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Conference Call Transcript

NG.L - National Grid PLC UK Regulatory Update Conference Call

Event Date/Time: Aug 04, 2011 / 01:30PM GMT



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PRESENTATION

Operator

Good day and welcome to the National Grid UK regulation update conference call. Today's conference is being recorded. At this time I'd like to turn the conference over to your host today Mr. John Dawson, Director of Investor Relations. Please go ahead, sir.

John Dawson - National Grid PLC - IR

Thank you very much. Hello everyone and welcome to National Grid's conference call on our UK regulatory developments. My name is John Dawson, Director of Investor Relations for National Grid and with me today are Nick Winser, Executive Director responsible for our UK businesses and Paul Whittaker, UK Director of Regulation.

The call should last around an hour, and we intend to spend the first 30 minutes sharing our perspective on the key issues arising from the business plan submission we made on Friday of last week. I would draw your attention to our cautionary statement, a copy of which you can find contained in the presentation.

Before we get into the main part of the call, let me update you on two other developments in recent weeks. We're not presenting today any detailed materials about Ofgem's initial proposals for the one year rollover of the transmission review that were published on Tuesday.

As you would've seen, these proposed a 6% real increase in revenues in our Electricity business next year and a 12% increase in our Gas business.

If you have any questions about this, you are welcome to ask them at the end of this call or to contact the IR team directly.

Moving briefly to the US for a moment, you would've seen that we filed for the recovery of a number of deferrals in our Niagara Mohawk Electric business. This is the expected filing we agreed to make as a result of our recent NiMo rate case covering both deferred expenses and capital expenditure. As we have said previously, this totals around \$236m and if approved, would come into effect on the January 1st, 2012.

Turning to the submission of our business plans, headlines include a combined TopEx of GBP30.7b on a nominal basis split GBP25.4b in CapEx and GBP5.3b in OpEx and split GBP22b in electricity and GBP9b in gas. Nick Winser will share with you a little more detail around this investment, why it is required, and what we will be delivering.

The plans also include our proposals on financing the notional regulated entities. In other words, NGET and NGGT. These include a cost of equity of 7.5% and 55% gearing. In addition, we have proposed a two period transition to 45 year asset lives for a new electricity investment. Paul Whittaker will take you through this in more detail.

Finally, as part of the funding of the notional entities and the move to a new capital structure, the plans include GBP4.1b of notional equity injections into the individual notional businesses.

I will conclude the presentation by providing a Group context and drawing a clear distinction between the financing of these individual notional businesses and that of the Group as a whole. We'll then turn the call over to questions.

Let me now hand you over to Nick, who will take you through the highlights of our submissions today.

Nick Winser - National Grid PLC - Executive Director UK

Thank you John and good afternoon, everybody. As you know, this is the first time that we've been through the RIIO process and what we've submitted is a fully thought through package.

Our proposal needs to balance four important drivers. First, maintaining safety, security of supply, and reliability. Second, delivery of legislative climate change targets. Thirdly, of course, affordability of customers and fourthly, all of this needs to be underpinned by the need to deliver reasonable returns to our investors.

We've carefully considered how best to balance between these four drivers. This thinking has informed our planning of what we will deliver, how we will deliver it, what is required to finance this, and how it will affect key stakeholders.

A key part of our decision making process has been the extensive program of stakeholder consultation. And I'd like to take the opportunity to thank all of our stakeholders for their really excellent input. Therefore, these plans have not been developed in isolation. This is not simply National Grid proposing what is needed for the next decade.

In putting together our submission, we took on board extensive feedback about possible changes to the business plan and Paul will talk about this later. In particular, we have included a number of important flexibility mechanisms to enable the price control to adjust for different outcomes.

Before I take you through the highlights of the plan I think it's worth reminding you of the context in which we are submitting these plans for the next decade of UK transmission development.

We are already a considerable way into an exciting and challenging time for the UK transmission businesses. Changing sources of gas supply, aging electricity generation fleets, and ambitious carbon reduction and other environmental targets are all driving changes to our systems.

At the same time, many of the existing assets on our transmission systems are reaching the end of their useful lives. We're in a decade of transmission development, which will be absolutely essential to pave the way towards a low carbon economy.

In order to aid our planning process, National Grid has developed a number of scenarios for the future energy supply mix taking account of the drivers I've just mentioned. Our gone green scenario is a view on how the energy mix might develop in order to meet the legally binding carbon targets for 2020 and beyond. It has gained general acceptance as a credible base case amongst our key stakeholders. This has determined the spend in our baseline plan.

The scenario only assumes a marginal increase in the level of demand for electricity over the next decade but, of course, significant growth thereafter. And that's allied to the big changes in the generation of electricity during the plan period, in particular to drive down the carbon intensity of that generation.

On electricity supply, we anticipate a big growth in wind generation, more interconnection, and some growth in gas generation plant, while nuclear remains a relatively steady proportion until the end of the decade. Most significantly, we see a drop in coal and oil generation that helps towards the 2020 government environmental target.

On gas, demand also remains relatively stable. But further investment is required on that network that connects new gas-fired generation plants and to accommodate new storage capacity and imports as domestic supplies reduce to around 25% of the total demand by 2020.

We recognize that this is one scenario amongst many and we have stress-tested our plan against a number of other scenarios, in particular around slower or accelerated investment in wind and nuclear generation.

