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Conference Call Transcript

NG..L - National Grid US Restructuring Announcement

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PRESENTATION

Steve Holliday - National Grid - Chief Executive

Welcome, everybody. It's Steve Holliday here. Thanks very much for joining us this morning. As you saw yesterday, we brought forward our IMS to coincide with the announcement around the changes in the US, which we wanted to make very clear in terms of internal communications, as you understand, to US employees. Hence the unusual time of the day, 2pm UK time.

This morning's call is really to focus chiefly on that restructuring, on the US, rather than the IMS. With me this morning I've got Andrew Bonfield, our FD. Tom King is on the line from the US, and Nick Winser is with us as well. Plan is to go through the presentation, and then we'll have plenty of time at the end for a Q&A session.

Just one quick point on logistics. We're going to take the questions on the conference call only. I know we tried before on the web. So we thought it would be more efficient today to actually do that on the telephone, which we'll do at the end of the presentation.

Turning to the presentation, as you will have seen, we announced management changes in the UK, but in particular in the US yesterday. And we're making these important changes to deliver the improvements to the way in which we run the business, and hence the results of that business. And I want to talk about the US, and we're going to really focus in, as I said, on the US here. Together with that was an announcement of a new reduction in costs in our US operations and a restructuring of how we deliver the service to our customers.

I hope I've been very clear in the past, but I'll say it again for the avoidance of doubt, we are not happy with the returns that we are currently earning in all of the jurisdictions in the US. Not in any way hiding behind the fact that some of those jurisdictions are earning not only their allowed returns, but above their allowed returns. We are not comfortable until we've got every part of our portfolio earning at least its allowed returns.

And the strategy in the US has been clear. We've been filing, as you all know, over the past 18 months, many new rate filings. That has brought in, to date, \$388m of additional revenue. And that includes the Niagara Mohawk outcome, which to be very clear about it was a disappointing outcome. It was not an outcome in any way we feel good about.

And we've also been filing for improvements in the way that the regulatory arrangements work, some of the structural changes that are important to protect returns going forward. And I think what's been clear as well is that we will also take action to improve the business ourselves, often referred to by some as self help, and drive to a new level of efficiency.

And that was at the heart of yesterday's announcement, three key measures to improving the business. The first of those is giving accountability for the US to Tom and a newly appointed leadership team under Tom. So we're creating a new role. It is not in any way going back to a role that existed some five or six years ago. It's a very different role, looking after the whole of the US, reporting in to me. Clear responsibility and accountability for delivering the targets that I'm going to come on to talk about, and all the actions around improving our performance in the US.

And then that role is mirrored to an extent with the expansion of Nick Winser's role in the UK, as Executive Director responsible for all the businesses in the UK. Nick will actually take over that responsibility after a transition of a month, so he'll do that in March. And Tom's new position is effective from April. So from the new financial year, the vast majority of the top level organization will be in place.

That doesn't mean that Mark will be leaving at the end of March. He's inevitably got things to do. Mark's been a great contributor to this Company for 21 years, including the last four on the Board, and I've got a lot to thank him for personally, actually. I'm sure he'll go on and do other things and be very successful.

The second piece yesterday was around efficiency and productivity. We have plans in place that we'll take you through in a moment to target \$200m a year of costs out of our business, which is a significant step to addressing the gap that's still left, despite the \$388m of revenue, between what we need to achieve allowed returns across all of our businesses. And as Tom will talk to, the particular gap is clearly in the old Niagara Mohawk business.

And thirdly, we're evolving our structure. And this is about how you have your cake and eat it. We still need to get the benefits of scale and we can do it in IT procurement across the UK and the US. We still need to use our scale in the US, in the way in which we service our businesses. But it's very clear, as we listen to customers and regulators, we need to evolve the structure, to improve the focus on the jurisdictions, with presidents in our states, as Tom will describe in a moment. And I think that's a trend not just in utilities, actually, but it's very clear to us that now is the right time to make that evolution.

And we have to align our costs to those allowed in each of our rate plans. We've got to ensure we've got people that are focused on that, focused on delivering the performance of each of those businesses. Yes, the relationships, but these positions, as Tom will describe, are not figureheads with just relationships. They're absolutely responsible for reliability, for customer service, and indeed for the service agreements with the business that makes sure that they hit the RoE targets in all of these businesses.

