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Conference Call Transcript

NG.L - Preliminary 2010/2011 National Grid PLC Earnings Conference Call

Event Date/Time: May 19, 2011 / 08:15AM GMT



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PRESENTATION

John Dawson - National Grid plc - IR Director

Good morning. My name is John Dawson. I'm the new Investor Relations Director at National Grid and it's my pleasure to welcome you here today to National Grid's presentation of its preliminary results for 2010/2011. Shortly I'll hand over to Steve Holliday who will kick off the presentation but before I do a few notices.

Before we start can I ask you please to turn off mobile devices? These can interfere with the presentation. As usual we will have a question and answer session at the end. Can I ask you to use the microphones? Please give your name and the name of your organization. We will give plenty of time to questions so please try and avoid asking five questions at once. Our presentation today may contain forward-looking statements and I need to draw your attention to the relevant statements in the pack and at the start of the online presentation if you're using the online service. Please refer to these when you're considering statements we may make today.

Without further ado, let me hand you over to Steve.

Steve Holliday - National Grid plc - Chief Executive

Thank you very much John, and good morning everyone and welcome. What we plan to do this morning is I'm going to start off by talking through some of the key highlights of the last year and then I'll hand over to Andrew, our new Chief Financial Officer, who'll take you through the detailed performance of 2010/11. But I've also asked Andrew this morning as the new CFO to give a fresh perspective, his perspectives as he comes into the business on the metrics that we use to measure our financial performance. I'll then return and outline the priorities for next year, for this 12 months that we're now in.

And as John said, after that Andrew and I will take your questions and Nick Winsor who runs our UK businesses and Tom King who runs our US businesses are here with us this morning as well.

I think it's fair to say that last year, 2010/11 has been a challenging year for me and for the team on a number of fronts. 12 months ago we launched an important equity issue to provide us with the balance sheet strength to deliver value from an ambitious capital program through to at least 2015. The rights issue was successful. It delivered GBP3.2b of cash. We appreciate the support and the trust of our shareholders in providing that new capital. We recognize the crucial importance of clear and thoughtful communication, particularly as we go forward and make decisions about our future investments and any changes to our portfolio.

We're committed to improving our approach going forwards and we've already made some changes. You'll hopefully start to see some of the early benefits of that in our presentation this morning. In the US we've completed our audit on cost allocations carried out for us by a company called Liberty Consulting and we've already begun to action many of the recommendations. Now we're engaged in working with several of our regulators in the US as they undertake their own independent reviews.

In January you'll have seen the disappointing outcome to our Niagara Mohawk electric rate case. However the team in the US have responded well and together with the benefits of our restructuring plans that we kicked off in February we are confident that we'll deliver meaningful progress on reducing our cost of service this year.

But despite those challenges it's been a solid financial year with some real operational highlights. We delivered a record GBP3.6b of capital investment. That includes the commissioning of 340 kilometers of new and replacement high voltage transmission lines, 68 kilometers of new high pressure gas transmission and two of our largest ever single investment projects, the third phase expansion of our Isle of Grain LNG facility and BritNed, the interconnector, commissioned on time and to budget.

We announced the sale, the agreed sale of our New Hampshire gas and electric businesses for a healthy premium to rate base. We had a satisfactory outcome in Massachusetts to the gas rate cases and of course we completed this first phase of our refilings across our US entities, a journey that's seen the implementation of most of the structural features we were seeking such as revenue decoupling and cost trackers, including achieving those features in the Niagara Mohawk case.

And then of course latterly in the year we announced the restructuring of our US business, a comprehensive program targeting \$200m of cost savings. And by the end of the last financial year, five months ahead of the original plan, we finally completed the savings from our KeySpan synergies.

Operationally, importantly we coped well with the exceptional weather last winter on both sides of the Atlantic. That included here in the UK the coldest December on record for over 80 years. Not surprisingly the weather caused major logistical and maintenance challenges for us on both sides of the Atlantic. At the same time we've delivered savings in both OpEx and CapEx led by careful control of our costs, good asset management and seeing improved benefits coming through from global procurement and from the globalizing of our IT systems.

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We've delivered another good year of operational performance in terms of safety, reliability and customer service. Today our employees are 40% less likely to have an injury at work than a mere three years ago but we still have more to do.

And finally, it's been a year of solid financial performance. I'm particularly pleased with operating profits up 15% to GBP3.6b, operating cash flows 12% up at GBP4.7b for the year and earnings increasing 23% to GBP1.75b. And in line with our target we are recommending an increase in the dividend of 8%.

Now I'm delighted for my first time actually to hand over to Andrew, the new CFO, who'll take you through those numbers in more detail and as I said give you some perspectives as he comes into this business. Andrew?

Andrew Bonfield - National Grid plc - Finance Director

Thank you Steve. Thank you and good morning. Thank you Steve and good morning everybody. It's great to be here. It's great to be able to present my first set of results for National Grid. I do remember it is National Grid. Unfortunately there are not goody bags outside so there's no longer Cadbury so unfortunately that's one advent John hasn't yet brought to Investor Relations, but I do believe the bacon sandwiches and the sausage rolls are the best in the City anyway. So that may be a small compensation for you all. As Steve said, after I look at the results I'm going to share some of my initial thoughts on how to assess the performance of National Grid.

But first, in terms of our actual performance in the last year let's start with a quick review of the business starting with Transmission, which on an operating profit basis represents around 42% of the Group. Operating profit was up 4% to GBP1.5b. Timing had a substantial impact. As expected there were minimal revenue increases due to RPI, a marked difference to last and next year, and I'll talk about that in a moment. Controllable operating costs were reduced in nominal terms, a 7% reduction in real terms, despite managing a larger asset base which resulted in a higher depreciation charge. Incentive performance was again strong.

In Gas Distribution operating profit was up 20% to GBP1.4b, primarily driven by the benefit of customer growth and revenue increases from US rate cases as well as timing impacts. Controllable operating costs were flat on a nominal basis, representing a 3% reduction in real terms. Bad debts were also down.

In ED&G operating profit was up 59% to GBP0.6b, again with positive benefits from timing but also due to strong underlying performance. Revenues were up due to the benefit of new US rate cases and a very hot summer in New York at a time when our revenues were not decoupled. Controllable operating costs were also down in nominal terms, a 5% reduction in real terms. Bad debts were flat.

Before I turn to our non-regulated businesses let me just make a few comments about our operational returns. Looking at the whole of National Grid relative to our allowed returns, around 82% of our regulated businesses by asset value delivered at or ahead of targets, around 7% operating below target but with an improving trend and around 11% below target and in need of further action to make substantial improvement.

