great shape and the Board and I are delighted with the strength of the leadership team that we have in place to take this business forward.

John Pettigrew has spent his whole career at National Grid in key roles throughout the group both here in the UK and in the US, and I am confident he will prove to be a great successor to Steve.

As you will have seen, we have also announced that Nicola Shaw will be joining to head the UK business on 1st July. Nicola brings with her enormous experience in the fields of regulation and infrastructure investment, and alongside Andrew and Dean completes a very strong team of executive directors.

So many thanks to Steve for his hard work, his commitment, his drive and focus which have not only created great value for shareholders but also for his leadership which has made National Grid the trusted and responsible company it is today.

Now that is quite enough from me. So over to you, John.

## *Presentation*

**John Pettigrew, Chief Executive**
Thank you, Sir Peter. Good morning everybody. Let me start by adding my own thanks to what Sir Peter has already said in just recognising Steve's tremendous contribution to National Grid over the last ten years. I am very proud to be taking over a business that's in such good shape, as demonstrated by the results that we've announced this morning.

Let me pick up on the main highlights of those results. So as you can see here it's been another year of strong performance. Headline operating profit of £4.1bn is up 6% from last year, driving earnings per share up 63.5 pence and group return on equity increasing by 50 basis points to 12.3%. In line with our dividend policy we're recommending a final dividend of 28.34 pence per share, bringing the proposed full year dividend to 43.34 pence, an increase of 1.1% reflecting last year's average inflation.

We continue to invest significant capex in infrastructure across the UK and the US. Last year we had the highest level of capital investment for the group, £3.9bn, up £364m from the prior year. Looking ahead we expect to maintain the high level of investment in existing and new assets.

Overall despite the low level of inflation last year's capital spend resulted in our combined RAV and rate based growing by 4%.

Safety and reliability remain our top priorities, and I'm pleased to say we've had one of our best years for safety performance across the Group. In the UK we have improved our key measures including our employee incident frequency rate, which at 0.07 benchmarks as world class. In the US we continued a positive trend. This year we saw a double digit of over 20% in most of our key safety metrics, and this has been achieved despite a higher level of operational activity. Moving forward our aim is to build upon this positive momentum with safety continuing to be at the heart of every activity we undertake.

As for reliability across our networks, this has remained strong throughout the year. In the US our electricity distribution network delivered solid performance with continued recognition of our storm response. And in the UK despite the ongoing concerns over tightening electricity margins our system operators managed these challenges extremely well.

So let me now review the key achievements and developments across the group, starting with the UK.

We have successfully maintained our strong track record of operational and financial performance. We reached major milestones on construction projects such as the London Power Tunnels where we commissioned the first high voltage sub-station in London for over 20 years.

Financially the UK businesses performed very well, with another good year of totex outperformance. This was achieved by our continued ability to find innovative and less expensive ways of delivering on our commitments. We also earned over £100m in incentives for outperformance against our key reliability, environmental and customer service targets.

One example I'd like to highlight where innovation has reduced costs for customers is our circuit breaker replacement programme where we piloted a new approach. Through a combination of lower procurement costs and a new engineering design we are now able to carry out circuit breaker replacements in half the time, and at half the cost. So far we've successfully completed ten trials, and overall we expect to generate future savings in excess of £100m through this new approach.

It's important to note that our achievement benefits our customers as well, as around 50% of those savings are shared with them. To date under RIIO the customer share savings is under £330m with '15/'16 being the first year when customers started to see those benefits.

Moving on to our other activities, as we outlined at the half year results our interconnector, property and other businesses have performed strongly, demonstrating the growing importance of these businesses for our Group. We have started the construction of new interconnectors to Belgium and Norway, and we're in advance stages of considering two further projects with France and with Denmark. I believe these interconnectors, together with metering, LNG, and property, present attractive opportunities for National Grid.

So turning now to regulation. As you know, Ofgem recently announced a mid-term review. As expected the scope of this review was narrow, with no change to key financial parameters. We welcome Ofgem's continued commitment to the clarity and the certainty offered by the eight year RIIO framework. Ofgem will run a consultation process this summer with any changes to be implemented in April next year.

The other important area Ofgem is consulting on is the extension of competition in electricity transmission. We have been very clear in our responses to Ofgem's consultations that any changes need to be in the interests of customers. We will continue to use our experience to inform this debate and strive to ensure that any proposals implemented are robust and can deliver value.

In addition we have been working with DECC and with Ofgem to consider how we evolve the current system operator model to make it more independent whilst remaining cost effective. In doing so we believe it's vital that there is no disruption to the pivotal role that National Grid plays as system operator in balancing the network.

Finally we are starting the process of separating the UK Gas Distribution business to prepare for the sale of a majority stake. This process is now on track with completion expected in early 2017. I will discuss it in more detail in the second part of my presentation.

So let me now turn to our US business which has delivered returns in line with expectations. Our team is concentrating on efficiency improvements which will help to manage our cost base ahead of new rates coming into effect. Overall total investment was a record £1.9bn contributing to a US rate based growth of 7.5% excluding movements in working capital. The higher level of investment reflects the strong growth potential of our US business driven by the need to replace gas mains and reinforce the electric systems across our regions.

The $100m Brooklyn Queens Interconnector is a project that is a great example of the type of investment completed last year. This project addresses long term gas supply issues in the New York City region. In addition last year we started construction of a $150m transmission project. This project will connect the first US offshore wind farm to the mainland in Rhode Island and is due to be in service later this year.