So turning now to look at some of the details of our baseline plan. To meet the requirements of the eight years from 2013 to 2021, our plan is to deliver the following. In our Electricity Transmission business, NGET, around 350 route kilometers of new transmission line, around 1,500 route kilometers of replacement lines, including phases one and two of our London Tunnels project, over 250 kilometers of underground cable, nearly 50 new substations, and two new HBDC interconnectors to Scotland, jointly owned with the Scottish TOs.

In our Gas Transmission business, NGGT, we expect to deliver 24 new compressors and around 1,000 kilometers of new pipeline.

Overall, compared to our investments over the last 10 years, this is a significant increase in activity. In order to achieve this, we estimate that we will need to recruit and train around 1,200 new engineers, project managers, and skilled technicians in electricity and nearly 400 in gas.

We've estimated the total costs, operating cost and capital cost, of delivering these outputs at approximately GBP31b over the eight year price control period. That's for both gas and electricity. These forecasts include challenging assumptions around underlying efficiency improvements on both capital spend and operating costs.

Looking at more detail of the electricity transmission business under the baseline plan, during the period we are predicting that we will connect 24 gigawatts of new generation and 2 gigawatts of additional interconnector capacity to our system and begin connection works for a further 24 gigawatts, in particular new offshore wind farms and nuclear plant.

The profile of spend we are proposing is broadly consistent with our previous plans; a steady increase to 2015 to '16 driven by an increase in load related CapEx and then a sustained level of investment until it tails off at the end of the decade. This reflects the very large reinforcement projects that we've identified as being required to enable the connection of future low carbon generation.

You will also notice a step up in the level of non-load related CapEx from 2017. In effect, we are using this workload as a balancing item over the period to, if you like, smooth the CapEx profile. To the extent load related expenditure moves backwards in time, we have the opportunity to bring forward some of this non-load CapEx. In using the non-load investment to balance the plan, we do of course need to consider carefully how we will manage network risk across the period. And we've done that.

To deliver all of the outputs we've discussed, we predict that we will need to spend GBP18.2b of CapEx and GBP3.7b of OpEx over the eight year period. Please note that these are forecast out-turn numbers, including assumption of future inflation of around 3% per annum.

All the numbers we've submitted to Ofgem are in 2009/'10 real prices, as specifically required by Ofgem. They are fully consistent with the out-turn numbers we are presenting here.

Turning to our Gas Transmission business, we expect investment in this business to be lower than that in electricity transmission but broadly proportional to the size of our existing business and with a much more volatile profile spend due to a small number of very large projects. We're predicting a steady increase in non-load related spend to 2014/'15.

As this declines after 2015, there will be a significant step up in load related CapEx. This includes major investment in additional transmission capacity to connect LNG importation, storage and new gas generation.

In total, we've estimated the costs of the gas transmission plan at GBP8.8b over the eight year price control period. This is, again, mainly driven by GBP7.2b of capital investment with GBP1.6b operating costs as well.

Overall, we believe this is a comprehensive and realistic plan to deliver safety, security of supply and reliability and to enable the industry to meet the climate change targets. At the same time, the impact on customer bills is minimized. As Paul will share with you, we expect the transmission

element of a typical annual household bill to only increase by on average GBP12 for both gas and electricity combined compared to the current level in real terms. Of course, this is all underpinned with the delivery of reasonable returns to our investors.

I'm now going to hand over to Paul, who has led the team responsible for the preparation and submission of these business plans. Paul is going to take you through some of the more detailed elements, including importantly, our financing submission. Over to you, Paul.

Paul Whittaker - National Grid PLC - UK Director of Regulation

Thank you Nick, and good afternoon everybody. I'd like to start by reiterating what Nick said earlier about stakeholder engagement. Our program has been very extensive and has driven a number of changes to our submission.

We've spoken to a range of stakeholders, including consumers, network users, government, and investors. And the main message we've received across the board is that we must continue to deliver network reliability and safety as well as value for money.

These discussions have also informed our views on return on equity and the other metrics required to attract new investments. As I'll cover in a moment, our plans assume funding at an individual entity level. This is very distinct from funding at a Group level and John will cover this later.

There are numerous examples where our own analysis and input from stakeholders has helped us to identify key design features for the plan. One concrete example is where feedback we've received has led us to consider carefully our assumption on the proportion of new electricity transmission lines that will need to be buried underground.

This is a controversial area. And we've assumed 10% undergrounding in the plan, something of an increase on historic levels. But recognizing that a debate continues, we've also proposed a mechanism to deal with the actual level that we're asked to deliver.

As I've said, our financing proposals also take account of the input we've received. And I'll run through these in more detail now.

But first, I should remind you that under Ofgem's methodology, we need to look at NGET and NGGT as notional companies funded by a set mix of equity and debt at an assumed debt interest rate. For each business, the metrics we calculate therefore are those for this notional company and do not represent forecasts of our actual out-turn or those of the wider Group.

In assessing financeability, we also assume the companies achieved their base level of return with mutual incentive performance.

In putting together our proposals for revenue and financeability, we considered a number of targets which we needed to meet. These targets included maintaining credit rating metrics at a suitable level for an A-minus rating. That's particularly FFO to debt and FFO interest cover; equity investor requirements, including support for appropriate dividend growth and a return commensurate with the level of risk; and finally and importantly, we considered the impact on customer bills while delivering long-term customer value.