Looking at the US in particular, our returns have improved from below 7% to 8.2% this year. This represents good progress, albeit somewhat flattered by the benefits of higher weather related volumes. This is the last year we expect to see a volume benefit or headwind as they are mostly decoupled. When you overlay the annualized benefits of our recent rate case reviews and the cost reduction actions announced in February we should be able to report further improvement in US returns in 2011 and 2012.

Our strategy has also been to deliver regulatory features such as decoupling and trackers which are necessary to protect against external factors and we have continued to make good progress in establishing these. Overall a good improvement, but there is still significant improvement to be made and we will need to refile for our Niagara Mohawk business in early 2012. With 12 rate plans in place you can expect us to make a number of new filings each year. This should be part of our routine activities as we move forward.

Now looking at our non-regulated businesses, which represent 3% of the Group, operating profit decreased by 18% to GBP119m, largely driven due to lower profits due to reduced UK gas meter population and increased US system costs, which have been recognized centrally. Grain LNG profits increased reflecting completion of phase three and favorable RPI-part-indexed revenues.

Bringing all of this together at a Group level operating profit was up GBP476m to GBP3.6b, driven considerably by timing items of GBP433m. More on that in a minute. Excluding timing operating profit was up a net GBP43m. Unlike in previous years and due to the deflation we saw in 2009 this year we had only a GBP7m increase in RPI-linked revenue inflation in our UK regulated businesses to offset increased costs. In

2009/10 this was some GBP150m. However, we are still delivering operating profit growth, reflecting a strong operating performance including the benefits of positive rate case outcomes offset by increased post-retirement costs of around GBP90m.

Additionally controllable costs were reduced despite inflation and let's have a quick look at that in a bit more detail. Our controllable operating costs were successfully reduced in nominal terms year on year. This represents about a 5% reduction in real terms. Together with higher net investment the reduction had a positive effect on our efficiency metric, which as you know is defined as controllable costs as a percentage of our asset base. This improved from 7.5% to 7.3%.

It is important to understand the impact of timing on this year's and next year's revenues. As you know, each year where we are decoupled we look to collect a specific amount from each type of consumer based on average demand profile for the year. Inevitably external effects such as the weather mean that actual volumes are often above or below this number, impacting our revenues. When this happens the following year's unit charge is adjusted so the outstanding balance can be reduced at the end of the year.

This had a double impact on year-on-year comparisons. In 2009/10 we had under-recovered revenues by GBP163m. Combined with prior year's under-recoveries this meant that in this year -- this year we started with a position of GBP204m under-recovered and we ended the year with GBP66m over-recovered. This means all other things being equal that we would expect to see negative timing differences of about GBP336m in 2011/12 as compared to 2010/11, in other words the GBP270m of in-year timing for 2010/11 that we would not expect to recur plus the GBP66m balance outstanding at the end of the year which we would expect to reduce in 2011/12.

On to interest, tax and earnings. Net financing costs were GBP1.1b, 2% lower than last year due to lower net debt and pension charges, partially offset by higher interest on our index-linked bonds. Our tax charge on profit was GBP722m, up GBP169m on the prior year, reflecting increased operating profit particularly in our US businesses. Our effective tax rate rose to 29.2% from 28% the year before. As a result earnings were up GBP329m to GBP1.7b. Earnings per share increased 4% from last year's restated 49.5p to 51.7p despite the dilutive effects of the rights issue.

In terms of cash flows we are also doing well. The higher operating profit together with reduced UK pension deficit contributions and positive working capital movements resulted in a net cash flow from operations of GBP4.7b, up over GBP500m from the prior year. Now some of this is timing but in general a strong performance.

CapEx was GBP3.6b including joint ventures. As we said at the interim results, this is down on our guidance given at this time last year, primarily due to procurement savings and discretionary non-regulated projects which did not proceed as the returns did not meet our hurdle rate.

So on an operating cash flow basis, after cash capital investment of GBP3.2b cash flow was also up around GBP450m to GBP1.4b. Around GBP550m of this was generated by the US business, providing strong support for Group's financing. Our closing net debt was GBP18.7b, some GBP3.4b lower than the end of March last year, reflecting the proceeds of the rights issue as well as improved cash flow from operations. We also benefited from foreign exchange movements to the tune of around GBP700m. Overall this represents a solid financial and operating performance in a challenging year.

Now let me turn to the second half of my agenda and share with you my approach to assessing the performance of the business and its implications for National Grid. Although National Grid looks different from many of the businesses I've been involved in in the past because of our regulated revenues, I believe the fundamental ingredients to a successful investment story are the same, a well-managed business creating economic value through an effective combination of investments in quality growth opportunities, sustainable cash generation and efficient balance sheet management.

National Grid fits this description well and it has all the ingredients to deliver outstanding shareholder value. Our challenge is to make sure we take the best growth opportunities, consistently deliver the returns and value our shareholders expect and communicate our story well. To me this requires a strong focus on operational performance and financial returns. What do I mean by this? To me maintaining a strong focus on day-to-day operating performance will be critical to our success. It's about managing our cost base, maximizing our incentives, generating strong cash flow and delivering on our customer and regulatory commitments.

All of this is academic unless we generate strong financial return for our shareholders and this is about managing the portfolio and investment, setting appropriate high hurdle rates for our discretionary capital projects, agreeing suitable rate plans and maintaining an efficient balance sheet.

What I'm going to share with you are my perspectives on each of these drivers of value and then provide a view on the changes you can expect to see on how we will report in the future. I will then discuss our near-term outlook before I hand you back to Steve for some closing remarks.

It is worth remembering that National Grid is a portfolio of distinct largely regulated businesses. This includes a mixture of developed assets with minimal future investment requirements such as existing interconnectors and metering, businesses with low to medium levels of growth such as UK Distribution and our US business, and businesses with high levels of investment in growth such as UK Electrical Transmission business and the potential for new unregulated investment. In particular the operating cash flow performance of each of these businesses varies with the nature of their growth profile. We need to maintain a balance within the portfolio to enable us to finance growth and achieve a satisfactory cash yield to return to shareholders through dividends.

In this portfolio absolutes will not always tell you the whole story as businesses will change their characteristics over time and we need to ensure that we are using the appropriate financial measures to assess performance and to make the right decisions about investment and the portfolio.

For example, businesses such as our UK Gas and US Distribution assets will naturally delever over time. This is because they benefit from a combination of a front-loaded income stream and a lower level of steady growth. As a result they will naturally compensate for businesses that would lever up as a result of high growth. This means that especially at a time when the UK Transmission business is in a period of high capital growth the US business in particular should contribute to the Group's ability to fund its growth and pay a dividend.