And as you know we've also made significant progress with major rate filings and extensions. Currently we have Massachusetts Electric, KEDLI, KEDNY and Niagara Mohawk all under review.

Improving terms in the US is a key focus area for me, and I will discuss the specifics of the rate filings in more detail later.

So overall last year was another strong year for National Grid, and I believe we're well positioned for the future. I'll now hand over to Andrew who'll discuss the financial performance in more detail.

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***Financial Review***

**Andrew Bonfield, Finance Director**

Thank you John and good morning everybody. As John has outlined, our financial performance in 2015/'16 was strong. Our regulated businesses delivered solid results which were enhanced by the strong contribution from other activities.

Total operating profit increased by 6% to £4.1bn, a 4% increase at constant currency. And earnings per share rose by 10% to 63.5 pence per share. Importantly, Group return on equity - a key measure of performance - increased by 50 basis points to 12.3%. Despite low inflation our regulated assets grew by 4% with value-added of £1.8bn and our balance sheet remains strong.

Now let me walk you through the performance of each of our segments. Starting with UK Electricity Transmission which continued to perform well with a return on equity of 13.9%. Overall the business delivered 370 basis points of our performance. Through our continued focus on innovation and efficiency we met our network output measures and this contributed 210 basis points of totex outperformance. Other incentive performance at 80 basis points benefited from the balancing system incentive scheme which delivered £27m of profit.

Additional allowances contributed 80 basis points of our performance, broadly in line with the previous year. IFRS operating profit was £1.2bn, slightly down on last year as the business started to return prior year efficiencies, and as last year benefited from a one-off legal settlement.

Capital investment totalled £1.1bn and the year end regulated asset value increased by 4% to £11.8bn.

Moving now to UK Gas Transmission which delivered a return on equity of 12.5%. The returns were down from last year, reflecting the expected reduction in additional allowances and the end of the gas permits scheme. Despite the impact of these items, incentive performance was strong and enabled us to outperform the allowed basis return by 250 basis points.

Operating profit was up 11% on a headline basis primarily due to timing. Excluding timing underlying operating profit was down due to the loss of income from gas permits.

Capital investment was similar to last year at £186m, and the regulated asset value was flat at £5.6bn.

UK Gas Distribution delivered another strong performance, delivering return on equity of 13%, 310 basis points above the allowed return.

The business earned 200 basis points from totex savings, primarily from the mains replacement programme. Other incentive performance at 100 basis points is ahead of last year, reflecting improved exit capacity incentives.

Operating profit of £878m is up 6% benefitting from high allowances following a change in the tax treatment of repex. Investment increased by £51m to £549m, and the regulated asset value increased to £8.7bn.

In the US the return on equity of 8% was lower than last year but in line with our expectations whilst we wait for new rates to come into effect. As normal our US ROEs are reported on a calendar year basis. In 2015 our New York businesses were impacted by adverse winter weather which led to higher repair costs and increased bad debt expense. In Massachusetts the electric business continues to face - a rolling returns - due to increased costs.

As you know we took the first steps to improve returns with the filings we've made with Massachusetts Electric in November and KEDNY and KEDLI in January. John will cover the progress we've made on these rate filings later on.

Our Rhode Island and FERC continue to perform well, achieving attractive rates of return.

Headline operating profit of £1.2bn is down 5% driven by timing, reflecting the warmer end to this year's winter. Excluding timing operating profit was £45m higher than the previous year.

We invested $2.7bn in our US networks and the rate base grew by 6% to $18.3bn. Excluding the movements to working capital the rate base grew by 7.5%.

Our portfolio of other activities delivered operating profit of £374m, almost doubling compared to the previous year. This increase in profitability was led by a strong year for our French interconnector, significant sales in our property business and a favourable one-off gain of £49m on exchange of the Iroquois investment. We also saw lower costs as we completed the US financial system implementation in the first half of last year. BritNed, our other interconnector, also performed well but its results are reflected in the JV line. Total investment in other activities was £271m.

Financing costs were 6% lower than last year in constant currency at just over £1bn. The effective interest rate fell from 4.3 to 3.8% as we refinanced debt at lower interest rates and benefitted from lower RPI increases in the UK.

We continued to be innovative in our approach to funding the business. During the year we raised about £1.8bn of new financing by issuing nine new bonds, including a cash settled convertible bond. We also continued to draw down on the EIB loan to fund capital investment. In KEDNY we've issued $1bn of debt, securing attractive low cost financing for 10 and 30 years.

Tax was in line with expectations. The effective rate of 24% was 20 basis points lower than the previous year and gave rise to a charge of £753m. Earnings increased to £2.4bn, and as you've heard before earnings per share increased to 63.5 pence.

Operating cash flow was £5.7bn, around £350m higher than the last year due to increases in profits and favourable movements in working capital. Our key credit metrics are comfortably above the levels expected for an A- rating. RCF to net debt was 11.5%, and 10.5% after reflecting a full cash dividend. FFO to net debt was 16.7% and interest was covered 5.5 times.

The strengthening of the US dollar had an impact of around £0.5bn on net debt, but no impact on gearing which fell by 1% to 62%.

Last year we invested £3.9bn, a record for the Group. Starting with the UK we invested £1 [audio jumps] bn in our regulated operations. Just over £1bn of that was in electricity transmission, of which over half was non-load related. In gas distribution, capex increased by £51m due to a step-up in the mains replacement programme. We replaced about 1,900km of pipes last year, up almost a quarter.