So these measures are absolutely at the heart of improving the performance of all of the businesses in the US, and not surprisingly particularly focused on improving Niagara Mohawk.

So, just before we get into a little bit more of the detail of that structure and the cost savings, I think it's just worth going back a little bit and reminding how we got to this point. We did have several good years of out-performing on our allowed RoEs under those long-term rate plans that were set up back in 1999 and 2000. But in the latter period, we have been under earning against our allowed returns, with an inability to get in and reset those rates. 10 years was, with hindsight, too long.

You've seen before in presentations that I've given, and others, that the primary driver for that underperformance has been our costs. It's not been over investment. There's been a small drag. The real primary driver is that our cost base has gone up with cost pressures, and the cost of service that was embedded in those old rate structures of a decade ago are clearly out of date.

And there's lots of drivers for that. The economic cycle has driven up bad debts. Pension costs, employee costs, have inevitably driven up over a 10-year period. And some of the spending on CapEx, as you know, has exceeded that that was originally enshrined in those old rate plans.

As we sit here today, there's still a gap in the allowance that we have for the cost of running these businesses. And that's what led, last year, to particularly poor returns in some of our companies, particularly Niagara Mohawk and Rhode Island, whilst at the same time our down state New

York gas businesses, our transmission businesses, and in fact this year you'll see our Massachusetts businesses all performing at or above their allowed returns and in good shape.

But we're always going to focus on the bit that isn't working. And low returns are unacceptable, and this action is at the heart of addressing those low returns. So the short-term strategy on the US is very clear; we file and take self help to improve the business ourselves.

So, since August of 2007, so just after the closure of the KeySpan deal, we've had over 10 rate filings that have led to the revenue increase of \$388m. And as Tom will outline, and I'm sure we'll pick up in Q&A, we'll continue to file. We're not entering into these long-term arrangements any more, to preserve the flexibility, as other utilities do, to file when we don't have the rate plan features that we require, or where there's a mismatch between the cost that we need to deliver, the right outcome for customers and that that is allowed in the revenues.

But it's not just about the filings and the regulatory agenda. We've got to make a step change in our own efficiency. And it's very clear to us, as we looked at what we are able to do, that we're able to start on a new phase. And this is the beginning, not the end, as well. But the first phase certainly we can deliver the \$200m of cost savings by March 2012.

So, with that as an intro, Tom, over in the US, I'm going to hand over to you and you can take us through particularly, I think, some of the regulatory journey and the NiMo outcome, and the new team that we've put in place. So, over to you, Tom.

Tom King - National Grid - Executive Director

Great. Thank you, Steve, and good morning, everyone.

And as Steve had mentioned, the US strategy has three key elements, and I'll just repeat them briefly and then build on them. Number one is setting the revenues at the right level to ensure cost recovery, investment recovery and returns. Number two is the right regulatory structure to sustain that cost recovery and the returns. And third, to continue to drive towards a very cost-efficient business and to sustain that cost efficiency.

This slide clearly demonstrates that our first -- on our first objective of cost recovery. We've been very active in rate filings over the last three years, and to date we have been awarded over \$380m in revenue increases as a result of those filings. This process is ongoing, and one that we will continue to file rate cases where we see the need to address any revenue deficiency.

The second element is having the right regulatory structure in place. This slide clearly demonstrates significant progress on that effort. Over the past few years, we have achieved the correct regulatory structure in many of our rate filings. This clearly sets us up to ensure that our ability to sustain the cost recovery and the returns is there in the regulatory structure.

And as we've mentioned before, the third key element is the cost efficiency. Yesterday, we announced yet another step to ensure cost efficiency by eliminating \$200m per year of cost within our business. More on this in just a couple of slides.

But first, now let me focus on the PSC decision on Niagara Mohawk. And to reiterate Steve's earlier comments, this is a very disappointing decision and not one that we were expecting. Nor is this the decision that helps us continue to operate Niagara Mohawk at the right levels of cost recovery.

We did achieve decoupling, which was a good outcome on the structure aspect of it. And I'll remind you that we filed for \$360m of incremental revenue to cover the costs that we expect are required to run this business, and we've fundamentally failed at achieving that outcome with the PSC's decision.