When we looked at the levers available to us to find an acceptable financing package while meeting those targets, we looked at allowed return on debt and equity, assumed notional gearing, levels of depreciation, transition arrangements and the capitalization ratio. And what I mean by that is the amount of spend treated as so-called fast money -- in other words OpEx -- versus the amount treated as slow money. In other words CapEx added to the RAV.

The Ofgem decisions document in March applied some guidelines as to which of these levers we could pull. Where Ofgem had not given guidance, we sought further input and we applied our own judgment as to appropriate limits.

So turning first to NGET, the financing proposal we submitted is as follows. A 7.5% cost of equity, 55% notional gearing, and transitions of 45 year asset lives on new investments over the course of two price control periods. We also capped the cost sharing factor under the incentive mechanism at 40%.

In addition, our modeling shows the need for notional equity injections totaling GBP3b into NGET over the course of the price control period. This allows us to reduce the notional gearing from the current assumed level of 60% and then to maintain it to an outreach at around 55%. Again, I should stress that this is part of the notional modeling and not reflective of anything required at the Group level. And included an additional revenue allowance equal to 5% of the amount of notional equity injected within our submission in accordance with Ofgem's guidance.

The need to inject new equity into the notional company is one of the many drivers for our requirement for a 7.5% cost of equity, which is outside of Ofgem's range of 6% to 7.2%. Investor feedback has made it clear to us that the cost of new equity is higher than equity in a business that can sell funds through sustained leverage.

Other drivers which take us outside the range include a longer regulatory period and related import price uncertainty and the scale of investment required and the related funding concerns. Our modeling shows that this proposal delivers what we would consider to be a financeable outcome at a cost which is manageable for customers.

Turning to the metrics, at 60% gearing with no adjustment to asset lives, all credit rating ratios were breached almost continually. As such, we had to apply the transition arrangements and the lower gearing we are proposing. The charts show the tramlines we used for setting financeability. As you can see, the notional company is broadly in line with the limits required for an A-minus rating on the FFO ratios but remains below for the PMICR ratio.

We believe the strength of the regulatory framework will provide sufficient support for an A-minus rating, but we will continue to discuss this with Ofgem and the credit rating agencies over the next few months.

2009/10 prices, the level of allowed revenue for NGET, increases under our plan to an average level of GBP2.2b a year over the period compared to GBP1.6b today.

Electricity transmission costs represent about 4% of the domestic consumer's electricity bill and the proposals would increase that to around 6%, assuming non-transmission costs remain constant. This is an extra GBP7 per annum for a domestic consumer.

For NGGT, the financing proposals we have submitted as follows. As for electricity transmission, we propose a 7.5% cost of equity, 55% notional gearing, and a cap on the cost sharing factor at 40%.

Gas Transmission already has a 45 year asset life, so transitional arrangements are not possible. However, our modeling shows that a notional company would not be financeable without some further support because of the size of the likely investment over the period relative to the cash generated by existing assets.

To accommodate that, we have proposed using a capitalization ratio consistent with a relatively conservative level of investments, effectively excluding projects expected but not yet committed, so that any additional investment above that conservative level attracts additional fast money over the period.

In addition, as with NGET, our modeling shows the need for notional equity injections totaling GBP1.1b over the course of the price control period.

For NGET, our modeling shows that this proposal again delivers relatively tight ratios, but we believe it would still support an A-minus credit rating.

In 2009/10 prices, the level of allowed revenue for NGGT increases under our plan to an average level of GBP1.2b per annum over the period compared to just under GBP1b today.

Gas transmission charges make up around 3% of the domestic consumer's gas bill. And the proposals have increased this to just under 4% assuming non-transmission costs remain constant. This is an increase of around GBP5 per annum for a domestic consumer.

Proposals we've made for expenditure, transition arrangements, and the split between fast and slow money all impact the expected growth in the RAV over the RIIIO price control period. Under our baseline plan assumptions, the RAV would've grown to approximately GBP24b in NGET and GBP12b in NGGT by March 2021, representing annual growth rates of 11% and 9%, respectively.

Eight years is a long time. So as Nick mentioned earlier, our business plan has to accommodate considerable uncertainty. Our plan proposes a range of potential uncertainty mechanisms set out on the slide. And these include revenue drivers to adjust for the timing and size of new electricity generation connections and the timing and size of new sources of gas supply and gas demands, trackers to cover large changes to input prices, such as the price of copper or steel, and, as I've mentioned, a volume driver to respond to the actual level of undergrounding required for our new electricity transmission assets.

Hand in hand with uncertainty will go incentives; the ability to earn enhanced returns as a reward for efficient management of the business.

The RIIO framework is designed to increase the incentives around delivering efficient outcomes. Our consideration of the required financial package assumes that uncertainty mechanisms are created for situations such as those I've outlined earlier and that sufficient incentive mechanisms are in place to allow efficient and effective companies a reasonable chance to deliver enhanced returns.

I've given you some details around the proposals we've made to finance our business plans. The plans we've submitted run to thousands of pages and cover many other topics. We will be publishing the majority of this material on our website today. The only material we won't publish is that which is commercially sensitive.

