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# National Grid

Investor Call

8th December 2016

## NATIONAL GRID

**John Pettigrew, Chief Executive**

**Andrew Bonfield, Finance Director**

## QUESTIONS FROM

**Chris Laybutt, JPM**

**Jenny Ping, Citi**

**Lakis Athanasiou, Agency Partners**

**Deepa Venkateswaran, Bernstein**

**Fraser McLaren, Bank of America Merrill Lynch**

**Dominic Nash, Macquarie**

**Guy MacKenzie, Credit Suisse**

**Ajay Patel, Goldman Sachs**

**Iain Turner, Exane BNP Paribas**

**Telephone Operator**
Good morning ladies and gentlemen and welcome to the National Grid Investor Call. My name is Tom and I will be your coordinator for today's conference.

For the duration of the call you will be on listen only. However, at the end of the call you will have the opportunity to ask questions. If at any time you need assistance, please press *0 on your telephone keypad and you will be connected to one of our operators.

I am now handing you over to John Pettigrew to begin today's conference. Thank you.

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***Introductory Remarks***

**John Pettigrew, Chief Executive**
Good morning everyone and thank you for joining us on this call regarding the sale of a majority stake in our UK Gas Distribution business. So having run a highly competitive process I'm pleased to announce that we have signed an agreement to sell a 61% share in the business for £8.4bn to a consortium of long term infrastructure investors.

This implied an enterprise value of £13.8bn for the Gas Distribution business as a whole.

As you would have seen from the statement the consortium comprises of a number of infrastructure investors. This consortium has longstanding experience investing in utilities and critical infrastructure in the UK. They are committed to being a long term investor and responsible custodians of the Gas Distribution business and we look forward to working in partnership with them.

This transaction will enable us to continue to build a strong asset portfolio that delivers an attractive combination of yield and growth for our shareholders. The sale will rebalance our portfolio towards asset growth within the 5 to 7% range, assuming RPI inflation of 3%, while sustaining dividends in line with our policy.

As I mentioned previously given the degree to which the Gas Distribution business was integrated within National Grid the process to create a standalone entity has been complex. To achieve this we've had to refinance the business with attractive rates, separate the large pension scheme into three sections, and transfer systems and processes that covered many key operational functions. Given all of this I'm pleased that we've been able to get this point in such tight timescales.

Following completion of this sale we expect to return £4bn to shareholders. The proceeds will be returned through a combination of a special dividend with share consolidation and a share buyback programme. We intend to return at least 75% of the proceeds via the special dividend.

I can also confirm that the Board has set aside £150m to be used for the benefit of energy consumers. I take very seriously the role we play in peoples' daily lives and I'm pleased we take this opportunity to ensure that our wider stakeholders benefit from the incremental value of the sale.

Looking forward, the transaction is subject to European Commission merger clearance, but is expected to be complete by the end of the first quarter of calendar 2017.

The consortium has expressed an interest in the potential purchase of a further 14% in the UK Gas Distribution business, this will be on broadly similar terms to today's announcement and we'll share further details if agreement is reached.

I would now like to hand over to Andrew, who will take you through more of the financial detail.

*Financial Detail*

**Andrew Bonfield, Finance Director**
Thank you John and good morning everyone.  I would now like to start by providing some detail around the valuation and return of proceeds.  We will realise the value of £8.4bn for a 61% share in the UK Gas Distribution.  As at 31st of March 2016 the Gas Distribution business had regulated asset value of £8.7bn, operating profit of £900m and profit before tax of £700m.

As you will have seen from this morning's announcement 61% of the equity in the Gas Distribution business has been valued at £3.6bn, in addition we will receive £1.8bn of cash released through additional debt financing.

We expect to return £4bn to shareholders after retaining £0.7bn of the additional debt financing to maintain our equity interest in National Grid Gas Distribution and after deducting transaction and other related costs of £0.5bn.  These costs are associated with business separation, debt management, which included the buyback of old high priced debt, advisory fees and other costs, including the voluntary contribution for the benefit of energy consumers.