A few key elements around the decision are important. First of all, \$67m of the revenue that was not allowed by the PSC in its decision relates principally to non-cash items, things that do not affect the RoE. For example, we requested an increase in the storm allowance, and prior to this rate case the storm allowance was set at \$20m per year. We requested an incremental \$30m over and above that \$20m, because that's based on the expectation and the forecast of what we're experiencing annually in storms. That incremental \$30m was not allowed. That doesn't mean that that is a decrease in the actual cash or cost of service; it's just we were trying to build a storm fund to prepare for future storms.

Second is the change in depreciation rates, which ultimately is a non-cash item for us on operating the business annually.

Now, the second key element of the decision was that we were awarded 9.1% RoE, with the ability to earn an additional 20 basis points if we did not file a new rate case in 2011. We have decided to apply the 9.3% to the decision. Further, we retain the ability to refile, but if we do, the 20 basis points would be refunded proportionately, based on when we actually make that filing.

This time allows us to focus on working with the PSC on several key financial issues. Currently, in front of the PSC, we have a pending CapEx filing that allows for both the cost recovery and the returns on the \$1.47b that we agreed to at the KeySpan merger for infrastructure improvements. Second, we have an opportunity to file for \$200m of deferral recovery that would go into effect in January of 2012. And third, we have to continue to work through the \$50m of temporary rates through the ongoing audits that have now been set up as a result of this past rate case.

One thing that I would like to point out to you that's very important in the decision is the \$1.47b investment that we've made into the Niagara Mohawk system in 2007, '08, '09, '10, as well as 2011, is in the new rate case that was established by the decision last week, and will be in the rate base and earning as of February 1 of 2011.

The remaining aspect of the CapEx discussion and decision from the Commission is the cost of money associated with making that CapEx filing - those CapEx expenditures over the past three to four years. And it's roughly about \$20m, and it's a one-time improvement in our earnings for the year.

So we will continue to pursue that application, we will pursue the filing for the \$200m of deferral, and we'll try to wrap up the \$50m of temporary rates, all within 2011. And that establishes a new base that we would go in at the end of 2011 or the beginning of 2012, to reset rates once again.

But clearly, however, there's still a gap in the remaining actual costs that the regulator believes that are required to run this business. It is this gap that essentially prevents us from earning the allowed return. We were granted \$119m increase in our revenues, and therefore we have a gap of roughly around \$100m in our revenue recovery relative to our cost. Our total requested O&M is roughly \$1b on an annual basis. This \$100m gap represents roughly about 9% of that cost of service. We will therefore be focused on removing that \$100m from our cost base.

Throughout the process, the regulatory attention on the allocated cost made it clear that we need to focus on the local jurisdictions and our own systems, in order to build trust with the regulators. Hence, the audits and the temporary rates are a result of that. Today's restructuring goes a long way to address this issue.

Now, let's pick up on the third key focus, our cost efficiency. Yesterday, as -- the next step was announced in our cost-reduction program in our US operations as part of the \$200m. This is a major step towards addressing the performance gap here in the US. We'll reduce our costs by roughly \$200m per year, and that includes a reduction of 1,200 positions here in the US.

We have already started this process. With the announcement of the senior executives yesterday, this first level appointment represents the new management and it also represents a 26% reduction in senior management. Within the next few weeks, we will set the next level of staff and we will also achieve another 25% to 30% reduction in that level of staffing. We will continue this momentum and we will cascade those reductions down through the rest of the organization.

And I want to emphasize that we are able to remove this significant amount of resource base, and we will not impact our ability to operate safely, efficiently and reliably. We are cutting the numbers of layers of management and it will result in fewer people, but it also means that we improve communication, we improve the speed of decision making, and we also increase the accountability and ownership at all levels of management. In short, we're a leaner, more efficient organization with this announcement.

Headcount reductions represent roughly 80% of the \$200m, and I expect these reductions to be delivered by August of this year, August of 2011. We also expect to hit the full \$200m run rate by March of 2012, and we have a structure and a plan that that's sustainable going forward. On top of the headcount reductions, there are other savings that we will continue to focus on, such as IS and other areas that we have previously announced and will continue to proceed forward with.

This is the first initiative that I'm announcing, and I do expect us to continue to be able to grow upon this and deliver ultimately with the right cost structure and the right revenue recovery here within the US.