In gas transmission most of our capital investment relates to asset health and emissions programmes. Both of these are expected to increase next year.

Looking now at the US where investment increased significantly to $2.7bn, or £1.9bn. The majority of this spend was in Gas Distribution, principally on the replacement of leak-prone pipe and to a lesser extent on converting new customers from oil to gas. We also made significant investment in Electricity Distribution where around $900m was invested, reinforcing the network, and connecting to a growing customer base. And $400m was invested, spent on improving and growing our US Transmission networks and other FERC related activity.

Finally the increase in investment in other activities was due to construction starting on the North Sea Link and Nemo interconnectors. This investment also covered projects such as the Road Tanker loading facility at Grain. As John has said, this segment presents the Group with interesting new opportunities.

As you can see from the chart our capex has risen, reflecting our focus on growing the portfolio through high quality organic investment. In the UK we are currently expected to invest around £16bn in the RIIO 1 period with around £10bn of this being investment in Electricity Transmission. Over the remainder of RIIO around two thirds of our investment in Transmission relates to non-load activity.

In respect of our load investment we are in consultation with Ofgem on the introduction of on-shore competition. Current proposals relate to strategic wider works, with anticipated capital spend in excess of £100m. We have two projects within RIIO 1 that could fall within the new arrangements. These are the connections for Hinckley Point and NuGen Moorside, which together represent about £1bn of capex. If Ofgem decides it is in the best interests of customers to make these important projects contestable, we are well positioned to bid competitively.

So with our UK capex projections and the growth potential that we see in the US, we expect to sustain a significant level of capex in the coming years. This supports our long run growth target to achieve 5 to 7% asset growth assuring UK RPI inflation of 3%. Assuming normal levels of UK inflation and excluding the US working capital investment movement, underlying asset growth in this year was 5%.

Consistent with our policy the Board is recommending a 1.1% increase in the dividend. We also have brought back last year's scrip, reflecting our strong balance sheet. As we have said previously we will continue to manage dilution whilst keeping a close eye on the need to finance growth within our current credit ratings.

Value-added in the year was strong, at £1.8bn or 47.6 pence per share. This is built from growth in group assets of £1.1bn, cash dividends and the repurchase of scrip which totalled just over £1.6bn, against the growth in net debt of around £0.9bn. Our expectations for value-add continue to support our commitment to sustainable dividend growth.

Looking ahead to next year as usual we've included a technical guidance section to support you with modelling assumptions. A few key points to note. We expect the UK to continue to deliver 200 to 300 basis points of out-performance, with slight reductions of legacy incentives in our Gas Transmission business as I flagged previously. In the US, returns are expected to be maintained during the year ahead of rate revisions in Massachusetts and New York. After removal of this year's one-off items and with lower interconnector revenue, we expect our other activities to return to more normal levels of performance. We also expect to see marginally higher interest costs and a tax rate similar to this year.

So let me summarise. The financial performance across the Group has been strong. Our capital investment is at record levels, supporting future growth opportunities. Our financial strategy remains robust, with strong operating cash flows and headroom in the balance sheet. With that I'll hand you back to John.

## *Outlook*

**John Pettigrew, Chief Executive**
Thank you Andrew. So as the new CEO of National Grid I'd now like to share with you my initial thoughts on our priorities in both the short and the long term.

Maximising value for our existing businesses has been and will continue to be the key priority. This year we have a number of important activities underway including the sale of a majority stake in our Gas Distribution business and the US rate filings. So let me start by updating you on the progress we've made on each of these, and after that I'll highlight the key areas that I believe are important for the continued long-term success of National Grid.

Starting with the update on our plans to sell our majority stake in the UK Gas Distribution business. With regards to the transaction itself we've seen a good level of buyer interest, and have been approached by a range of investors who are in the process of forming bidding consortia. However, before formally launching the sales process there is a huge amount of work required to start the separation of the business. UK Gas Distribution is not a standalone business. It is fully integrated with the other UK businesses and utilises shared services from finance, HR, and IT. This means that separating out the business is complex.

Our goal is to create a standalone business that can operate efficiently whilst maintaining its primary role as a provider of safe and reliable networks. Internally we are consulting with our employees and with the pension trustees, and externally we are working closely with Ofgem and the HSE to secure all the necessary regulatory consents prior to separation.

I am pleased to say that this work is progressing well. The formal sales process will launch in the summer, and we expect the transaction to complete in early 2017. After which our portfolio will be in a strong position in support of higher growth, delivering an attractive dividend whilst ensuring we maintain a healthy balance sheet.

As we indicated when we announced our plans, we expect to return substantially all the net proceeds to shareholders following completion of the sale.

Now turning to the second major activity which is the rate filings in the US. As you know from the completion of the SAP implementation we have now started more frequent rate filings. Our objective is simple - to improve the performance of the business and consistently earn close to the allowed level of returns. To achieve this we are focusing on three things. Firstly being more efficient, which will help to keep costs down and improve our underlying financial performance. Secondly, we must continue to file for new rates on a regular basis which we're now much more able to do. And thirdly we need to extend the mechanisms for capex trackers and true-ups to ensure efficient cost recovery.

Looking at the specific rate cases filed, starting with KEDNY and KEDLI which we filed in January, this is the first rate case filing for these entities since 2006. In terms of the timetable and the next steps, we are in the discovery phase which typically involves responding to a very large number of information requests. The next stage in the process is when we receive PSE staff rebuttal testimony, which we're expecting tomorrow. This will determine the next stage in the process with a decision due in December this year.