In terms of the method for the return, as John has mentioned, we expect to return at least 75% of the proceeds via a special dividend.  Given the size of the special dividend we will carry out a share consolidation to reduce the number of shares in issue in proportion to the reduction in the asset base.  This consolidation also ensures that the share prices, earnings per share, and dividend per share remain consistent before and after the transaction, making it easier for shareholders to compare year on year performance.

A share consolidation requires shareholders' approval and accordingly a general meeting will be convened, we will share the details of the meeting in due course, it is our intention to pay the special dividend as possible after completion and depending on the timing of completion this is currently expected to be in the second quarter of calendar 2017.

The share buyback programme will also commence following completion.

Turning now to the expected impact of the transaction on the P&L and balance sheet, on completion we will fair value our 39% interest in Gas Distribution and treat this as an associate for the accounting purposes.

Profit after tax from the business will be included in the associate's line and our cash flow will benefit from ongoing dividends from the business.

Reflecting the 39% minority share the Gas Distribution debt will be deconsolidated from the Group balance sheet.  Our balance sheet and credit metrics will remain strong post the transaction and we will maintain our existing dividend policy.  We expect our Group credit ratings to remain unchanged.

We plan to complete at the end of the first quarter of calendar 2017 and we will keep you updated on progress.

Thank you very much for your attention.  John and I are now happy to take your questions.

*Questions and Answers*

**Telephone Operator**


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Ladies and gentlemen if you would like to ask a question please press *1 on your telephone keypad. If you change your mind and you want to withdraw your question please press *1 again. Please ensure your line remains unmuted locally, you will be prompted when to ask your question.

So once again ladies and gentlemen it's just *1 on your telephone keypad.

Okay, our first question comes from the line of Chris Lambert. Please go ahead Chris you are now unmuted.

**Chris Lambert**
Good morning, just two questions please. In terms of the dividend policy going forward, do you expect your coverage metrics to be unaffected by the sell down, given your expanded - sorry your asset base will be slightly reduced through the sell down process?

And secondly, just on costs in terms of the £0.5bn that you've announced today, does that include anything for the debt refinancing activities and the balance sheet adjustment that you announced recently?

**John Pettigrew, Chief Executive**
Andrew, do you want to take that one?

**Andrew Bonfield, Finance Director**
Certainly. So on the dividend policy what will happen is obviously with the share consolidation effectively the number of shares in issue will be reduced, so we expect the dividend earnings per share to be comparable going forward, so therefore there will be no change in dividend policy and the dividend policy will be to obviously grow the dividend in line with RPI inflation for the foreseeable future. That was one of the key reasons why we are doing the share consolidation as well.

And then the cost, the £500m includes a proportion of the costs related to the refinancing. So if you remember there was £718m of costs at the half year, on a post tax there's about £140m of that, the balance is then split almost evenly between Gas Distribution and our Electricity Transmission. Electricity Transmission obviously will not be part of those transaction costs, but we will charge 61% of the Gas D element of the costs of between £250m and £300m to the transaction. So that is included in the £500m.

**Chris Laybutt, JPM**
So the implication there is that we shouldn't then add in additional debt costs to adjust the EV, we're comfortable at this point that the £500m accounts for all of those costs relating to this transaction?

**Andrew Bonfield, Finance Director**
Yes it accounts for all which relate to the transaction itself, yeah.

**Chris Laybutt**
Thanks very much.

**Telephone Operator**
Our next question comes from the line of Jenny Ping from Citi. Please go ahead Jenny you're now unmuted.

**Jenny Ping, Citigroup**
Morning, I have two questions also. Firstly can you give us the net debt RAV of the new company, what the financial gearing structure would look like?

And secondly can you also give us some colour as to what the reason is why you didn't agree on selling the additional 14% equity today, given the buyers are also talking about a similar price for the additional equity value, why didn't you sell the 75% today, what's the logic behind it? Thank you.