You'll have an opportunity to review this material during August. A number of members of my team will be available on a follow-up call on the September 6th to answer your questions on the details of our submission once you've had a chance to digest them. I look forward to talking to you again then. In the meantime, I'll hand back to John.

John Dawson - National Grid PLC - IR

Thank you, Paul. I hope you found this a helpful summary of the plans we have submitted and can see why we think they are realistic in terms of the overall investment required and that they provide a sensible framework under which we can deliver stakeholder needs at a price that consumers can afford.

My closing remarks are going to focus on two areas; to provide a Group context for the long-term investment program that Nick and Paul have taken you through and to outline some of the Group-level considerations you should be thinking about when reflecting on the detail of these UK transmission focused proposals.

In May 2010, we set out our GBP22b Group capital investment plan from 2010 through to March 2015. This chart sets out that program, reflecting our view on phasing and updating for actuals in the inflation.

If you overlay that plan with the detailed elements of our RIIO gas and electricity transmission programs, you will see that the profile of our investments are refaced, pushed back a little from our earlier thoughts, including changes in our UK distribution, US, and other business investments as well.

Based on the RIIO submission, the overall investment in the five years from 2010 to 2015 would be expected to fall slightly to just under GBP22b. A straightforward summation of the submissions for 2015, '16 through to 2021 combined with realistic profiles, realistic assumptions for the other areas of our activity provides the investment profile you see here.

As you've heard, one of the key objectives of our submission is to embed flexibility into the eight year regime to ensure that there is an effective alignment of incentives with optimally delivered outcomes. As has been demonstrated in the past, no matter how well you plan to deliver three or four years out, or even in the next 12 to 24 months, the final outcome will be impacted by the timing of connections, planning permissions and other events. This is particularly true when you add in three other lines of business, each with potentially significant investment needs.

This uncertainty has been dealt with in some detail in our submissions to protect customers and the investors. As Nick has said earlier, we have stress-tested our plan against a number of other scenarios, such as slower or accelerated investment in wind and UK generation.

As a result, when you factor in these sorts of eventualities, we can see quite a wide glide-path of investment outcomes through the RIIO planning period, all of which present very different funding characteristics. And we will need to consider these at the Group level at the appropriate time.

Paul has talked about notional equity injections as part of the funding process for both NGET and NGGT of GBP3b and GBP1.1b, respectively, in part related to the change in the underlying notional capital structure as well as to support the significant growth in net debt that will develop through the period of investment.

These are equity injections into the notional operating companies and not equity injections into National Grid Plc. We've already funded a large part of this with our rights issue in 2010, which supplies sufficient balance sheet strength at the corporate level to maintain appropriate credit rating ratios.

As Paul stated, the ratios that we show for the notional companies are not necessarily those that we would expect to see from the actual businesses and particularly not from the Group as a whole. Our overall metrics will be significantly influenced by other factors. Around half of National Grid's total activities are much more steady state in terms of investment needs than the businesses we have talked about today.

In addition, operating performance should improve in the US. Investment in non-regulated activities will, by their very nature, be opportunistic. And we have a significant tail-off in CapEx towards the end of the decade.

As a result, all other things being equal, we are very confident that we remain well placed in terms of our financial strength through to at least 2015.

Looking beyond 2015, given the range of uncertainties and other outcomes across the Group, we will have ample time once we have agreed our final investment plans with Ofgem to set out our longer-term financing needs; taking forward and outline the key measures that we have been thinking about to ensure appropriate funding and returns for both NGET and NGGT.

As they have said, it is essential that the whole package, the profile of investments and proposed mechanisms for cash flows, capital structure, and returns, provides a framework for sustaining an attractive investment proposition through our equity investors, based around a combination of healthy dividends and equity value growth within the business, whilst maintaining appropriate credit ratings.

In this context, we would ask you to reflect on the importance of how the different tools in the plan have to work together to create a program that is realistic in terms of scale, affordable for the consumer, and attractive for equity and debt investors alike. The cost of equity, capital structure, and transition arrangements are an integrated solution to these challenges. As a result, changes to individual elements will probably necessitate adjustments elsewhere if this balance is to be maintained.

Following today's publication of the plans, we expect feedback from and further engagements with stakeholders. Ofgem will publish their initial review of the plans in October.

As you know, we are keen to be as transparent as possible with you throughout this process. To that end, we will be holding another call on the 6th September to focus on your key questions with more time for questions and answers. We will send out details of this call in due course.

Thank you for your attention. Now we'll hand you back to the operator for your questions.

QUESTION AND ANSWER

Operator

Thank you, gentlemen. (Operator Instructions). And we'll take our first question from Bobby Chada from Morgan Stanley. Please go ahead.

Bobby Chada - Morgan Stanley - Analyst

Thanks. Good afternoon everyone. I had two questions. The first is, can you -- is it possible to breakdown for us the split of the revenue that you've requested in the business plan between, if you like, underlying regulatory revenues, financeability related revenues, and transitional arrangement related revenues to give a feel for how much those financeability and transition arrangements contribute to what you've requested?

And then secondly, on the rollover proposals which were published a day or two ago, I noticed that the CapEx and the RAV numbers seem to be substantially lower than the numbers that you've talked about. Is that simply a logging-up issue? Can you explain the difference between the CapEx in that document and what you've discussed with us previously?

John Dawson - National Grid PLC - IR

Thank you, Bobby. Why don't I ask Paul to tackle the first part of that question and Nick to do the second part?