In addition to KEDNY and KEDLI, last November we also filed the Massachusetts Electric rate case. Since starting the filings we have completed discovery and we're now in the hearing phase. This started earlier this month and will continue for the next four weeks, with new rates coming into effect in October 2016.

In December 2015 we also filed a capex petition for Niagara Mohawk seeking to provide funding for $1.4bn of capex across the fiscal year '16/'17 and '17/'18. The filing is currently being considered by the PSC, and we expect to hear from them shortly with an extension coming in effect from April 2016. So, we are working closely with our regulators in each of our jurisdictions, and we're highly focused on ensuring a fair outcome for the significant filings made last year.

Looking ahead, I expect the US business to undertake frequent rate filings. The next will be in 2017 with filings for both Niagara Mohawk businesses and Massachusetts Gas. Our other jurisdictions in Rhode Island and FERC are performing well, with no immediate need to file.

So, this has been a busy year for us and our teams are highly focused on delivering on our short term priorities. But we also need to look forward. I'd now like to share with you my thoughts on the four areas that I believe are absolutely critical to the continued long-term success of National Grid.

First of all our customers. We take pride in connecting our customers to the energy they need. We want them to receive a service that's safe, reliable and affordable. However customer's needs are evolving, with much greater engagement, awareness and a desire to manage their energy use. It's vital therefore that we remain close to our customers so that we can respond to their changing needs and deliver them an outstanding service. As customer requirements evolve, so much National Grid. This will bring further opportunities to grow and drive value.

The next area is performance optimisation. National Grid is massively more efficient and agile than the business that I joined 25 years ago. But there is always more that can and must be done. To my mind the entire organisation should regard performance optimisation as part of the day job, relentlessly driving efficiency and doing things better. For us to succeed it's essential that we maintain and strengthen the Group's performance culture.

Moving to the third area which is growth, we have a strong growth potential that's underpinned by the need for significant investment in the regions where we operate. We see plenty of opportunities in our regulated businesses, and we expect to sustain high levels of investment over the coming years. We also see attractive prospects in our interconnectors, transmission and property businesses, and in addition from time to time we will review acquisition opportunities that arise in our markets.

Overall we have access to multiple sources of growth but we will only invest in projects that meet our strict investment criteria and represent the best value for our shareholders. This requires strong investment discipline and I want to ensure that this discipline is at the core of every decision that we make.

Finally looking ahead to the future. The use of renewable energy sources today together with the drive for energy efficiency are two major objectives that continue to grow in importance for our customers and our regulators. Steady improvement in the economics of distributed generation and energy storage are both adding pace to this momentum. At National Grid we support these changes and we want to play our role in promoting clean energy and energy efficiency. We are working on many exciting projects that position National Grid at the heart of consumer led developments.

For example in Massachusetts we have a Smart Grid pilot which offers 15,000 customers advanced meters and in-home technology that is helping them to manage their energy use in real time. And in the UK managing system flexibility given all the changes in the industry is a major focus area for us. A good example is a service we call Demand Turn-Up, which is part of our prior response programme. It essentially creates the market for businesses to earn revenue by shifting consumption to periods of oversupply in the system.

So, we are actively innovating and developing new products and services that are in synch with the needs of our evolving industry. Over the longer term there are other trends that will become relevant for National Grid such as electrification of heating and transport. These will result in more interaction between the transmission and distribution grids, which in turn will drive further investment in a range of opportunities. Overall I believe if we concentrate on these four areas we will be in a strong position to deliver our long-term commitments for all our stakeholders.

Let me summarise. National Grid is a strong business, as demonstrated by the performance that we delivered last year. As I said earlier maximising value from our core business is our key priority. This year we are focused on the sale of a majority stake in our UK gas distribution business and the US rate filings. Looking further out we have good growth opportunities across the portfolio and we are well positioned to deliver value for shareholders.

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

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***Questions and Answers***

**Mark Freshney, Credit Suisse**

I have two questions. Firstly on the competitive tendering it seems that the government are very intent on going ahead with this alongside Ofgem. Some of the infra-funds that you're competing against and also looking to sell assets to are taking exceptionally low returns, and if you were to compete against them taking those low returns it may be dilutive to the overall Group performance. So in this new world of competitive tendering what would be your kind of competitive advantage so to speak?

And just secondly on the sale of UK Gas Distribution, I think there's been some press speculation on difficulties with or challenges with novating bonds and also on the pensions liabilities. What kind of structure can we expect to see? Would you pre-package it with debt and make it easier? Would it need a bigger financing package?

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**John Pettigrew, Chief Executive**
Let me start with the competitive onshore transmission. So clearly work is still progressing on that in terms of exactly what the shape of that competition is. We've been very clear to Ofgem and to other stakeholders that if onshore competition is in the interests of customers then we're very supportive of it. But there's still a long way to go to make sure that we understand exactly what that onshore competition looks like.

The select committee last week, you would have seen their findings which I think were very sensible in setting out that for significant onshore transmission projects then there should be an assessment of whether there is actually benefits for customers or not. So there's a long way to go Mark in terms of exactly what it would look like. In RIIO-T1 there are only two projects as Andrew said in his presentation that would be impacted by competition. It's still not clear whether they will be or not because we don't know exactly what the definitions are, but back in 2013 Ofgem said the strategic wider works which is basically Hinckley and Moorside new gen could be open to competition. They're incredibly complex projects. You know we've been at Hinckley for five years and up in the northwest for three. I'm sure Ofgem will need to assess not just the economics but actually the timeliness of delivery as well. So there's only two projects that will be impacted in RIIO-T1 and then further on there may be further impacts.