**John Pettigrew, Chief Executive**
Okay thank you Jenny, I'll take the second one and I'll hand the first one over to Andrew. In terms of the second one, so what we've announced today is the 61% sale, we've also indicated that there is the potential to agree with the consortium an additional 14%. We're continuing that discussion, we'll be hopeful that we'll be in a positon to announce something before the completion of the sale in Q1. So it's not a case that we've not taken the option, we're still in discussion with regards to the consortium, with regards to the 14%.

Andrew do you want to pick up the first item?

**Andrew Bonfield, Finance Director**
Yeah, on the debt within the entity itself, within the operating entity it will be the regulated debt Jenny at 65% approximately and then actually all the additional financing that's raised will be in a Mid Co structure which is the £1.8bn.

**Jenny Ping, Citigroup**
Okay, so £1.8bn on top of the operating, okay fine - thank you very much.

**Telephone Operator**
Our next question comes from the line of Lakis Athanasiou and Lakis is calling from Agency Partners. Please go ahead Lakis you're not unmuted.

**Lakis Athanasiou, Agency Partners**
Two questions please. The first, have the rating agencies given an indication of how they'll treat your associate Gas Distribution companies, whether they'll look at them as an investment or whether they'll consolidate proportionately?

The second thing is I'm not entirely sure about what you guys are actually holding as your associate holding. Will it include the Mid Co debt as well, or are you at the kind of Op Co holding level?

**Andrew Bonfield, Finance Director**
On the rating agencies we've had obviously preliminary discussions with them, obviously they need to look at the shareholder agreement and confirm with us that they are happy that it does reflect deconsolidation. We believe that it will because obviously control and operating control sits with the consortium themselves, and effectively we don't - that's why we are accounting for it as an associate as well, so it should meet their requirements and it shouldn't require proportional consolidation either.

And then on the equity value, what will happen on the balance sheet is we will value the equity today as if we had actually sold it and grossed it up. On the Mid Co debt cash we've received, effectively that will be cash sitting on our balance sheet, so it won't be sitting within the associate line it will actually be sitting within the - and offset against …

**Lakis Athanasiou, Agency Partners**
I understand that, but the Mid Co debt will be debt that the purchasers have a liability on, you're not involved in that. I mean it doesn't matter how you got the money or where it came from, you got the money so it's an artificial split the 3.6 and the 1.8, but you don't have any liability on that 1.8 Mid Co debt is what I was asking?

**Andrew Bonfield, Finance Director**
No we don't.

**Lakis Athanasiou, Agency Partners**
Right.

**Andrew Bonfield, Finance Director**
So that will not be on the balance sheet yeah.

**Lakis Athanasiou, Agency Partners**
Yeah, yeah - like I understood.

**John Pettigrew, Chief Executive**
Thanks Lakis.

**Telephone Operator**
Our next question comes from the line of Deepa Venkateswaran, from Bernstein. Please go ahead Deepa you are now unmuted.

**Deepa Venkateswaran, Bernstein**
Thank you, I had two questions, just to clarify how much of debt should we assume is deconsolidated after the transaction, is the 65% on that?

And secondly in terms of accounting when will you deconsolidate it, is it essentially next financial year or already once the transaction is completed say Q1 of '17?

**Andrew Bonfield, Finance Director**
Deepa, the debt is the 65% so that will be deconsolidated, so about £5.6bn as of 31st of March 2016.

As regards deconsolidation we will probably - we will now probably be in a position where we have to treat the assets as held for disposal, if we produced accounts and it wasn't completed by the 31st of March, we expect the completion to be by the end of 31st of March, so effectively it will then now be treated as an assets disposed of an associate created in the balance sheet.

**Deepa Venkateswaran, Bernstein**
Okay so for the full year, even for the period where you were still holding it as a subsidiary on the P&L?

**Andrew Bonfield, Finance Director**
Be a discontinued operation yeah.

**Telephone Operator**
Our next question comes from the line of Fraser McLaren from Bank of America. Please go ahead Fraser you're now unmuted.

**Fraser McLaren, Bank of America Merrill Lynch**
Good morning. I also have two questions. The first is just in relation to the potential additional 14% stake. What would you plan to do with the proceeds if that was to go ahead?