The strategy behind building a business in the US was and remains a good one for National Grid. Establishing a footprint in an attractive regulated market with similar returns but a structurally different economic proposition with long-term growth prospects was a good use of cash. However, unlike the UK, the US regulatory framework did not provide a buffer against some macroeconomic effects such as inflation and consumer volumes, and frankly we did not anticipate the impact that this would have, especially when we were locked into 10-year rate plans. So when the economic downturn occurred and volumes declined our cost base was far too high relative to our allowed cost of service. So along with other utilities, this results in a fairly rapid drop in financial performance.

The actions to improve the US are clear and we are partway through the journey. We have focused on a progressive combination of rate case reviews and tough cost management while at the same time delivering better customer service, an important incentive with regulators. It is as much about changing the culture and focus of the business as it is about cutting costs and getting the business to operate within the parameters set by the regulators.

In this respect Tom and his team have made good progress so far but our program is by no means complete and we will have several more steps to go through before we can feel confident about the long term business performance. We also need to strengthen our customer focus and regulatory engagement and we believe that the new US structure will make a significant difference here.

In the medium term I believe we have a structure and opportunity to generate returns in the US equally attractive to those in the UK. Why do I say that? If you assume the same capital structure between the UK and the US reflecting that of the Group as a whole then US returns increased by around about 200 basis points compared to equivalent returns in the UK. Differences in the regulatory approach then provide different incentives around delivering the best outcome. In the UK the regulatory focus is to provide potential for revenue incentives and cost management to drive a higher return over the allowed level as a way of rewarding our performance. In the US the level of incentives is typically smaller and in some cases suffers from regulatory lag.

The current underperformance of parts of our US business is an issue we have to fix though we should not dismiss the potential for our US businesses to generate attractive returns for investors, comparable with those that we should be able to deliver in the long run in the UK.

Clearly we operate with two important large stakeholder constituencies that are extremely important to us, the regulators and consumers who provide the principal part of our returns, and the equity investors and bondholders who provide the financing. Our regulated returns are clearly understood and are an effective way of managing towards our regulatory targets and driving efficiency in customer service whether comparing to a broad equity debt allowable return in the UK or a narrow definition of allowed regulated returns on equity in the US. However, due to the differences in the way each regulator sets these objectives I would observe that these are not suitable measures for comparing each part of the business with another.

At a Group level we need to be making the right judgments about our portfolio and the way in which we are running it to create shareholder value. In this respect it is essential we evaluate how our businesses are performing compared to one another and how they will generate value from incremental investments we decide to make in each one. To do that we have to have clear comparable measures of financial performance that look through the regulatory and accounting differences. In my view we don't do that well enough today.

I think this is something we can improve on and also with regards to our overall financial metrics so I have asked my finance team to review our key measures to improve our ability to support our major investment decisions and how to explain these to our shareholders. We will have this

together so that I can share the conclusion to this with you in the summer when we should also have the re-presentations of our business segment results to reflect the new operating structure available for you to use in any modeling going forward.

I would also like us to remove many of the inconsistencies in the different calculations, particularly where we are drawing direct comparisons for the benefit of our shareholders between returns on investment and underlying performance. In comparing between operating Group level returns the differences between IFRS and US GAAP, timing and other adjustments have a material effect on the direct comparability of our returns on equity. As we go into our first year under the new operating structure it is important we find a way of being consistent across all of our businesses.

Before I hand you back to Steve let me finish with some closing remarks on our guidance and outlook for 2011/12. At this early stage in the year we expect our financing costs to be a little lower than 2010/11 and our effective tax rate to be around 30%. As we've said already, we are making good progress on the US restructuring and expect to be delivering the full run rate benefit of \$200m per annum by March 2012 with a cash cost to achieve of up to \$100m primarily being incurred in 2011/12.

In terms of revenue, as I said earlier we expect to see negative timing differences of around GBP336m. However, there is some compensation in that the effect of retail price inflation on our UK businesses is expected to increase revenues by about GBP180m. We also expect to see other revenue increases at BritNed, Grain LNG III and the new US rate cases making full year contributions for the first time. Finally, given a consistent level of capital expenditure, we would expect net debt to increase by about GBP1b over the full year.

So to conclude, a good year financially albeit flattered by timing but delivering operating profit growth despite the effects of deflation from 2009. Our outlook for next year is positive. We expect to deliver another year of good operating performance impacted by the timing differences that benefited 2010/11. With net debt of GBP18.7b we are confident in the strength of our balance sheet and business model to successfully deliver our program of investment and deliver attractive returns to shareholders.

Now I'll hand you back to Steve.

Steve Holliday - National Grid plc - Chief Executive

Thanks Andrew. Last year, as you can see clearly, a solid year from a financial perspective, but going forward we have a real opportunity to add further value for shareholders by making the right investments and the right portfolio decisions.

One of the things I'm constantly reinforcing with my team is the need for capital discipline. Even though we have the balance sheet capacity to invest we absolutely will not spend unless we're convinced we'll earn the appropriate returns. You see that last year, as an example, in the case of the offshore transmission round one in the UK. We were not willing to lower our hurdle rate to the levels at which infrastructure funds were happy to invest and bid. Nevertheless, we remain optimistic that our experience and our scale will provide further opportunities in future rounds.

The phasing of our capital program has changed from a year ago. It's due to the changes in our non-regulated investments and the timing of some of the connections on the electric transmission system. As you can now see, with the CapEx that Andrew outlined for next year we are now expecting a marked step-up in the final three years, but our long-term expectations remain unchanged, GBP22b over the five-year period and around GBP2b of that is unregulated. It's still GBP12b, so half of that investment program, into our UK regulated businesses.

But the discipline around that that we've been exhibiting doesn't just apply to capital projects. It equally applies to the way we look at our portfolio. We continually review the many businesses we own and evaluate their long term value and it's in line with the strategic direction of National Grid. As Andrew mentioned, it's important that we focus on the optimum mix of these businesses, those that are naturally cash generative and those that are cash consumptive and high growth, so as to maximize value for shareholders and ensure we've got a balance between growing our business whilst generating sufficient cash to ensure a continued dividend.

Where we don't see a long term strategic fit or where we believe the time is right to maximize value we will consider divesting as was the case in New Hampshire. This isn't about a knee-jerk reaction to short-term underperformance. As we discussed back at the half-year in November, in some of the US jurisdictions we may need to be content to go through two regulatory filing cycles to ensure we've got the right frameworks in place to drive long-term value for our investors and deliver the needs of our customers. So while we continue to review the optimum mix of our businesses the day-to-day focus remains very firmly on maximizing returns across all the businesses in National Grid.

The priorities for 2011 and 2012 are crystal clear. Firstly in the US we've got to deliver the new operating model, reduce costs and drive up returns. At the same time we're determined to provide greater scrutiny and greater ownership at a local level. These priorities are the key for the management team in the US over the next 12 months and we're on track to hit the \$200m of cost savings as a run rate by the end of March next year.