In terms of competitive advantage well it depends on the definition of competition. So National Grid has got a huge amount of experience in developing major infrastructure projects right across the UK. So the whole process of planning, consenting and getting the agreement with local communities to design and agree the infrastructure is something that National Grid has got a lot of experience in and infra-funds certainly haven't.

In terms of the Gas sale let me start and then I'll hand over to Andrew perhaps to talk about the bond issue. So as I said in my presentation the process is on track. We're expecting to formally start the process this summer and we're on track to complete the transaction in early 2017. As I said it is complex in that we need to separate out the business, but all that work is progressing very, very well.

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**Andrew Bonfield, Finance Director**
Both from a pensions perspective we are working with the pension trustees and working very well with them to get to agreement on how we actually separate the liabilities into the different entities, so that report was actually incorrect from that perspective.

And then secondly on the liability management exercise we actually do have to work through a process of actually putting, because don't forget all the bonds that have been issued in NGG, we would have to get consent from bondholders to switch over. So we will look to see what's the optimal way of actually putting a mixture of existing debt and new debt into the structure. But effectively that is an ongoing process. The time issue at the moment for us actually is the separation from a business perspective on the back office and people part, that is actually probably the bigger time constraint than actually liability management or pensions. So no real issue there.

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**Bobby Chada, Morgan Stanley**
Can I just follow up on the onshore competition point? So specifically those two examples you quoted of Hinckley and Moorside, National Grid has put a lot of time, effort, organisational skill into those projects already. Would there be any compensation?

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**John Pettigrew, Chief Executive**
So actually Bobby for strategic wider works as part of the RIIO funding mechanism there was a pot of money put aside for the pre-engineering work. So National Grid has effectively had its costs recovered for that. Where costs aren't recovered they're a part of pre-engineering then we look to indemnify with the customer themselves.

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**Bobby Chada, Morgan Stanley**
So in a sense if they force these projects to go into some kind of competitive tender you could have acted as a - effectively you've sort of facilitated them, but in the next round of competitive tenders you wouldn't expect to take that facilitation role would you?

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**John Pettigrew, Chief Executive**
No I mean it's sort of at the heart of what's the definition of competition. So you know are they going to compete our requirement that the system operator has for an increasing capacity, which they've described as the early model. Or are they going to actually have detailed work done by National Grid or other parties to do all the design work and all the planning and then only compete out actually a project that's fully engineered and designed. That I think is still being discussed and debated but in a world in which it's early and it was competed out, no National Grid wouldn't do it.

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**Bobby Chada, Morgan Stanley**
And when do you expect to have a decision on early versus well defined?

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**John Pettigrew, Chief Executive**
Well the timetable seems to be working through over the next few months. So Ofgem have been doing the consultations. They've set out some of their preferences and recommendations so I suspect it's towards the end of the summer.

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**Dominic Nash, Macquarie**
Two questions please. Firstly on system operation, when are we expecting the new flow from the SOs and what are the options actually available as to in extremes could it be stripped from you into an independent company? And then sort of following up from Bobby's question would there be compensation for that sort of role?

And secondly all the action going forward in networks looks like it's getting more local and distributed. And the DSO, the creation of a DSO, when would we expect to hear from a potential creation of a lower voltage system operator?

And then my second - sorry probably three then I guess, which is on the storage. I mean Turner is building a big storage facility in southern Italy as a replacement for transmission. When would you start to expect to see sort of large scale storage in the UK and what opportunities and threats does that sort of throw up your way?

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**John Pettigrew, Chief Executive**
We'll have a go at each of them in turn. Shall we start with the system operator? So a bit of context here, so I mean this goes right back to Amber Rudd's reset speech where she mentioned she wanted to look at whether there was value in increased separation of system operator. And it's probably worth just saying that the system operator role you know has evolve every year over the last 20 odd years, and National Grid has always had to put the right controls and governance and separation in place to make sure that there aren't any perceived or actual conflicts of interest.

But we do recognise that the market needs to have confidence that those separations and those controls are in place. So there is discussion going on with DECC and with Ofgem about what they might look like. The options are that given that the role has evolved over the last couple of years there may be a need for further controls to be put in place, that is one option. The second option which is debated far and wide is a move to an independent system operator.

My personal view is I don't think moving to an independent system operator is the right thing for the UK at this time. You know there's an awful lot going on in the industry with the need for inward investment. We need stability as we focus on things like balancing the network with a lot of new generation coming on, and it would be a hugely disruptive thing to do. But in terms of the timescales it's with government so we're in discussions. So I'm not sure what the exact timescales are. My personal view is it's probably going to be in 2016.

The second question was around I think just the interaction between distribution and transmission networks.

**Dominic Nash, Macquarie**
Ratio of a DSO itself.

**John Pettigrew, Chief Executive**
Yeah again in terms of timing of a DSO it's unclear to me. You're absolutely right that there is a huge amount of more interaction now between the transmission networks and the distribution networks. And we've done a lot of work over the last 12 months working with the DNOs to be able to make sure that we get the right information flow so that there aren't any inhibitors to distributed generation connecting to the distribution networks. We are at a point where quite often reinforcements are now needed on the transmission system in order to facilitate the flows that we're seeing on the distribution network. So the DNOs are becoming more active in the way that they manage their networks. There has been lots of discussion around whether they're going to formally become distribution system operators. But that's going to continue to evolve in my view.