And secondly notwithstanding the effect of the consolidation could you confirm that the other parameters of the transaction meets your original aim of it being broadly earnings neutral in future?

**John Pettigrew, Chief Executive**
So let me pick up the first one and I'll hand the second to Andrew.

So in terms of the potential 14% so let me just be clear on this, so what - over the next quarter we will look to get an agreement with the consortium on it. No decision has been made with regards to when we would sell any of the remaining 39% including the 14%, and therefore it's way too early to be honest Fraser to be thinking about you know exactly what we're going to do in terms of return of funds on that.

Andrew do you want to pick up the earnings point?

**Andrew Bonfield, Finance Director**

Yeah. So obviously this year it's going to be slightly confusing Fraser because obviously it's a discontinued operation. The results are excluded from earnings per share. And therefore you will see a headline earnings per share number which excludes the Gas Distribution. But because we haven't done the share consolidation obviously you don't have the reduction in the number of shares. So effectively you'll see a drop in the headline earnings per share this year, and then a significant rise back up next year once we have the - paid the special dividend and done the share consolidation, so net-net actually you broadly restart back at the same place. Yes it does get you back there, it's just the methodology and we'll obviously spend a little bit of time in May making sure you guys are comfortable with how that all works through.

**Fraser McLaren, Bank of America Merrill Lynch**
Okay many thanks.

**Telephone Operator**
Our next question comes from the line of Dominic Nash from Macquarie. Please go ahead Dominic you're now unmuted.

**Dominic Nash, Macquarie**
Hi there, yes I've got two questions as well please. Firstly coming back to this structure, just for clarity again, are you going to be owning 39% of the 65% levered entity and the consortium essentially owns the 61% via the Mid Co where the debt set sits? And if so does that mean that actually the headline value that you're getting for your stake sale isn't necessarily the same value that you yourselves would have because you've got a different capital structure and tax issues?

And the second question is that you've said that you're going to give back £150m to customers. Do you know how you're going to do that?

**John Pettigrew, Chief Executive**
So again let me pick up the first and I'll ask Andy just to run through this structure and the Mid Co piece again I think. So in terms of the £150m, so what you would have seen in the statement today is that we've announced our intention is to return £150m to customers. We think it's important that all our stakeholders benefit from the incremental value that's being created through the transaction. At this stage we haven't decided exactly what that route is because National Grid hasn't got effectively a distribution route to the final customers what we said is that we'll work with Ofgem about how that £150m can have the biggest impact on energy consumers in the UK. So once we've got that worked out on it we'll let the market know, but it's a piece of work we'll do with Ofgem over the next few weeks.

In terms of the structure Andrew do you want to just run through that again?

**Andrew Bonfield, Finance Director**
Yeah so to be 100% clear we will own a 39% stake in the Mid Co structure, there's a Top Co, Mid Co and the operating company. So the £1.8bn we get back from the refinancing of the Mid Co is 100% of that. We are giving back 61% to shareholders and we are retaining 39%, so in effect we retain the same economic equity value in the entity itself, except for that will be seen as cash on our balance sheet because in effect the entity itself will be having more leverage than would normally be. So we

would actually effectively hold it in our balance sheets as being offset against that incremental leverage.

**Dominic Nash, Macquarie**
So when the dust settles essentially your own 39% of the 65% levered entity is what you're saying?

**Andrew Bonfield, Finance Director**
Economically that's what effectively it is but the reality is we actually own 39% of the 85% entity, so it's slightly confusing we know.

**Dominic Nash, Macquarie**
Okay thank you.

**Telephone Operator**
Our next question comes from the line of Guy MacKenzie from Credit Suisse. Please go ahead Guy you're now unmuted.

**Guy MacKenzie, Credit Suisse**
Good morning. Two questions from me. Firstly just on the remaining 39% can you tell us anything about what the lock up period is or what kind of pre-emption rates you know the consortium might have beyond obviously the 14% that you're already in discussions with selling to them additionally?

Secondly I mean you mentioned that you're confident on maintaining the credit rating but can you tell us a bit more precisely what happens to your Group credit ratios following the sale, in particular your RCF to net debt ratio going forward?