Now, let me summarize how the management team will function. There will be regional presidents in New York, Massachusetts, Rhode Island, New Hampshire and on Long Island. And we will have a president responsible for our Federal Regulated Businesses. Each president will be responsible for delivering safe, efficient, reliable and cost-effective services for customers and regulators in each of those jurisdictions. They will

be accountable for aligning our cost with our allowances and our revenue enhancement. And the Long Island role will specifically be accountable for the business performance of our Long Island Power Authority relationship.

To give you an example of how these roles will function, for example, Ken Daly, who is now our President of New York, Ken will be responsible for all three of our New York jurisdictional entities. That includes Niagara Mohawk Power Corp, KeySpan Long Island and KeySpan New York. And he'll have full accountability for the delivery of the P&L, the regulatory strategy, and the relationships and community relationships as we move forward with each jurisdiction.

These new leadership teams will ensure best practice across all of our processes and drive efficiency through single point accountability for each function. For example, this would include operations, maintenance, construction, safety, human resources, etc., and working with each of the jurisdictional leads.

And also, the global functions, which include finance, procurement, IS, will continue to be a part of the US management team. And they will allow us to capture the benefits of our global scale, but also tailor the services to the local needs, as well as providing a single point of accountability.

So very, very significant change for us here in the US, where we've got a very clear sense of where the accountability sits, and a new management team that is aligned to hit these cost targets and to deliver on the objectives as we've outlined today.

So, with that, I'll hand it over to Andrew, to talk you through the financials. Andrew?

Andrew Bonfield - National Grid - Finance Director

Thank you, Tom, and good morning, everybody.

You will have seen from the IMS release yesterday that we expect 2010/11 to be a strong year, particularly for our US businesses. Some of this is due to timing, starting with the Group position of about a GBP200m under-recovery at the beginning of the year. In the US we've seen strong weather-driven volumes, with a hot summer followed by a cold winter, whilst in the UK we are benefiting from full recovery of K. This means we expect any under-recovery at the end of this year to be broadly neutral. So whilst the benefit will disappear next year, we don't expect it to reverse.

So, similar to what you saw at the half-year, we do expect operating profit to be significantly ahead of the prior year. Earnings per share will be broadly in line with the restated 2009/10 level of 49.5p, eliminating the dilution of the rights issue.

Looking at capital expenditure, we are expecting to invest GBP3.6b by the end of the year. Significantly up on last year, this is down on the guidance we gave at the half-year, mainly due to additional procurement savings. Obviously we are not immune to commodity pricing pressure, so at this point we don't expect any permanent impact on our overall capital program.

You should also note that we will be allocating \$100m, or around GBP63m, to exceptionals, although most of that will be in the next financial year, as the cost to achieve for our US cost-reduction initiative that Tom spoke about a moment ago.

Looking at our returns on equity in the US, which you should remember are calculated on a calendar year basis and are expressed on a US GAAP basis as well. We haven't quite finalized the 2010 RoEs yet, and we'll inform you of these at the year-end results in May. But they are expected to show an improvement on last year, as rate increases come through and due to weather-related benefits.

In addition, the impact of increased revenues and rate cases will have completed in 2010, but will only impact after January 1 of this year, are expected to improve pro forma returns going forward by about another 0.9%. The cost-reduction measures that were announced yesterday are on a pro forma basis, also expected to improve returns by about another 1.5%. These two factors are expected to make a significant contribution to closing the US performance gap.

Obviously, however, the world does not stand still, and there is always a lag during the implementation of these measures and revenue increases, during which other cost pressures may increase. And we may have to offset some of the impacts of our savings as part of the refund strategy we were talking about earlier.

As Tom said, yesterday's announcement is the next step in addressing the returns underperformance. But we will have to make additional measures in due course, which will include further rate filings, in order to achieve the desired returns.

Now I'll hand back to Steve.

Steve Holliday - National Grid - Chief Executive

Thanks, Andrew. So, just before we open up to questions, just a summary.

This is the next step towards the right organization in 2011, frankly, to drive improved performance in the US. And we have a commitment, while we own all those assets, to drive that performance. We've got changes in place that will improve the performance of all of the jurisdictions here, because of the way in which the costs are allocated across the businesses, but clearly there's a particular focus on Niagara Mohawk.