And your third question around storage, so in terms of storage you're right, as technology prices fall then storage starts to become an option for a number of different types of service. So in our mind it can provide an extremely useful balancing service. So as we see more intermittent generation on the network then the need to have fast acting frequency response which battery storage is a fantastic provider of, becomes a really valuable service to us. Of course you could also see it as being an alternative to building infrastructure depending on what type of flows you have on the network, and of course it's got the opportunity for energy arbitrage as well.

When the National Infrastructure Commission came up with their findings which I think were very helpful that said that we need to get the right frameworks in place in the UK to make sure that those three tranches of opportunity and storage can be exploited I think was bang on in my view. So I think the actions that they put to DECC and Ofgem are going to be important to get the right framework. We are certainly looking at it from a system operator perspective at the moment in terms of potentially seeing if there's an opportunity to have fast acting frequency response through battery storage.

**Deepa Venkateswaran, Bernstein**
I had a couple of questions. The first one is your interconnectors; I mean if there were to be a Brexit would that actually impact any of your existing projects where you've already taken FID or maybe even the future projects?

Secondly could you also explain the working capital movements in the US which I think there was some statement that you wouldn't be seeing a similar working capital move next year? And then I think the rate base growth was different so can you just explain what that does?

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**John Pettigrew, Chief Executive**
I'll give Andrew the working capital one.

In terms of the impact on the interconnectors, I think our expectation is that we're not expecting to see a significant impact as a result of Brexit on our interconnector flows. The economics and the desire to have interconnection between the UK and Europe exists so there are people on both sides that are keen to trade across that interconnector. Exactly what form that will take is really dependent on exactly what the exit looks like and what set of rules we get the other side of it in terms of whether we're part of the internal energy market in a world in which we're outside of Europe, so it's difficult to exactly predict what that will look like. But the desire to have interconnection between the UK and Europe is on both sides so I don't see it having a significant impact.

In terms of working capital Andrew?

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**Andrew Bonfield, Finance Director**
Yeah certainly Deepa. On working capital some jurisdictions in the US do actually put working capital into rate base. And obviously when you have winter weather fluctuations you do see. So 31st March 2015 very cold winter, very high level of debtors, resulted in very high working capital. And last year when we talked about underlying growth in the US the headline growth was 9% in rate base. We talked about 5% underlying.

This year obviously very mild winter in the US so on 31st March 2016 the low level of debtors, we actually saw a working capital reduction. So effectively the headline rate - down the line rate was 7.5% but the headline rate was 6%. We just normalise for that just to take it out so you can see what the real underlying expectation is of rate base growth.

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**Edmund Reid, Lazarus Partners**
Three questions. The first on DSR. You're obviously making quite a push for DSR in the UK. I think DSR is a lot less prevalent in the UK than it is in the US. I was wondering why that was the case and what you can do to improve it?

Secondly on battery storage. Do you think most of the battery storage will be at the Transmission or Distribution level and do you see it as more of an opportunity for your UK or your US business?

And then thirdly on metering revenues. Looks like smart metres are finally being introduced or speeding up. What's that going to do to your legacy metering business?

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**John Pettigrew, Chief Executive**

Okay thanks. So let's start with DSR. And I might ask Dean for his comments on the US. So certainly in the UK over the last 12 months National Grid actually launched a programme called Power Responsive campaign which was really trying to identify where are the blockers in the UK for encouraging increased demand side response. So from a system operator perspective we see demand side as being a really important part of balancing the network going forward, particularly when you've got increased intermittent generation. So the Power Responsive campaign was very much about getting people across the industry together to understand where those blockers are and then to try and develop the different types of products and services.

Over the last year I think we've had some real successes with that so we are seeing increased use of DSR in terms of balancing our network. As I mentioned in my speech we've introduced new products such as the demand step-up product. And we'll continue to do that. As an aspiration we've set out that potentially you could see, from a balancing action perspective in the UK, about half of our actions being on the demand side and half in the generation side. Now that's a long term aspiration but one that we think is achievable because of the scale and the capability of the demand side.

So why is it not flourishing in the UK as much as perhaps in the US? If you talk to people who are providing those services then what they're looking for is long term contracts and certainty. We need to work with the regulators and with the providers themselves to make sure that they have that to be able to make the investments to shift their processes to be able to provide the services.

Dean did you want to mention anything on the US side, demand side?

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**Dean Seavers, Executive Director, US**

Good morning. I don't have a lot to add to that. I think from the standpoint of both working with our regulators as well as I'd say just incentives we definitely are seeing that in the US.

I think - I did want to pick up on another point too, another question that was asked relative to the storage piece for us and the distributed generation. The reality is a lot of the regulations and incentives are really driving that. It's put a lot of pressure on the system from a peak standpoint. John mentioned the fact that it had some requirements on our network but in terms of the test that John mentioned in his earlier prepared speech the reality is we're testing a lot of those from a micro grid standpoint. You know if you go from what we're trying to do with our customers from a resiliency and from a reliability standpoint, we're testing micro grids and some of our RAV initiatives so you'll see a lot more results from that going forward.