Paul Whittaker - National Grid PLC - UK Director of Regulation

So on the first of those, breaking down the revenues between those different buckets I don't think our business plan sets it out in those terms. My easy answer to many of the questions will be you've got all the detail available on the website this afternoon. I don't think we have split it down in that way, so perhaps we'll take that away and have a look at it and see if we can re-present the information in that way.

Nick Winser - National Grid PLC - Executive Director UK

On the -- Bobby, on the rollout, what's quite clear from the words from Ofgem is that there is quite a bit of discussion still to go. I think understandably for both organizations, we're focusing on RIIO and so there is a substantial debate still to be had which I think Ofgem has generously signaled about the OpEx and CapEx levels.

Paul, do you want to pick up the detail point on the rollover?

John Dawson - National Grid PLC - IR

I would add one thing. There's clearly quite a few discrepancies in terms of the specific definitions of what we've included in the CapEx figures you see in the RIIO submission versus those that are actually dealt with in this initial proposal from Ofgem under the rollover review. And I think there are some various aspects of anticipatory CapEx etc. and incentive related CapEx that we will have put into the bucket in our general submission but which are not actually addressed in this particular detailed document that Ofgem have put out. I don't know, Paul, do you want to add anything else on that?

Paul Whittaker - National Grid PLC - UK Director of Regulation

Well not really. I think you've covered the point quite well. I suppose in summary we're still going through the numbers as well, and I think we probably need to have a bit of a chat with Ofgem to make sure that we can square all the numbers up. But I don't think we're seeing a missing bit of RAV anywhere. I think it's just question of reconciling things that are in different buckets into a sort of common format. So still a bit of work to go on that I'm afraid.

Bobby Chada - Morgan Stanley - Analyst

Okay.

John Dawson - National Grid PLC - IR

Does that give you a satisfactory answer?

Bobby Chada - Morgan Stanley - Analyst

To a certain extent yes.

John Dawson - National Grid PLC - IR

We'll follow up I think is the best thing we can say. The level of detail in these disclosures and the actual definitions that are used do tend to get mixed up a little bit and that's one of the problems we're seeing with the Ofgem review.

Bobby Chada - Morgan Stanley - Analyst

Okay, this is -- it is an unusual difference I would say in terms of the order of magnitude.

John Dawson - National Grid PLC - IR

In terms of our preliminary analysis, we think it's fully accounted for. We just haven't got all the facts and figures in front of us to be able to present that simply and in a logical way quickly on a call. So I think the best thing we can do is to follow up more generally when we've actually set out the appropriate schedules and also confirmed that these are right in relation to what Ofgem was attempting to say in its document on Tuesday.

Paul Whittaker - National Grid PLC - UK Director of Regulation

Yes, but. Sorry, at the risk of keep on coming back at this and chewing at it, Bobby, there absolutely are two different elements here. There's a question of reconciling things into the same buckets which accounts for some of the difference. So some things aren't in the Ofgem numbers that were in ours and are sort of acknowledged as not being in there. Not in the sense they're disallowed but things like anticipatory spends may not be included in those numbers.

So then, but there are also then definitely as well as just a question of are the buckets being compared with the same ones, there are also then still areas where Ofgem are saying they require more evidence that particular investments need to be done and in particular, that they need to be done in that particular year. So there's a big timing question about, in particular, some of the non-load investment which clearly is going to be inevitably with RIIO being such a long period is a matter of, well does it appear in the rollover year or does it appear in RIIO because together, this is a long period of time in the context of assets that have a 40 year life. This is about a quarter of it. So things that ultimately don't get done in the rollover will inevitably fall into RIIO.

Bobby Chada - Morgan Stanley - Analyst

Okay, great. Thank you.

Nick Winser - National Grid PLC - Executive Director UK

We'll try to give you some more color on that.

Bobby Chada - Morgan Stanley - Analyst

Great. Thanks very much.

John Dawson - National Grid PLC - IR

Operator, next question.

Operator

Our next question comes from Mark Freshney from Credit Suisse. Please go ahead.

Mark Freshney - Credit Suisse - Analyst

Yes, afternoon. You mentioned that the base case is modeled around the going green scenario which, I guess, maps to Ofgem's project discovery green transition roughly. But given what we've seen with your end customers recently deferring investment decisions and so forth, the scenario that we've seen is more like the dash for energy. And under such a scenario, is it fair to say that the CapEx would be towards the bottom of those, if you like, those columns on the scenario analysis that John presented at the end.

Nick Winsor - National Grid PLC - Executive Director UK

You can reckon that the gone green scenario is very much like the discovery scenario. I'm sure there are differences between them but they wouldn't be very significant. And that gone green scenario of course has had a wide airing, not only through this stakeholder process but also it was accepted by ENSG, you know the Group with Ofgem and DECC on it that looked at anticipatory spend. So we're all working broadly to that.

I think you make an interesting point about, well, is the current evidence that gone green is playing out there, is that evidence there. And my answer to that is no, not clearly but you wouldn't sort of expect it to be because critical to playing out of gone green is EMR. And while the market reform proposals are still being debated, and rightly with urgency, it's going to be difficult to see the generators committing completely through to FID to a lot of the greener end of the generation mix that we're looking to see.