Secondly, here in the UK we need to continue to ensure a successful delivery of our investment program. The value from the investments in the growth in UK transmission is at the heart of our business plan and was of course a year ago the whole basis for the rights issue. And importantly we need to progress the regulatory regime RIIO. Although we saw an improvement in the framework in March of this year we recognize there's still a significant way to go to get the right incentives in place to ensure investment in essential infrastructure and the long term support of investors.

As another important part of that process, an important phase this year at the end of July that we will lodge with Ofgem our eight-year business plans from 2013 out to 2021. And of course by the end of the calendar year we will have the arrangements in place for the rollover, the one-year extension of the transmission price controls here in the UK.

And thirdly across all of National Grid we remain focused on delivering further reductions in our cost base. It's fundamental for continued success and a particular area of focus in this year is our UK Gas Distribution business where delivery of new field-force systems are intended to drive us to the frontier performance.

And finally I've got to go back to the US. Completing the actions from our audit and the other audits, focusing on delivery and cost efficiency, getting the cost of service right, that will rebuild the trust that we need with key stakeholders.

So it is a very clear set of priorities for this new year and the delivery of those will position us well, position us well with returns and position us well for investments in the future.

And Andrew and I, as I said, are delighted to take your questions and Nick and Tom, as I said, are here this morning as well. Thank you very much.

QUESTION AND ANSWER

Steve Holliday - National Grid plc - Chief Executive

Martin? You have to wait for the microphone John instructs.

Martin Brough - Deutsche Bank - Analyst

Martin Brough from Deutsche Bank. Just a question on the July business plans. Ofgem have very much put the onus on the companies to set out in terms of financeability the framework that they would like to receive. So when you're submitting the business plans to Ofgem what kind of capital structure will you be assuming for the different businesses? How will you deal with financeability?

And are you going to be forced to assume that the trailing average on the cost of debt comes through in terms of the returns over the eight-year period and that therefore the allowed cost of debt at least converges to where the current index lies?

Steve Holliday - National Grid plc - Chief Executive

You mean all the headlines of your business plan for July now please. That's not meant to be a joke. We haven't finished all this work clearly. No absolutely, we will be looking at what we believe is the right way of financing the growth in that business in the legal entity that is the Transmission business. We'll take on board some of the suggestions but we won't necessarily follow that to the letter, not least on the trailing average of debt, which we still think has some work to do, finessing to go.

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But the key point I think for this morning is it is the end of July, we haven't finished all that work yet, but the CapEx that we see in those plans is absolutely consistent with the CapEx profile that we talked about a year ago. And the first few years of that are consistent with the GBP22b and investment in the UK is rising, as you know. But then going out beyond 2015, 2016 there's still a lot of investment, but it's probably about flat for the rest of that period. We haven't finished all the work yet but that's I think where it's going to end up.

And that is the story in the UK here. There's an enormous investment phase in transmission in the UK in this decade. There's a different investment phase after 2021 in other parts of the initiative, but the transmission has got to be put in place now. So there's a big lump of investment in the transmission things. But we'll put those plans together and you're right, they are very detailed plans. As Ofgem refer to them, it's the well-justified business plans, and it will be from National Grid, I assure you.

Jose Ruiz Fernandez - Exane BNP Paribas - Analyst

Good morning. Jose Ruiz from Exane BNP. Just a clarification on the rate base in New York because I see, in all I see an increase in the US but in New York State I see three businesses where the rate base goes down. In one you're clarifying that you're removing the standard cost but for example in Gas Distribution in upstate New York the rate base is going down by around 20%. If you could have a clarification on why is that.

Andrew Bonfield - National Grid plc - Finance Director

To be honest I can't give you the answer. I don't know if Tom if you --

Tom King - National Grid plc - Executive Director

Good morning everyone. In each of the rate cases there are decisions around what goes into rate base and how they adjust from a depreciation life etc. So what you do see investment falling in. It also is reflecting the current depreciation structure as agreed to and stated within the recent rate case. But there is incremental investment for pipeline replacement, main replacement etc. in each of the gas cases.

Bobby Chada - Morgan Stanley - Analyst

Morning. It's Bobby Chada from Morgan Stanley. I have two questions if that's alright.

Steve Holliday - National Grid plc - Chief Executive

Two's okay. I think there's a five (inaudible).

Bobby Chada - Morgan Stanley - Analyst

Yes, so promise it's two. The first is about the capital structure. So you've helpfully said in the statement that there's just shy of GBP7b of debt which is at corporate level rather than in the individual entities. How do you think about allocating that in your mind? Obviously some of it is related to trying to leverage the US businesses a bit more but it can't be very much given the size of the rate base. How much relates to what you would allocate mentally to the unregulated businesses and what's the rest for?

Andrew Bonfield - National Grid plc - Finance Director

Yes, Bobby. As we think about it I think overall based on rate base, the rate -- the regulated asset value at the end of the year, the gearing ratio is about 59%. The UK obviously from a regulated perspective actually is a 60/40 split.

I would tend to look at it and say if you apply that sort of ratio across the Group when you're looking at individual businesses to get return calculations because at the end of the day we are a Group. We don't allocate that part of the debt so much to the US, so much to the UK. The US is managed on the individual entity basis on the allowed amount of debt that we're actually allowed in there and the loan-to-equity ratio, which normally is around 50/50. But obviously we are able to take on additional leverage at the Group level because we are a portfolio of businesses.

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So it's a -- I wouldn't be too specific or too explicit about saying it is X percent, but I think generally if you apply an overall Group percentage across I think that's a reasonable way that I would look at it as the CFO because I think it's hard to say it's explicitly either Grain or it's the US asset or it's a UK asset in particular.

Steve Holliday - National Grid plc - Chief Executive

What you do have is clearly the cash flow generation from those businesses that allows you to fund one amount of debt overall at a Group level.

Bobby Chada - Morgan Stanley - Analyst

Second question. In your -- that slide with the bubble that showed which businesses consume cash and which don't, and the comments about the US Distribution business effectively being a source of funds through deleverage, does that mean that you no longer expect in the medium term US CapEx to increase dramatically?

Steve Holliday - National Grid plc - Chief Executive

Absolutely does. These comments are very important about the way in which we look at the mixture of assets as the right mixture for the future. It's the right business to have today and the five to 10 year profile as well.

But we're very clear at the rights issue again about US CapEx being flat through the five-year period, GBP1.1b a year roughly year on year. That's exactly what it was last year. That's what's enshrined in all of the rate cases that we've agreed today. As we think about what's required in new rate cases that picture's not changed. Certainly for the next five-year period it's flat. As we think about the future and think about the scenarios and what's the right mix to have in the future at some stage we do expect US CapEx to increase but it's beyond this five-year period.