We are putting in place this jurisdictional structure, as Tom said. But just for clarity, 98% of all of our people actually sit in the services that provide, on that chart, the actual execution. The jurisdictional heads have very small teams to manage that direct responsibility. And I'm confident that we will improve the performance, and in some cases will outperform our RoEs. But let's make no bones about it; we've got more to do. We recognize that. This is a big step in the right direction. But I think, as Andrew said and as Tom said, there is still more to do.

So, with that, let's open it -- if I can hand back to the moderator, and we'll take some questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). We'll take our first question today from Bobby Chada from Morgan Stanley. Please go ahead.

Bobby Chada - Morgan Stanley - Analyst

Thanks. Good morning, everyone. I have two questions, please. The first is on the -- in the individual US jurisdictions that you're now setting up, one of the main problems in the NiMo rig is agreeing the cost allocations with the staff. Will you have to go through a cost allocation and a regulatory cost audit in each of the jurisdictions? And is there any risk, do you think, that some of the centralized costs will not be agreed within those cost allocations? How do you manage that risk?

And then the second question was does this reorganization involve new systems? And how long do you think it will take to put the new IT systems and operations in place?

Steve Holliday - National Grid - Chief Executive

Thanks, Bobby. Tom, why don't you pick up the first one and then Andrew talk to the systems one.

Tom King - National Grid - Executive Director

Okay. Yes, Bobby, the -- first of all, the cost allocation issue, as you've probably followed us through this last year on the rate cases, is now an issue broadly across the US. So we're -- we know that. And we're going to go through a process that resets the cost allocation appropriately in each of the jurisdictions, and it will be part of our ongoing rate proceedings.

I don't think it is an increased risk. I think it's an issue for any multi-state holding enterprise across various jurisdictions. I think what we have is an opportunity to reset the proper allocation across each of the entities, and that's how we'll proceed with it going forward. And I don't think the centralized component necessarily is an increased risk, because the reality of where that's centralized ultimately delivers its benefits to the customers of a more efficient organization.

So it's -- the responsibility and accountability clearly sits with myself and the management team, to prove out the benefits of those centralized centers of excellence, etc., and to get the proper cost allocation across each of the entities. We know that, and that will be a key focus of how we proceed forward.

So, Andrew, do you want to pick up the systems?

Andrew Bonfield - National Grid - Finance Director

Yes. We actually have an SAP project underway in the US. One of the key things that actually we needed to resolve was the jurisdictional focus, in order to make sure we configure the system in the right way. We expect to have that up and running probably by the end of the 2011/12 financial year, and implementation thereafter.

I think a couple of quick points on cost allocations. One of the things we are going to do by having the new structure is we will be appointing a CFO in the US. That appointment is in process. We're looking externally. And the aim will be to have a business partner who can work with Tom and the jurisdictional heads, to get a better handle on the understanding of the overall cost allocations.

I think, with 65% of our cost allocated in the US, that is one of the benefits of having the jurisdictional heads overseeing how that moves from a regulatory perspective. And again, as Tom said, trying to make sure we focus people on the performance of the business and how the individual jurisdictions benefit from centralized allocation methodologies.

Bobby Chada - Morgan Stanley - Analyst

Great. Thank you.

Operator

We'll take our next question from Dominic Nash from Liberum Capital. Please go ahead.

Dominic Nash - Liberum Capital - Analyst

Hi. Good morning. I've got three questions, if I may, please. The first one is on benchmarking. When you look at your new divisions' employees and costs per operating metrics, after your cost-cutting initiative, where do you think you're going to be sitting relative to your peer group? And what scope is there for further cost cutting beyond that?

Secondly, what's been the union and political feedback from this, and whether you think there's going to be any sort of ramifications from regulatory cases and your unions taking the job losses?

And thirdly, on the -- if you get your RoEs above 10%, as it seems that you possibly could, is it fair to assume that you won't be reopening or refiling a NiMo rate case, once you've actually started to strip the costs down?

Steve Holliday - National Grid - Chief Executive

Okay. Thanks, Dominic. Let me pick up the benchmarking and then I'll hand over to Tom on the next one, and Andrew can pick up the third one, actually.