A final comment though is of course, we talked about during the equity raising last year, it's quite noticeable that even if you move to a sort of slow progression with, if you like, gas-fired CCGT taking more of the strain in terms of new plant coming on than nuclear and wind with nuclear and wind going backwards, it's noticeable how little difference it actually makes to our projected capital spend.

What it does, is it moves it around. It is, to take CCGTs, we don't connect them up for free either. There, if you look historically at the amount of money that's spent to connect up CCGTs you still get a very significant spend. So in essence almost whatever, I think it is very, very fair to expect the coal and oil to close down. That's almost certain I would say, and the Magnox, so whatever replaces it is going to mean significant investment by us.

And the CCGT one is fascinating in the sense that whilst you might well see a slightly lower level but still significant spend on the electricity system, we end up with a load of spend on the gas system to connect up the CCGT to the gas network. So it's sort of moves around in our portfolio and that's why we think it's absolutely critical to have very, very well worked uncertainty mechanisms which then development of -- further development of the revenue drivers so that the thing automatically adjusts for those different scenarios.

Paul Whittaker - National Grid PLC - UK Director of Regulation

Can I just add a couple of points? Just going back to points that we sort of made in the presentation, we are smoothing our workload on the electricity plan used in the non-load. So to the extent that our workforce is taken off of -- doesn't need to make an effort on the load stuff, we will be able to bring forward the non-load to balance the workload over the period of the plan.

I think the other thing that's kind of come up over the last year particularly as we've been out trying to route some of these new transmission circuits is the question of undergrounding. And although we put a slightly higher percentage of undergrounding in our plan you shouldn't be in any doubt that there are a number of people out there who prefer to see us undergrounding a lot more of our transmission lines. That will tend to increase the expenditure. So there are a number of factors that you're sort of balancing across the overall plan here.

Mark Freshney - Credit Suisse - Analyst

Okay, thank you. And just a follow-up question regarding the two HBDC links because I guess those are subjective and that there may be alternatives. How much of those are -- what's the quantum of the CapEx for those?

Nick Winsor - National Grid PLC - Executive Director UK

The western one is the most well developed and, of course, Ofgem has been looking at that recently and that's around GBP1b. That's the total cost which is obviously split between Scottish Power and ourselves. That's pretty well developed and Ofgem have considered that and broadly, with some understandable caveats about monitoring progress, they've broadly given that the green light to proceed through to delivery for 2015.

The eastern interconnector, I forget the actual capital cost. And as so but that's just back slightly in the process of discussion with Ofgem. I think we're agreed that the western one should go forward first. That the eastern one is contained in the RIIO plan.

Mark Freshney - Credit Suisse - Analyst

Okay, thank you.

Operator

and we'll take our next question from Jamie Tunnicliffe from Redburn Partners.

Jamie Tunnicliffe - Redburn Partners - Analyst

Yes, good afternoon. I wondered if you could just set out -- obviously as you've clearly highlighted in your slide, the credit metrics are quite important in determining the whole profile of revenues. Can just talk about the individual credit metrics you've used, which ones matter most, what sort of constraint level that you have used in taking these judgments in your business plan and the proposals?

Jamie Tunnicliffe - Redburn Partners - Analyst

And then can I just add on a second question which is just in terms of that question that was asked earlier on in terms of the rollover. As you pointed out you said there's potentially some issues about sort of base costs and then maybe some extra costs where -- of doing additional things where Ofgem seem to have come back and said they require a bit more evidence that you're going to have the ability to provide between now and November. Do you have any feel or could you give us any guidance sort of how the difference between what you've asked for falls between those two categories. Thank you.

Paul Whittaker - National Grid PLC - UK Director of Regulation

So shall I take the credit metrics first? I think there is a lot of detail on the way that we've done the calculation set out in the documents that are going to be on the website today.

You know to stand back from all that detail, this is a sort of broad judgment thing so we have -- we've sought to sort of take Ofgem's guidance on where they think the credit metrics ought to be set. We've compared it with our understanding of the approach taken by the various rating agencies and then we have to look at how those credit metrics kind of adjust under a range of different scenarios. Now all of that is kind set out in quite gruesome detail in the plans and I'm think I'm going to refer you to those if you don't mind.

Jamie Tunnicliffe - Redburn Partners - Analyst

Can I ask what have you typically found to be more binding of the five or so credit metrics that seem to be the most important?

Paul Whittaker - National Grid PLC - UK Director of Regulation

Well the one that we sort of struggle with the most, as I think I've sort alluded to, are the PMICR, the adjusted ratios because they're immune to transitional measures. So I think that's been one that we had to work hardest to live with, if that helps.

Jamie Tunnicliffe - Redburn Partners - Analyst

Okay, thank you.

Nick Winsor - National Grid PLC - Executive Director UK

On the rollover, to give you a flavor of some of the stuff that's certainly for significant further discussion with Ofgem as we come through the next couple of months, the load related is -- there is reasonably good alignment actually as you'd expect at this point.

The cuts appear to be around non-load, which would be a question, a legitimate question for discussion on timing obviously although we will certainly evidence very strongly that if we're to avoid a significant bow wave of asset replacement building up that we really need to get cracking. I know there's a sort of temptation to want to hold it back to RIIO but you know we can't afford that bow wave to build up. We will be asserting that strongly.