**John Pettigrew, Chief Executive**
Okay let me pick up the first one and then I'll hand over to Andrew for the second one. So in terms of the first one, so there are no conditions on the remaining 39% so as we said we've taken no decision on selling the remaining 39% and there are no pre-emption rights at all.

In terms of the credit ratings Andrew?

**Andrew Bonfield, Finance Director**
Yeah actually we will get a slight tick up on the RCF to debt because for two reasons. One while we hold the remaining 39% we'll receive income in the form of a dividend stream which will help obviously the top operating cash flow, and then we will no longer be consolidating the debt, and as we know the debt in Gas D is a higher proportion of debt than other parts of our business. So we expect a small improvement in the RCF to debt metric as a result of the transaction.

**Guy MacKenzie, Credit Suisse**

Thanks very much.

**Telephone Operator**
Our next question comes from the line of John Musk. Please go ahead John, you're now unmuted.

**John Musk**
It's all right; my questions have been answered.

**Telephone Operator**
Okay thank you John, I'll remute your line. Just a second please. Okay moving onto our next question then it comes from the line of Ajay Patel and Ajay is calling from Goldman Sachs. Please go ahead Ajay you're now unmuted.

**Ajay Patel, Goldman Sachs**
Good morning. I just wanted to check the tax implications of this deal. Is that all - if you could just go through actually how that works, as in will there be an additional tax burden for this or not, and is that included in the £500m that you're talking about in terms of the cost for the overall deal?

**John Pettigrew, Chief Executive**
Most of the - there is virtually no tax payable on the deal. We pre-cleared most - obtained tax clearances already. There will be some small amounts paid but that is included within the sort of £500m number.

**Ajay Patel, Goldman Sachs**
Okay thank you.

**Telephone Operator**
Our next question comes from the line of Deepa Venkateswaran from Bernstein again. So you're now unmuted Deepa, please go ahead and ask your question.

**Deepa Venkateswaran, Bernstein**
Thank you. I just wanted to clarify what might be the dividend policy of the new entity, just so we understand how much we can model in in terms of cash inflows from your 39% stake?

**Andrew Bonfield, Finance Director**
Yeah I think my understanding Deepa is as part of the shareholder agreement we will agree a distribution policy and that policy mostly will be to distribute what cash is in the entity itself each year.

**Deepa Venkateswaran, Bernstein**
Okay thank you.

**Telephone Operator**
Ladies and gentlemen we currently have no more questions in the queue so please be reminded if you do want to ask a question just press *1 on your telephone keypad now.

Okay we've got another question coming through and it comes from the line of Iain Turner and Ian is calling from Exane. Please go ahead Ian, you're now unmuted.

**Iain Turner, Exane BNP Paribas**
Morning gentlemen. Could I just get you to go through how you calculate the EV of £13.8bn? I think it's probably - I'm struggling with this 1.8 again. What we need is a diagram.

**John Pettigrew, Chief Executive**
Andrew?

**Andrew Bonfield, Finance Director**
Yeah so the way to think about it is effectively we get equity - the equity portion, our 61% is £3.6bn. So that equates to an entity value of around £6bn if you own - for 100% of that. You add back the Mid Co debt at £1.8bn, then you add back Op Co debt at fair value which is £6bn rather than £5.6bn and that gets you to your £13.8bn.

**Iain Turner, Exane BNP Paribas**
Why don't you add back 13 - why don't you gross up the 1.8? Why have you got all of the 1.8, why haven't you got 39% of it?

**Andrew Bonfield, Finance Director**
Because effectively it is the financing put into the mid part of the structure which effectively then is used as a way of leverage effectively, and all that cash through refinancing comes straight back to us as part of a transaction just ahead of the deal being completed.

**Iain Turner, Exane BNP Paribas**
Okay thanks a lot.

**Telephone Operator**
Ladies and gentlemen there are no further questions in the queue. At this point the conference will conclude. Thank you for joining today's call, you may now replace your handsets.

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