Bobby Chada - Morgan Stanley - Analyst

So it's fair to say then that the rate of growth in the US rate base that we've seen of late when you've been spending roughly GBP1.1b is a good indicator for the current investment period?

Steve Holliday - National Grid plc - Chief Executive

Yes, absolutely. Absolutely.

Bobby Chada - Morgan Stanley - Analyst

Thank you.

Edmund Reid - JP Morgan - Analyst

Edmund Reid from JP Morgan. Three questions if I may. The first question is on net debt. So net debt came in I think at GBP18.7b. Previous guidance had been GBP19.5b. I think you mentioned that some of that was timing, some of that was underlying performance. I was wondering if you could quantify that.

The second question is on the rollover review in UK Transmission. I believe there's a sort of RAV reconciliation to be done in that rollover review and I was wondering if you could remind us of the difference between the RAV that Ofgem has and the RAV that you think you have given the CapEx that you spent?

And then the third question was on the business plan. Will that be made public? Can we see it?

Steve Holliday - National Grid plc - Chief Executive

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Let's do them in reverse order. I'll do the last one first. Yes, it will. We will submit our business plan into Ofgem. It will through the Ofgem process get into the public domain. I don't know the timing of that action but absolutely.

Andrew, do you want to pick up the first one and, Nick, can you comment on the rollover second?

Andrew Bonfield - National Grid plc - Finance Director

Okay, the GBP270m, as mentioned timing was about GBP270m in-year impact in 2010/11. So you have to tax effect that so it would probably be about GBP180m of favorability on cash flow, operating cash flow as a result of that. I think the other thing to note is FX. As indicated, FX came in quite a lot --- with a lot more favorability at the end of the year than we originally expected. That was about GBP700m for the full year. Obviously some of that was expected at the beginning of the year. So those were the two biggest drivers.

Again, if you think about where we are from a business perspective, when we gave our guidance, and this is as you think through modeling and implications for 2010/11, when we gave our guidance at the beginning of February at that stage we expected to be broadly a neutral position from a timing perspective at the end of the year. That's our base case assumption for planning. That's what you would normally plan to assume you get back to a zero balance.

So we've slightly over-recovered because of the favorable weather in the US from a Gas perspective in January, February. So what that --- and it drove volumes so that meant we slightly over-recovered for the year. So again as you think about 2010/11 some of that will reverse as we move forward. So it's that little bit of favorability.

Nick Winser - National Grid plc - Executive Director

So on a rollover true-up, we'll have to see what the document in August says specifically. The detail isn't entirely clear on how that will be treated. Ofgem have given an indication that they'll true up for WIP, which is quite a considerable amount. There was also an indication that they might not true up for some of the logging up. But broadly we would expect the rate base to be true'd up to something like the numbers that we quote in our documentation of our estimated round.

Edmund Reid - JP Morgan - Analyst

If I can follow up on that. So in terms of the returns that you're getting, the revenues that you're getting on electricity transmission, those are based on the current Ofgem RAV numbers rather than the kind of true-up numbers. Is that correct?

Steve Holliday - National Grid plc - Chief Executive

Yes. Because this year we're still based on, but you're -- we're talking about this year's clear. Next year's not yet clear until we've got the rollover in place.

Edmund Reid - JP Morgan - Analyst

Okay.

Jamie Tunnicliffe - Redburn Partners - Analyst

I think Andrew mentioned about creating -- sorry, Jamie Tunnicliffe from Redburn. Andrew talked about -- mentioned creating economic value in the performance metrics and how you're going to improve them and consistency and so on. So I just wondered, does that mean returns in the US will be restated based on what you paid for those assets?

And the second question is how you trade off therefore expected returns on an asset against your desire for a portfolio of assets that has positive cash-generating assets with negative growth assets?

Andrew Bonfield - National Grid plc - Finance Director

Jamie, let me give you -- obviously we do have internal financial performance metrics we're using which are a wide range of measures looking at the business performance. It's not just a single factor. What we need to decide is for external consumption what is it we're actually happy, A, to disclose, B, also to go through some verification process of that and make sure we're robust enough about that for the future.

Personally my path would be, tend to be cash flow return is a great metric. But that would actually misrepresent some of the UK return, which is RPI-based and therefore would actually decrease the UK's returns relative to the US. That's not fair either because part of the thing we have is we do have that RPI indexation which does, in the long term, benefit shareholders. So it's again going through that, it's one of the things I'm learning about the business as I've come in. This is not an easy straightforward metric that you can use, just one metric and say that's going to be the ideal one. And it's going through the ideal balance between maybe there may be one or two that we use to give people a relative performance.

On the portfolio mix, this is no different from any other business I've been in, which is you have investment opportunities, and particularly in UK Transmission, we have these wonderful investment opportunities over the next several years. But the fact is any business needs to have ways of generating cash flow and actually reducing our asset base by going -- by actually getting more cash out, as you may see over the next several years in some of the businesses, UK metering, it's a cash cow. You manage that business to generate cash flow. You know it's a diminishing asset over time as far as growth's concerned, but that's a real positive thing. It's a real way of contributing to the asset -- to the investment you have.

And that's about managing a portfolio. When you think about strategy and you think about things for the long term, it's about maintaining the balance on the different parts so you actually optimize the whole from a shareholder perspective. And that's the process we will continue to go through. It's part business planning. It's part of something that every business goes through and does on a regular basis. And it turns and things are going to change over time.

Back to the comment earlier about the US business, if in the US we move from a sort of relatively benign investment phase to a relatively high investment phase, the US bubble would move from where it is over here on the right-hand side towards where the UK Transmission bubble is today. So that's why we say things change over time. So you can't just look at it, a point in time is not necessarily the right thing to do. You have to look through a portfolio over a period and measure that and assess that and say does this fit the right optimal structure for shareholders to drive their value.

Steve Holliday - National Grid plc - Chief Executive

To just add two quick points to that, this is about -- of course we make these decisions today. We've made loads over the last 10 years haven't we, of businesses we've decided the right thing to do is sell them. How do you find a simple new metric that allows investors to clearly see how those decisions are going to be made? That's the challenge because it's not clear today.

The other point I wanted to make is this doesn't dilute our focus on regulatory returns. This is an additional. We've got to still keep focus, hold our feet to the fire on delivering those regulatory returns. That's not going to go away. Every presentation you see of the National Grid across the portfolio of assets we will always focus on the individual entity's performance against their allowed returns as well. This is a value metric on top of that.

Jamie Tunnicliffe - Redburn Partners - Analyst

Just to follow up then, just check then, so then the return is more important than the portfolio effect, is what you seem to be coming down to. If you have to -- it's more important that you're getting an acceptable return on that investment as against a portfolio of cash in versus cash out?