Also on non-load there is the old chestnut in these discussions of unit costs. So those of us who have been through a few of these will know that there's always a debate about unit costs, so volumes tend to be easier to agree. We will be going back with very strong arguments about unit costs to deliver the volumes that are there.

There was a significant amount of IT investment that's not been included. That was -- quite a bit of that was all about sort of some of the sophisticated IT systems that we'll need for balancing wind power on the system. You know greater intermittency, more frequent forecasting of weather systems going. Sort of SO type of IT, which we will argue very strongly that we really do need to get on with this. If you look across Europe at the difficulties that other utilities are having with very significant amounts of wind on the systems, one of the lessons we must learn is that we still have time to make sure that we can manage this in a very professional way. But we need to be free to get on with that and invest in significant IT to make sure that we can keep the system stable as we get increasing amounts of renewable. So we will be arguing that strongly.

On gas, a big cut in network flexibility which is a, and I have some sympathy for Ofgem on this, this is a very important part of the discussion we'll have as part of RIIO. It all about essentially saying that with intermittency coming on to the system we're going to see gas-fired electricity generation need to ramp up and down very fast to cover intermittency. That will create not capacity constraints on the gas system, but the ability to, if you like, to increase the throughput on the transmission systems, gas transmission system very rapidly as you see gas fired generation replace wind.

It's also about the quite significant change to the supply characteristic of gas itself. So the UK CS used to be predictable and relatively steady. When you had losses offshore they were relatively small. That's not the situation we're in now. We have a very good diverse and plentiful supply of gas into the country but it's very different. And what we're seeing is when, for example, you get as we did last winter, significant loss on the Norwegian continental shelf, we're seeing very rapid ramp up from LNG importation facilities.

So this is all about us needing to make that case very strongly and give a lot more evidence to Ofgem. That that need to create a faster reacting gas network as well as one with adequate capacity is legitimate and we will be coming forward with substantial new evidence on that for Ofgem.

Jamie Tunnicliffe - Redburn Partners - Analyst

Thank you very much.

John Dawson - National Grid PLC - IR

Okay, Jamie.

Operator

And we'll take our next question from Peter Atherton from Citigroup. Please go ahead.

Peter Atherton - Citigroup - Analyst

Afternoon gentlemen. I've just got a couple of groups of questions really, so couple of parts. Just on the nominal injection of equity into the OpCos, can you just confirm how you model that in terms of timing? Does it all go in 2015 or 2016 or do you sort of stage it?

And I know it's not part of this presentation, but could you give us a feel for whether you think any of your other businesses like UK Gas distribution or the US also need nominal increases in their equity within this sort of timeframe.

John Dawson - National Grid PLC - IR

Paul, why don't you take the first part?

Paul Whittaker - National Grid PLC - UK Director of Regulation

Well on the timing on these notional injections, we're putting a GBP1b in at the start to get from 60% to 55% and then I think all of the rest of it is after 2015. And it's kind of sensitive. It's sensitive to the actual phasing of the CapEx within the plan. So under the baseline plan, it's that sort of timescale. Under different versions of the plan, it would be at slightly different times.

Nick Winser - National Grid PLC - Executive Director UK

Yes, inevitably it just tends to move with the individual funding requirements as per the necessity to maintain the gearing structure that we're proposing in all of this and therefore, there is an interplay in there.

Paul Whittaker - National Grid PLC - UK Director of Regulation

But broadly, it's a small amount to get down to 15% right at the start and then the bulk of it is in the second half of the decade. And the numbers will be in the finance pack so you can pluck them out.

John Dawson - National Grid PLC - IR

And as I made the observation later on in the presentation, Peter, the other businesses generally present much more steady state characteristics in terms of long-term funding. They're less lumpy. The need for heavy investment isn't there in the same way. Clearly, non-regulated activities are quite discrete in nature and whatever you do there you're going to injecting equity to build a business depending on what nature it has.

So in the concept of these being notional equity injections, you move equity around a business in order to present the funding opportunity that individual businesses need. I guess the bigger question which we were trying to address at the end is when you collate that together and look at it as a Group what does it really mean for us as a Group in terms of the equity and capital structure for the business.

And as we really say it's too early to really determine at this point in time until we've gone through to the end of the RIIO process and looked at the needs of the other businesses as well what the potential situation will be for the Group beyond 2015 and '16. It is not to say these can't happen, but it's not to say there'll also be significant or indeed, actually relevant to our overall Group capital management.

Peter Atherton - Citigroup - Analyst

Okay, perfect, thanks. And my second question was really about your capacity or the risks that you face in this big step up in CapEx. At a Group level you'd be running going from GBP3.5b a year to a potentially up to GBP7b a year within three or four year from now. Can you take us through how you're going to manage that step up in terms of supply chain, what the risks are in terms of inflation and crucially, where you think the biggest bottlenecks might be in terms of skills, equipment or whatever?

John Dawson - National Grid PLC - IR

Yes, so Peter the supply chain issues we think we're well on top of. We, as you know, have had alliances and coalition type framework agreements with the major supply chain companies for some years. And we are very, very grateful that we took that initiative and established those long-term relationships, because as well as mobilizing a great resource for detailed design, which we have captured by having those arrangements, we've also managed to signal to the supply chain to allow them to increase their capacity on the basis of our forecast. Of course, merely tendering individual projects doesn't have that characteristic. It's very hard for the supply chain to justify those investments. So we're very happy with that.