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**John Pettigrew, Chief Executive**

And in terms of battery storage in the UK. So there are opportunities in Transmission, it's quite clear. Whether they're going to be larger than the people putting the battery on their home which is what all the adverts are showing at the moment, I think it's just too early to say if I'm honest. I mean there is an issue in the UK that actually National

Grid couldn't own storage as it's currently defined as an asset class because at the moment it's classed as a generator. Now there are a lot of people think that's probably not right in terms of the role that storage plays, but in terms of potentially providing a service to Transmission or as an alternative infrastructure, clearly if prices keep coming down it's a sensible solution.

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**Andrew Bonfield, Finance Director**
Then on metering we did see some reduction in the number of metres, gas metres. Obviously the share - most of them were prepayment, but actually we were able to offset the impact of that so profits were actually flat year on year. It's been interesting watching the metering business. I've now been here for five and a half years and every year it's going to go down and my budget for next year is slightly down year on year given the change, but we'll obviously just manage the business as best we can Ed. Obviously over time we do expect the rollout of Smart to have an impact.

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**Iain Turner, Exane BNP Paribas**
Can I ask a couple of questions? Firstly could you just go through the change to the tax treatment in repex and explain that a bit more because I didn't get that?

And then secondly I think in the statement you give a figure for how much tax you paid in the UK but you don't give a figure for how much you paid in the US which I guess means it's probably quite a small number. Is that a liability going forward in terms of the political, the regulatory system and situation in the US?

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**Andrew Bonfield, Finance Director**
Okay so first of all on tax change and repex this was a very technical accounting issue effectively relates to adding IFRS accounting to UK entities. As a result of that - as a result of the change to IFRS accounting effectively mains replacements expenditure was now capitalised and depreciated. That results in a change to the tax treatment because the HMRC was going to follow what IFRS accounting was going to do. So our allowances had to change to reflect that because as you know we're remunerated on cash taxes.

In the US we don't pay any cash tax, it's bonus depreciation which obviously increases the deferred tax liability. As far as the political climate is concerned actually they've just extended bonus depreciation through 2019 although tailed it off. It is about the desire to see investment.

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**Lakis Athanasiou, Agency Partners**
Three questions for me. You mentioned the IFRS changes, are you seeing any different treatments in regard to your current tax on derivative with the change to your subsidiaries being accounted as IFRS?

Secondly, could I press you on your response on storage and DSR, particularly in the UK? It is a technology that's very good for a system operator but it's very bad for a transmission owner. And you seem remarkably relaxed that, you know, these activities will cannibalise your growth in assets, and I'm thinking particularly the UK where you do get some good returns on your assets going into the RAV.

And thirdly on debt separation in Gas Distribution. Andrew spoke about it but can I press you on that one a bit more, because if I was a debt holder in NGG I certainly wouldn't want my debt ending up in the new Gas Distribution entity with the potential that it gets levered up down the road. And I see that as a problem that - well I mean is it surmountable and how could it be given that bond holders wouldn't want to see their debt going into the new entity?

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**Andrew Bonfield, Finance Director**
Do you want me to start? Okay start with that one first. Firstly there is a regulatory reason why you wouldn't actually gear up the entity itself and that is actually because of the interest deduction on cash taxes. There is a restriction on how much debt you would actually be able to put in. So that will be one thing, there's the thing. You cannot gear these entities up to the level that you are expecting. You will actually have to do it within the structure rather than the actual individual entities.

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**Lakis Athanasiou, Agency Partners**
You don't get the tax credit but we've seen in the water sector when these things happen they come in and they gear up. Now okay they lose the taxing but they still gear up.

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**Andrew Bonfield, Finance Director**
But like I said it's one of the things - we will still have a 49% ownership, we will not want to lose the tax credit so we actually do have restriction. We do have things we would continue to watch on.

As far as actually on the IFRS accounting for derivatives that doesn't impact because derivatives are for our own account. There was no impact. This was because obviously with repex there is a regulatory allowance around whether it was capitalised or not capitalised for IFRS accounting and then for tax purposes.

Tax on derivatives or booked tax on derivatives is actually as reflected in the accounts; there will be no impact of that just from a book accounting perspective.

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**Lakis Athanasiou, Agency Partners**
My third question on globalising Transmission?

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**John Pettigrew, Chief Executive**
I mean in terms of investment in the UK business, so as you look forward we've got a strong investment profile so we're going to spend £16bn on our networks in RIIO-T1. And a large part of that continues to be asset replacement as well as supporting renewables and new generation.

There are opportunities for Transmission to use storage, but DSR and storage do impact on the overall profile of demand. So demand has been flat for a number of years now. How that actually plays out, it's just too early to say in terms of exactly what it means. We're actually finding at the moment that actually through intermittent generation and distributed generation that we're identifying projects on our Transmission business that are required in order to support the Distribution networks doing what's happening on their DNO networks. So it's not one way is what we're seeing at the moment, it's impacting what we need in terms of reactive power on our networks so we're putting a lot of equipment of reactive on the networks at the moment. So I don't see it as a spiral of decline.

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**Verity Mitchell, HSBC**
I've just got a couple of questions. One is a technical one about FERC and the complicated moving down and up of returns. Perhaps we can have a bit of clarification about that, the FERC businesses? I mean you earned 11.4% ROE this year, but I know that the FERC is reviewing its allowed returns. And that's the first question.

And the second question is just about your technical guidance on strong interconnector performance this year. And perhaps you could explain why you think that might not continue in the current year?

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**John Pettigrew, Chief Executive**
Dean would you like to take the FERC one?