Andrew Bonfield - National Grid plc - Finance Director

I think it's a balance between the two. You have to maintain and look at it and it's again through the cycle. So -- but at the end of the day, returns are important. Just to reiterate and reinforce as well, the regulated returns that we publish for the US are not comparable to the regulated returns we publish in the UK. One's on a US-GAAP basis, one's on a calendar year basis and the other one includes an RPI indexation. So it's not like for like. It doesn't reflect the underlying performance. It reflects performance against regulatory allowances.

So returns are important. We need to find the right return metrics we can publish externally which are going to be consistent year on year, not change because we decide it doesn't show what we really want it to show, but be able to show some of the things that we think through as a management team on how we make those decisions. And whether it's just a simple cash flow return or a more -- we'll need to, we still need to finalize what that actually is to help you understand our thinking as we go through it.

Jamie Tunnicliffe - Redburn Partners - Analyst

Very helpful.

Steve Holliday - National Grid plc - Chief Executive

Can you pass back to Peter, if you would?

Peter Atherton - Citigroup - Analyst

Peter Atherton from Citigroup. Two and a half questions, if I may. Just on strategy of the Group, Steve, would it be right in summarizing what you're effectively saying is, we've had a strategic review, that review has decided that the shape of the business as is is the optimal one, you're looking at individual businesses within that shape, but for all practical purposes we can now rule out a big-bang breakup of the Group either by wholesale sale of the US business or by IPO of the US business, for all practical purposes? A yes or no will do.

Steve Holliday - National Grid plc - Chief Executive

I think -- I don't recall saying that ever, but let's join all these bits up. That's not what we're saying, Peter. But let's not be trite about it either. As we look at this bit, at the mix of assets we've got today, and we'll keep looking at it. It's not just this notion of there's a review that by May 19 the decision is made. These are long term businesses. We've got to keep looking at next five years to five to 10 years, what's the right mix of businesses to do what Andrew and I have been talking about, to grow this business for investors, deliver good returns and pay from cash yields the dividend that people will want in the future? And it's going to change. It's going to change.

So there'll be lots of decisions over a long period of time about that mixture. Wholesale exit from the US, when you look today, in May 2011, about what that would do to National Grid, does not look like a value-constructive thing to do. It does not. But you should never rule out anything in terms of selling this and buying that etc. etc. We need to keep this mix of businesses under review. The mix of businesses we've got today, the focus right now has got to on getting them all up to their regulatory allowances. So absolute performance this year, drive return up.

Meanwhile keep the right review of the portfolio under review, so we're shaping it. We've got the cash generation assets in there and the growth assets. And that, when we're ready to make any announcements about things that flow out of those constant reviews, we'll do so. But right now the focus is on what we've got today.

Peter Atherton - Citigroup - Analyst

I think that was a yes. Can I just clarify what you were saying on the CapEx of the -- for the forthcoming business plan without preempting exactly the numbers in it? You said you expect it to be sort of flattish against current levels of expenditure. Is that against the average run rate in the current five-year plan for the UK, which is about GBP3.3b, or what will be a higher level presumably in '14 and '15 because you're under-spending in the first two years?

Steve Holliday - National Grid plc - Chief Executive

It's the latter. And I was trying to just try and give you some information with that. We have not finished. We have not reviewed and signed off yet our submission. But I know people are modeling and thinking, and it's absolutely right to think about the enormous amount of CapEx that we need to invest for customers and the industry here in the UK. So the profile does build up and it does go up quite substantially to GBP5b or so a year in the latter three years of this period. The part that contributes to that, the GBP3b or so on Transmission, it's roughly that number for the rest of the period. We've not finished yet, but it's not continually going up and up and up. It begins to flatten off during the course of that period.

Peter Atherton - Citigroup - Analyst

Thanks. And my final question was are you expecting the US business to actually start paying a dividend to the Group?

Andrew Bonfield - National Grid plc - Finance Director

I know you asked that question at the interim, Peter. The way we structure our US business actually from a tax efficiency perspective, we probably will very rarely, if ever, pay a dividend. There are other ways of bringing cash back from the US without necessarily paying a dividend.

Steve Holliday - National Grid plc - Chief Executive

But, as Andrew said, GBP550m of cash generation from the US businesses in this financial year.

Iain Turner - RBS - Analyst

Iain Turner from RBS. Can I just ask a couple of questions, if I may? On pension costs, if I add it all up right, there seems to be an extra GBP100m of pension cost in the P&L and then a further GBP300m on the cash flow statement. Can you just go through where that's being spent and what's driving it and how hopefully you recover that from the regulator?

And then secondly on the offshore transmission, you said you aren't going to bid for any more for the first round. I'm presuming your ambitions on the second round and subsequent stuff are still there. But can you comment on the returns that you think infrastructure funds are looking for for these sort of dumb assets and whether that gives you any cause to think again about things like the LDZs in terms of if there's an appetite out there of that sort of return.

Steve Holliday - National Grid plc - Chief Executive

Let's do the second one first, if I may, and be clear what I said. Round one is finished, done and dusted. We did bid for some of those assets, but we did not win those assets at the returns that we believe our investors need. The structured funds clearly had a different view. Now we do believe with the scale expertise that we have that we'll bid in future rounds, but at the end of the day we're going to be disciplined about this. We really are.

Need to ask them whether they believe their cost of capital is so low and I think the amount of leverage that they think they're going to put on these things, how much equity is really in there. That's the political concern in many ways about if you've got this important piece of infrastructure but not a lot of equity into it, and even though there's a 20-year contract that pays, there is operational risk. If there is a risk, are those people going to stand behind those investments? That's the bigger question I think for the government in the UK.

But for National Grid, very disciplined. We know the returns that we need for a bid. If we don't win them, then we don't win.

Andrew Bonfield - National Grid plc - Finance Director

On pension costs, pension cost ratio up about GBP90m, GBP89m, I think I referred to in my speech. That mostly was obviously the US businesses, because a lot of it's post-retirement benefits. The UK was up slightly but not hugely year on year. Obviously some of that will be recovered now that we actually have pension trackers in place and OPEB trackers in place. There will be a lag, probably an annual lag, but the vast majority of those should be recovered as we move forward.

So one of the key things to note is by actually going through the rate reviews we've now set up a process of actually achieving the right mechanisms in the future to ensure -- because the reality is OPEB and pensions were probably the single biggest factor in the misalignment of the cost of service historically.

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Cash flow, I actually thought we saw a positive benefit up there. It's GBP300m outflow versus GBP520m in the year before. That's not a year-on-year movement. It's the GBP300m outflow. We still have a --- the pension deficit on an accounting basis has reduced, but from about GBP3b to about GBP2b in the year. But we had an outflow in '09 and '10 of GBP521m. This year it's GBP304m.