We come to the re-letting of the principle electricity alliance arrangements this autumn, which will be going through in due process. But broadly we will continue with those sort of supply chain arrangements. That's not to say there aren't issues in the supply chain. In particular, we're all I

think very aware that supply of HB cables continues to be very thin on a global basis. The ability to get enough cables through the system is well known and we're working hard to make sure that we're right at the front of the queue on that.

In terms of recruiting, these plans do show significant recruitment; 1,200 electricity, 400 gas, so I'm happy to say we're well on top of that.

But the thing that should give you real comfort is that that isn't us just saying, okay Ofgem, we're proposing to do this in the RIIO period. We've already started very significantly. We have invested. It takes up to five years to get people through and to make them competent to really deliver, so it was important that we ramped up early. We have done. Last year we recruited 381. This year we will be recruiting of the order of 500.

So we're not just, if you like, pitching this into Ofgem and seeing what happens. We're well ahead of the game. We're investing in new training facilities or extension to our training facilities. We're leaders in terms of -- we were the leading company in terms of foundation engineers. Our apprentice programs, our graduate programs are all stepping up.

In terms of inflation, we will be putting forward as one of our uncertainty mechanisms specific indices associated with the principal commodity costs. So they are already in the plan and are quantified in the plan, the real price effects that we see and the sharing of risk between customers and shareholders that we're proposing to mitigate those real price effects.

John Dawson - National Grid PLC - IR

I would make one final observation Peter. You touched on the idea that when you looked at the modeling of the uncertainties chart that CapEx can go from GBP3b to GBP7b. Slide 28, when you look at the pack which gives you the solid bar of how things roll up when you take the base plan and overlay it with steady state or realistic objectives for the other businesses, really gives you in many ways what I would regard as upper limits unless you're firmly in the belief scenario that the accelerated investment phase could occur in the UK around wind and nuclear rather than more of the slow progression or the baseline business plan which we are presenting here to Ofgem. So you really need to factor in your personal positions on whether you see slow progression as a more realistic outcome in which case you should be looking towards the bottom of those charts rather than top.

Peter Atherton - Citigroup - Analyst

Sure, I was just using it as a top end number.

John Dawson - National Grid PLC - IR

Well in that sense as, an uncertainty, I think it's one which there will be a -- you need to take a sensible judgment on.

Peter Atherton - Citigroup - Analyst

Sure, great, thanks very much guys.

John Dawson - National Grid PLC - IR

Thank you. Operator, back to you.

Operator

Thank you gentlemen. (Operator Instructions.) And we'll take our next question from Edmund Reid from JP Morgan. Please go ahead.

Edmund Reid - JP Morgan - Analyst

Good afternoon guys. Two questions. Firstly, in terms of the dividend policy of the OpCos to the HoldCo I wondered if you could give us any detail on what you're seeing in terms of maybe pay out ratio.

And then the second thing, in terms of your modeling, how do look at SO profitability going forward?

Paul Whittaker - National Grid PLC - UK Director of Regulation

Okay, so on dividend policy for modeling purposes we've assumed that the OpCos pay up 5% of the equity RAV, equity share of the RAV, as a dividend each year. So that's pretty straightforward.

In terms of SO profitability, I think these numbers on the whole are without SO impacts built in. They basically represent TO plans.

Edmund Reid - JP Morgan - Analyst

Okay, but I was just thinking in terms of--

Paul Whittaker - National Grid PLC - UK Director of Regulation

There might be some SO investment, but you're talking about SO incentive scheme regimes are you?

Edmund Reid - JP Morgan - Analyst

Well yes, just in terms of historically, you've performed quite well under the SO incentive schemes which, I imagine, stay within the OpCos. So isn't that another potential area of I guess sort of equity financing.

Nick Winsor - National Grid PLC - Executive Director UK

Well the SO costs so in terms of CapEx and OpEx obviously they will flow through these submissions and so you should regard those as having incentive arrangements the same as the TO essentially. So that is modeled in.

The incentives we haven't modeled in because they are symmetrical. Ofgem are very keen to make them either symmetrical or indeed, I say with a slight smile, some of them seem to be tending to more stick than carrot. So assuming overall a sort of neutrality in that you can -- obviously we will endeavor as a management team to deliver strongly but they shouldn't be regarded in any sense as a further source of funding that will baked into these plans. They can deliver well or obviously they can deliver less well.

Edmund Reid - JP Morgan - Analyst

Okay. Thank you.

John Dawson - National Grid PLC - IR

Thank you, operator.

Operator

Gentlemen, there are currently no question in the queue at this time.

John Dawson - National Grid PLC - IR

Aug 04, 2011 / 01:30PM GMT, NG.L - National Grid PLC UK Regulatory Update Conference Call

Okay, well look that brings us quite well to our one hour conference call so if there are no further questions can I just thank everybody for taking part, thank Paul, thank Nick for their contributions. We are holding another call on the 6th as we said. There are a large quantity of materials that people can take to the beach with them over the summer if they wish. And hopefully they will have other questions etc which the team can tackle.

We're also doing quite a few different investor activities which we will set out in some communications during September so there'll be lots of opportunities to meet with the team and to talk about these things in more detail. And we look forward to engaging with all our investors and analysts in due course. Thank you all very much for taking part.

Operator

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

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