We have done a lot of benchmarking. I think we talked a little bit about it in the announcement yesterday. We don't have an industry going on here, I can assure you, of benchmarking some businesses go and get themselves into the spiral of. But we do take a look, through a series of studies, at our costs. We don't just use utility industry either, because we don't think that's a good benchmark at times, frankly, for things like IT costs, for example, when we look at other big industrial groups.

The simple answer is when you look across the main process drivers of costs, there are some where we benchmark very, very well. In fact, we're right in the upper quartile. There are others where we're nowhere near. So, as we look at the organization and the structure, it's absolutely designed to hit the places where it's very clear there are opportunities for us to do things more efficiently.

In fact, when you get into the utility sector in the US, Dominic, and we benchmark again some of our costs, although on one or two of those areas we are close or near to the top, top being the most efficient, actually, we should be a long way ahead because that is not a demonstration of the scale that we should be bringing to bear. So, even when it actually says you're doing okay, then when you compare with the others who are similar cost structure, it's pretty clear that we should be exploiting our scale more.

So there's quite a bit of benchmarking that's gone in here, which gives us very much the confidence, as Tom said, that what we're doing is not in any way putting at risk reliability or operation at all. We've got overlap. We've got opportunities to strip out layers of management here and crispen up the whole accountability and focus. And that will lead to the significant reduction in costs.

Tom, you were in the heart yesterday of talking to many of our stakeholders externally. So why don't you give Dominic and others on the call a bit of feedback from that, please?

Tom King - National Grid - Executive Director

I'd be happy to. Dominic, the initiative of the 1,200 positions do not involve the union group. So we roughly have 17,500 employees here in the US. 6,000 of that represents management. And the target of the 1,200 positions is the management group, not the union. So, little feedback on union relative to that, because they are not impacted by the announcement.

Broadly, both the political and regulatory feedback, I will continue through that process today. I think, in general, I think it would be fair to say how can we -- the response is what is it that we can do to continue to work with National Grid and make sure that we're hearing the needs of what's required for you to run the business. And we want to continue to work with you on that.

I think it's important to point out that, as we've discussed here on the call, we've now taken the entire US through the regulatory process. So we have a very clear indication from the regulators on where they're willing to fund the business. That's what's driving the gap between the actual cost base and what the regulators are willing to fund. Therefore, the action that we're taking is to adjust our cost base down to what the regulators are willing to fund, in line with the benchmarking that Steve just talked about, to ensure that we can still operate the system, maintain delivery, reliability and safe operations.

So, a big part of our discussion that I've had yesterday and today with them is we are going to operate the business and live within what you're willing to fund. We'll continue to tell you where we think we should be funding the business, and hence that will be a key part of the rate cases going forward. I think we'll find a strong interest, both politically as well as the regulatory body, to really understand those numbers and make sure they clearly understand and align with where we think we need the funding, to deliver both on the energy policy objectives, employment objectives and an efficient operation. And that's exactly where we'll be focused as we go forward through the regulatory process.

So, Andrew, do you want to pick up the RoE?

Andrew Bonfield - National Grid - Finance Director

On the RoE, Dominic, as Tom indicated, we have about a \$100m gap between the cost of service that we're allowed by the regulator and our expected cost of service for NiMo. The cost savings are \$200m across the US as a whole. The NiMo business represents about 30%. So, assuming as we go through this that we are unable to allocate a disproportionate impact to NiMo, we still will not get to the allowed RoE of 9.3%. So we don't get to the 10% as a result of this. We will need to refile, and we will need to continue to look at the cost base as we move forward.

Dominic Nash - Liberum Capital - Analyst

Okay. Thanks very much.

Operator

We'll now take our next question from Edmund Reid from JP Morgan. Please go ahead.

Edmund Reid - JP Morgan Cazenove - Analyst

Good morning, guys. I've got three questions, if I may. Firstly on the overall level of investment in the US, I think other US utilities have seen a fairly reasonable step up in CapEx. I think you've talked before about underinvestment in the US networks. How does that kind of square with the cost-reduction program? Do you think you can continue to run networks reliably and also reduce costs?

The second question is, I guess, more strategic. Given the sort of reorganization and the move to more regional lines rather than global, what do you see as the synergies between the UK and the US business? And do you think you've achieved them to date? Do you think there's more that you can go for?