Steve Holliday - National Grid plc - Chief Executive

We -- this gets very complicated. We had a -- in the last regulatory review in the UK, the structure of paying down the deficit, put cash into the revenues each year which we then put in to bring that deficit down. So this is just in line with that regulatory review. As you can see, the actual deficits are lower GBP1b year on year.

Andrew Bonfield - National Grid plc - Finance Director

That's money outflow this year. And it was -- but it was GBP500m the year before. So it is -- year on year (inaudible).

Steve Holliday - National Grid plc - Chief Executive

It is revenue in and money out.

Can we go across to John, if that makes more sense? John's the other side.

John Musk - Nomura - Analyst

Yes. Morning. It's John Musk at Nomura. Can I ask, on the dividend, obviously that runs out in March 2012, do you know or is there any thoughts on when you're going to communicate the new dividend?

And then as you think about that, you've talked obviously a lot today about the portfolio effects and managing the different assets within the Group, does that mean it's going to be very difficult to be as explicit in your dividend pledge going forward as you have been over the last, what was it, five-year pledge? Can you commit to four years at X-percent or five years at X-percent when you look at the new dividend?

Steve Holliday - National Grid plc - Chief Executive

Let's get in mind a timetable to an extent here because I think investors enjoy understanding clarity. And as we think about the portfolio, I don't want you to think there's an every-week a decision here either because there are periods of time -- I think we've financed ourselves for this period of growth, which you know the sort of shape of the business. So I expect we'll still be able to give projections and targets on dividends that will be for multiple years.

But clearly as you've listened to where we are today in this unusual period we've got where we're in the last year of the price controls in the UK and when we set the dividend commitment of 8% growth originally of course we thought it was going to be a new price control from the end of this year. Ofgem have delayed that by a year. And so --- and it's very much driven, the 60% of the business clearly still in the UK. To commit to a dividend without knowing the outcome of that review would look slightly foolish, I suspect.

So we'll look later on this year as to what's, based particularly on the rollover what's the right thing to do for 2012/13, and probably look at the longer term dividend as we get the results from the RIIO review through. The new year we're just in now of course it's 8% is still our target for this year.

Scott Phillips - UniCredit - Analyst

Hi. It's Scott Phillips from UniCredit here. Two questions please. Could you make a comment on Ofgem's new range for the cost of equity? If that ROE were to come in at 6%, do you feel that this would provide you with a strong enough signal to invest in the UK?

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And secondly, I believe there's been some discussions that the Health and Safety Executive are reviewing the scope of the RepEx program. Could you confirm if this is indeed the case and, if so, what it might mean for capital expenditure in the business plan and cash distribution? Thanks.

Steve Holliday - National Grid plc - Chief Executive

I think I was clear hopefully in the remarks this morning, and we've been pretty clear as a business as well, the improvements that were made in the latest update in March were clearly sensible steps in the right direction. But there's an enormous amount of investment required in the UK, and the sort of returns that we are earning in that business today are the sort of returns that investors expect when they provided us with new equity a year ago.

And we are very consistent therefore with our messaging with Ofgem and investors have been overwhelmingly. We need to still be able to earn those sort of returns on equity going forward. The bottom end of that range makes that very challenging indeed. So in my remarks, that's why I said there is still more to do here to get the right regime in place to ensure that investment flows.

The Gas Distribution business, you're absolutely right. There is a discussion going on between the two regulators, Ofgem and the Health and Safety Executive, about the rate of replacement of gas pipes into the future. And that will continue to go on as they shape therefore their next set of proposals. Is it still right to continue to replace the pipes at the rate that we have been doing? National Grid, I think the evidence speaks for itself in terms of the safety improvements and the continuation that we need still to remove a lot of very old pipe to be sure we've got safety of the public at heart.

Mark Freshney - Credit Suisse - Analyst

Hi. Mark Freshney from Credit Suisse. Just on your views on CapEx. You still have this aspiration that you're going to invest GBP19b over the coming four years, but the next year is going to be flat. And you're very bullish on CapEx. But it's kind of contradictory to what your customers are doing. They're quietly shelving new build projects, not taking up Section 36 consents. They're doing nothing for the next 18 months until they've got clarity on the electricity market reform. How do you -- is there a risk that GBP19b over the next four years actually becomes something like GBP14b or GBP15b?

And just secondly, one of your slides, you spoke about potentially disposing of businesses where there's no strategic fit and when the time is right. I guess in terms of what doesn't fit strategically now but the time isn't right, which assets are those?

Steve Holliday - National Grid plc - Chief Executive

Thanks a lot Mark because your observations around the investments are absolutely right. Clearly there's enormous uncertainty as energy market reform is going on. But the white paper is due in June, the legislation first quarter 2012 and lots of people waiting to know what they should be investing in. That's partly why we see a little bit of slowdown in the first few years. But nevertheless, despite your comment on Section 36, the planning process for getting things done here, we have signed up in the last six months again another whole raft of connections. As we sit here today the total generation that's applied for connection to the system between now and 2020 I think is nearly 60 gigawatts in total.

Now it won't all happen clearly. It won't all happen and some of it is going back. But when we did the rights issue we stressed very carefully that if it doesn't, work else we'll go on because we still need to make sure that we've got secure electricity supplies and gas supplies. And that's flexed that CapEx by no more than GBP1b. As Andrew said today and I've repeated, our business plan that we're looking at today out through that time period is still GBP22b. Is there a chance it's going to come down by GBP3b or GBP4b? No. Could it flex a little bit? At the margin it could.

Nick, do you want to add anything to that?

Nick Winser - National Grid plc - Executive Director

Yes, there's a lot of non-load investment. In fact the up-tick in UK Transmission in the year we're reporting was driven mainly by non-load. So you've got some big things occurring, like London tunnels and so on, which will start in any case.

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In terms of the order book for load-related, just remember there's also a big chunk of investment in those numbers around gas transmission, decline of UKCS. We're pretty sure that some significant investment will need to go in there, and we talked about that as part of the rights issue presentation.

In terms of so then going to your point about so is all of this electricity generation going to go back, what see is an order book which has multiple components to it, so where the generators are effectively applying for different portfolios of plant going forward. So we know that there's a lot of plant that will retire just because of coming to the end of its life or because of environmental directives. So what you'd expect to happen is even if some of the low-carbon stuff goes back, we know that, for example, a significant amount of the CCGT would likely then come on to make up the difference because we know that there is a substantial amount of generation which will come off the system.

In the rights issue, when we looked at all of that and did the sensitivities as to changes in that whole portfolio, they were relatively minor impact on the total sum. And I expect our submission to Ofgem as part of RIIO with the sensitivities to really reinforce that.