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**Dean Seavers, Executive Director, US**
Yeah. On the FERC we've had a couple of challenges on the returns and in a couple of cases they've been reduced, but in reality we've had a case that has just come back and the decision was in the first year it was reduced and in the second year it was actually increased. So from our perspective obviously in terms of the relationship with the regulator is to make sure we get fairer outcomes than that but to get the heavyweights stabilised. So that's kind of what we're seeing recently.

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**Andrew Bonfield, Finance Director**
And Verity on the technical guidance, we were pointing out - if you remember at the half year I did actually point out we saw very strong performance over the summer. Part of that was due to changes with the climate change levy which did result in a very significant arbitrage opportunity which boosted auction prices. That we don't expect to recur next year so we do expect the profitability to decline as a result of that.

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**James Brown, Deutsche Bank**
Two questions. First one is on the US. You talked about a desire to get the returns up in the US to close to the base returns and that's a key focus. Is that something we should expect to happen over the course of the next round of rate filings in the next kind of two to three years, or is that more of a medium term ambition for the next five or six years?

And second question, obviously a lot of focus on your system operator role and lots of talk about how next winter looks very, very tight certainly based on the capacity that's going to be available in the market. Obviously you have the SBR as well. I was just wondering whether you could share some thoughts around next winter? Whether you think you have the tools that you need to keep the lights on and keep prices at a reasonable level, and whether there are any levers that you can pull to avoid frequent price spikes next winter?

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**John Pettigrew, Chief Executive**
So in terms of the US rate filings, so as I said in my presentation so we've currently got KEDLI and KEDNY and Massachusetts out for rate filings. We expect Massachusetts to conclude in October and KEDLI and KEDNY to conclude in January. So we will see a small benefit in this fiscal year from those rate filings which will effectively offset some of the cost pressures we've got in other parts of the business. So as our outlook sets out we're expecting returns in the US for this coming year to be similar to what we've seen last year.

However with those rate filings in place and then with the next tranche of rate filings going in, which will be the Niagara Mohawk and Massachusetts Gas, then we would expect to start to reduce that headroom between the allowed returns and the actual returns.

In terms of the system operator role in next winter, so part of our role as National Grid obviously is to do the assessment in terms of what does the winter look like. We've done that assessment based on what we see, and with the closures that we've seen in the last 12 months next winter looks tight but manageable so similar to the words that we used in previous winters. National Grid has already purchased 3.5 gigawatts of supplemental balance in reserve. We've got a tender out at the moment for demand side supplemental balance in reserve. Based on where we are today and the analysis that we've done we feel that we've got the tools that we need. But it's a long way to go till the winter so we continuously assess it and we'll continue to do that through the summer, right up to our winter outlook report in the autumn to make sure that we have the tools to balance the system.

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**Peter Atherton, Jefferies**
These are easy ones I think. In the financial calculations on the return on RAVs there's a 3% indexation. Can you just remind me when that gets trued up to actual inflation?

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**Andrew Bonfield, Finance Director**
The actual numbers we produce are value add and actually what the rate base growth we talked about are at actual rates of inflation. So they reflect the 1.6% that was there at the 31st of March on our PI. When we do for purposes of actually giving our ROE calculations and showing our returns, rather than go to effect - because we have nominal regulation in the UK - nominal in the US, real in the UK we just give them nominal but we use their long term inflation assumption which is 3% which is the Bank of England 2% plus 1% for RPI.

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**Peter Atherton, Jefferies**
Okay thanks. And just final one on sort of managing the system. I mean we've seen a collapse in coal output in the UK in recent weeks and months and it doesn't look great for the coming months as well on the economics of coal. What sort of challenges does that throw up if any?

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**John Pettigrew, Chief Executive**
So in terms of the - there was a lot in the media wasn't there in the last couple of weeks about it was the first time in 100 odd years that we've run the network without any coal on it. So the characteristics of the network have changed Peter, you're absolutely right, so we see a lot of solar in the day, a lot of wind, and then the gas coming on in the evening and a lot less coal on the network.

The challenge it throws up is particularly around intermittency which is why we've been developing products like the demand turn up product and fast frequency response, so as the network is evolving we have to develop new products to make sure that we can manage the system in real time. I'm very pleased actually with the way that the system operator is managing that, and the new products we put in place seem to be very economic and a good way of meeting those challenges.

Going to take this as a final question I think.

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**Analyst, Bloomberg Intelligence**
Two questions please. Can you remind us what the system operator earnings are as a part of your operating profit and net income please?

And the second question is on M&A. Obviously you said you're trying to grow organically mostly but you're open for new opportunities. Could you give us a bit more colour what geographies we're talking about? Is it just US and UK or are you open to new geographies? And what areas, is it just the Transmission, interconnectors or Distribution?

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**John Pettigrew, Chief Executive**
So in terms of the system operator the operating profits are very modest, they're about 1% of our total operating profit. So in terms of my comments on M&A, National Grid is in a very good position in terms of the sources of growth. So we've got strong growth in our core business in both the UK and the US, and as Andrew said we're targeting 5% to 7% growth across the Group. In addition to that we've got some exciting development opportunities with things like interconnectors and Transmission in the US. But as you'd expect of a company like National Grid, from time to time we will look to see if there is an opportunity for acquisitions. But we will only do that if we believe it aligns with our strategy and that it creates value for our shareholders.

Okay so I'm going to conclude the Q&A there so thank you very much everybody for attending today. So as you saw last year strong results for National Grid, and hopefully as you got a sense from the presentation the management team is very focused on our short term priorities and in very good shape for the future. So thank you very much everybody.

Applause

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