And the final question is slightly outside the scope of the call, but in your IMS yesterday you talked about the UK regulation and you thought the fact that OFGEM was more constructive on that regulation. I was just wondering if you can give us color on what leads you to that conclusion. Thanks.

Steve Holliday - National Grid - Chief Executive

Okay. Thanks, Ed. Let me pick up the first couple and actually give Nick a chance to comment on the call on the third one. And, Tom, if you can add anything if you think you need to.

Just to go backwards a little bit here, we have hugely increased the amount of investment into our US businesses from where they were three years ago. I think we talked at last year's full-year results, actually, at what is essentially, for the next five-year period, a GBP1.1b/GBP1.2b a year of CapEx going into the US, is not commensurate with the long-term view that anyone, I think, in the industry would have about the capital needs of modernizing and replacing old infrastructure, but it's consistent with maintaining the status quo.

So I'd point, actually, to this year, when you see our reliability stats again, other than a storm in Massachusetts, as the IMS says, yet again we've hit the big reliability targets. If you go back three, four years, we were, in many of the jurisdictions, not hitting those reliability targets, actually, which led to penalties. So we've got the business, in a reliability sense, performing. Customer satisfaction has gone up again this year. It's better than it was.

But we're going to hold the status quo. Are we modernizing the networks at the rate that they need? No. That remains the opportunity for the future, but we're very comfortable with the CapEx that's going in today to maintain things. And absolutely the costs, as Tom has said, we're comfortable that we can continue with the reliability and improving the customer stats that we have been doing.

On the second one, Ed, and I think we'll come back to this with all of you in future conversations, I'm sure, we've delivered a lot from the structure we put in place four years ago. That was about driving consistency where it made sense across the UK and the US. In fact, Mark's played a big part in that. Many of our processes in our gas businesses are very similar on both sides of the Atlantic. Many of our asset management processes that are all PASS 55 accredited on both sides of the pond now, from a standing start. And we've got that professionalism in place.

And the two big areas of exploitation of scale were in IT and procurement, and we've not delivered those as fast as I or others actually wanted. We've made a bit of a slow start. In the last year, that has really gained some traction. And the new structure is very much about not throwing that away. We continue to have a global IT and asset procurement activity, and there's much more to go for in that space in the future.

But having put a lot of common processes in place, it's very clear now, from the things that Tom said, we can drive crisper accountabilities and significantly reduce the layers of management in the US and take a lot of costs out, while maintaining some of the things that we've built in the last three or four years.

I know that all of you on this call have the pleasure of being with Ofgem in only a few hours, so I guess you'll get some answers to those questions. But as part of the process, we were in talking to Ofgem last week on the gas distribution review, and we will be in talking again to GEMA this week on the transmission review.

Nick, would you like to just make a couple of comments on RIIO and where we see it at the moment?

Nick Winsor - National Grid - Executive Director

Yes. Thanks, Steve, and good morning, everybody. We remain positive on RIO. Clearly it's very early days, which Ofgem themselves will say. We've still got the best part of two years to run on this process. But the discussions we're having with Ofgem are ratcheting up in intensity.

And the backdrop, I think it's worth thinking about the backdrop to all of this. The discussions on most of the -- certainly the increases in CapEx that we'll be getting into over the next two years are all about delivering key energy policy outcomes. And they're associated, clearly, with the decline of UKCS gas, and even more so associated with decarbonization of the electricity sector and very, very high profile and vital asset replacements such as the London cable tunnels.

So the backdrop to all of the discussion around RIIO is a set of investments which are absolutely critical to government, and we are closely tied in to discussions both with government and with Ofgem around that. As a sign of that, I think it's worth reflecting on the progress that's been made on the anticipatory spend, where we've -- over the last two or three years we've, within a price control period, set up very positive conversations with the industry, with government, with Ofgem, and seen new allowances come through within the price control period to allow us to get on with this really vital investment.

So I certainly don't want to sound complacent about this, because I'm not. We will need to engage very strongly on some issues with Ofgem, that we will. I'm sure you'll be making a variety of views known to them as well. But the overview is that these are vital investments, and we think Ofgem knows that and knows that they will need to provide attractive returns to investors.

Steve Holliday - National Grid - Chief Executive

Thanks, Nick. I hope that helps a bit, Ed.

Edmund Reid - JP Morgan Cazenove - Analyst

That's great. Thank you very much.

Tom King - National Grid - Executive Director

Yes. Steve, let me add just something real quick that I think is important for everyone to understand is if you look at the direct O&M that's funded at each of the regulated entities across the jurisdictions, they're roughly funding the operations and maintenance of each one of those entities, the daily operating costs of maintaining the networks. That's number one. Number two is we're not impacting the field force. So we'll have a field force that will continue to be present and responsive in maintaining the networks and responsive to customers.

The problem in the US is fundamentally in the allocated costs, the allocated overhead costs, and that's where we'll go after with this \$200m. So we'll be able to maintain the networks, have safe, reliable, delivery of the networks, and get the fundamental allocated costs down.

Steve Holliday - National Grid - Chief Executive

Thanks, Tom.

Operator

We'll take our next question now from Iain Turner from RBS. Please go ahead.

Iain Turner - RBS - Analyst

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Morning, gentlemen. Can I just ask you, the return in New York at 9.1% or 9.3%, even if you get your cost control through, that seems to be the upper limit of what you can achieve. So why are you still enthusiastic to spend more CapEx into that network, when the returns are probably lower than you would expect or lower than what your actual cost of equity would be?

And then, secondly, would you expect to be changing the way you report your segments going forward, once you've made these changes in the US?

Steve Holliday - National Grid - Chief Executive

Hi, Iain. Let me take the first couple and Andrew can talk about the segments. Interesting you used the word enthusiastic. I'm not quite sure where you picked up enthusiasm for. But these are long-term businesses, as you well know, with all your experience. And we are not enthusiastic to put any new capital to work in New York at the current rates of return. I think Tom in his conversations yesterday made that point very, very clear.

We clearly have a year deal at the moment. And we have a capital allocation, if you like, an agreement of what we'll invest in those networks, which is consistent with the comments I made about it will maintain the reliability of the system, because it's all about asset replacement, essentially. That's where all the CapEx is going. Does that system need more in the future? Yes. We're certainly not enthusiastic about increasing above that level until the returns in that business, not just the allowed, the delivered returns, are more attractive than they are today.

You'll also know that when you look at risk-free rates in the US today you can calculate, at a spot in time, some pretty low theoretical equity returns. So what we don't do is comment and say that's the right number this week, because that's not how this business runs, actually. I think we understand the process that you go through in the short-term deals here, but don't believe that those low, risk-free rates are long-term sustainable, so don't believe that big investments should be made into these systems and attracting that sort of return.

That's very much the statements we've made to our regulators. We've got to earn that allowed return to start with in this business. But longer term, to want to invest more, I and we completely agree with you, we need to have arrangements that allow us to earn much higher returns. Absolutely right.

Andrew Bonfield - National Grid - Finance Director

Iain, on the segmental analysis, we are in the process of reviewing that. The fact we are moving from a -- executive responsibility from lines of business to geographic means we will probably change segmental analysis. The likelihood is we will end up with three segments, because that is the minimum normally required. It probably will be the US, and in the UK we'll separate transmission and distribution. But we will confirm that in May.

Iain Turner - RBS - Analyst

Thank you.

Operator

(Operator Instructions). We will now take our next question from Jamie Tunnicliffe from Redburn Partners. Please go ahead.

Jamie Tunnicliffe - Redburn Partners - Analyst

Yes. Good morning. A question for Andrew, I think. Just, Andrew, when you look at the current exchange rate, where would you expect net debt to be at the end of March?

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Andrew Bonfield - *National Grid - Finance Director*

We expect net debt to be broadly in line with where we are at the half-year. It would be somewhere around the GBP19b to GBP19.5b level. Obviously exchange rate does have some impact on that.

Jamie Tunnicliffe - *Redburn Partners - Analyst*

That's great. Thanks.

Operator

We have no further questions in the queue at this time.

Steve Holliday - *National Grid - Chief Executive*

Okay. If there are no more questions, thank you very much for joining us this morning. I know you've all got a busy day ahead of you with the Ofgem session this afternoon. If there's anything else you need, then you know the team's numbers. But thanks again for joining us this morning. Much appreciated.

Operator

Thank you, ladies and gentlemen. That will conclude today's conference call. Thank you for your participation. You may now disconnect.

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