Andrew Bonfield - *National Grid plc - Finance Director*

On the businesses there from a strategic perspective that don't fit but we haven't decided yet the time's not right, we've actually done quite a good job of actually clearing out some of those non-strategic businesses, like the home services business in the US. There are a couple of very, very small little things that are needed around tidying up. But nothing that material to get excited about, or anything that really probably would impact the results.

Mark Freshney - *Credit Suisse - Analyst*

So items that are less than GBP1b?

Andrew Bonfield - *National Grid plc - Finance Director*

Yes, much less than that. Much, much, much. Probably even less than the GBP100m state. That's the sort of size we're left.

Mark Freshney - *Credit Suisse - Analyst*

Thank you.

Steve Holliday - *National Grid plc - Chief Executive*

If we come down here, if you would, please.

Dominic Nash - *Liberum Capital - Analyst*

Hi there. Dominic Nash from Liberum Capital. Two questions please. One is the inverse to Mark's question on non-strategic businesses that don't fit to strategic businesses that you don't own. And are you constantly monitoring in-fills or other analogous assets that could add value to, e.g. the Scottish transmission networks? Are there interconnections with US businesses?

And secondly, on your metering business, you obviously had a year-on-year quite substantial percentage decline in profitability. There's a lot of I think uncertainty over the metering business with changes in regulation going out. Can you give us guidance on the medium term profitability profile of this business?

Steve Holliday - *National Grid plc - Chief Executive*

I can give you a guide, but as Andrew said when he articulated that characteristics of that business, is generally it's cash. Once upon a time we had every gas meter in the UK and clearly as they're being replaced the portfolio is running down, and that will continue.

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I can think, say to the first question, I think we should be fired if we never look at anything other than selling bits of the portfolio we've got today. Because if you talk about the portfolio, it clearly means what's fixed, what's in there today, what shouldn't be in there, what might be in there in the future, and there are clearly logical businesses that might make sense.

It's not high on the agenda. The agenda has been pretty clear about what's on the agenda for this year. It's our performance US, regulatory arrangements in the UK, deliver our CapEx, take costs out. That's the focus, focus, focus. But quite rightly we should look for opportunities in the future that come into the portfolio overall and look again at the right balance of growth and cash generation.

Andrew Bonfield - *National Grid plc - Finance Director*

Now on the metering business I think you will certainly expect us to see a steady decline of some of the rates we've expected this year, assuming that we get a position where smart metering is actually a way of the norm going forward. Obviously there is still some uncertainty as to the final Ofgem regulations as far as that's concerned, but we expect that business to be gradually declining over time.

Steve Holliday - *National Grid plc - Chief Executive*

Can you pass it forward? Thanks.

Bobby Chada - *Morgan Stanley - Analyst*

Thanks. I was interested with one and a half fresh sets of eyes, Andrew for one and Nick's got a new business so he's the half. When I looked at the --- because electricity you already had, right? When I looked at the Ofgem documents, and obviously they make mistakes and they interpret things differently, and there are all sorts of ways that you can look at the data, but I was pretty surprised that I think three of your four Gas Distribution businesses in the UK are in the bottom four on a return on regulatory equity, both the electricity business -- both the Transmission businesses are starting forth for a return on regulatory equity.

And clearly that wasn't the target when you sold half of your gas businesses. Before you kept -- I think from the big presentation you gave, Steve, was supposed to be the frontiers and stretch the boundaries etc. etc. What's changed that means those businesses are performing badly relative to the four that you've sold off?

Steve Holliday - *National Grid plc - Chief Executive*

Okay. Nick can add. Let me just start off. We never did say that at the beginning actually, Bobby. We said that I believe that the scale would bring us some benefits over time. There was --- there's certainly a network in the UK that was always going to be the frontier because of the demographics of that network. And London is probably likely always to be the worst-performing network because of the cost base of operating in London and the lack, despite some extra allowances, never enough to actually make up for that.

Outside of those two, in the other six, we should absolutely have the top three. And we haven't done that; you're quite right. We didn't anticipate the opportunity that people have with a fresh piece of paper of course and taking away all the overheads to rebuild from a low base.

One of the other things I think that's happened over this period of time is new businesses of course. Some of the things like new trainees and hiring, they weren't in that phase and are now getting back into hiring and training and bringing in a lot of apprentices and what have you, and you can see the cost building. I was very clear though we're not happy where we are in that sense and the front office that we're putting in in the UK is totally designed to ensure that our networks do get to the frontier over the course of the next 18 months. That's the objective that Nick's very happy now to talk to.

Nick Winser - *National Grid plc - Executive Director*

So the -- thank you, Steve. So the -- I think you're referring to the RORE analysis, which deserves a separate discussion actually because there are many adjustments to that in that analysis which don't reflect what we think is a sensible view of these businesses. The treatment of some of the pieces of CapEx that will then come in and be remunerated later, no treatments for SO, etc. etc., and of course we do make substantial returns from SO activities.

So the whole RORE, we ought to try to talk you through how we see that analysis. But that's not to take away from the fact that of course we are undertaking a significant program to improve efficiency in gas distribution, which is well underway and a very good program, as I see it. And we will be working very hard through RIIO to make sure that we get absolutely clear alignment between customers and shareholders. Again, that whole package, there was a question earlier about how important is the cost equity, very important. But of course we will look at the whole package and make sure that that allows us to live up to the expectation that we've set you all as part of the discussions last year.

Bobby Chada - Morgan Stanley - Analyst

The return on equity that you report for UK gas turns up over time?

Nick Winser - National Grid plc - Executive Director

The current, on Gas Distribution the current proposals -- they're not proposals. The current guidance that we've had from Ofgem still creates an envelope that we think we can deliver to the sort of numbers we were talking about, the 12%-type of numbers.

We will be feeding back strongly to Ofgem that actually the incentive opportunities on Gas Distribution as yet aren't as clear as they are on the Transmission businesses. And we certainly see some advantage in increasing those give us the opportunity to get that envelope to fully encompass the sort of returns that we see there. But that's certainly still within scope of the discussions and Ofgem themselves very much want to find ways of making sure that there are good incentives to align with customers and create the sort of numbers we've talked about.

Steve Holliday - National Grid plc - Chief Executive

Without getting too complex this morning, also of course one of the things that Ofgem have rightly done is to have a look at CopEx, a combination of CapEx and OpEx that ultimately the customers do pay for. We're very clear that our four networks, our CapEx has been significantly lower actually. So that's all part and parcel of this review.

Ed Reid - JP Morgan Cazenove - Analyst

Two questions. Firstly on the SO profitability. I think from memory the gas transmission SO profitability grows again last year. What would you expect the trends to be going forward? It seems to be at quite a high level at the moment.

And then the second question was on the US ROE. I think you'd mentioned there'd been some, once again, timing issues around volumes in the US. And I was wondering if you had a sort of underlying ROE.

Andrew Bonfield - National Grid plc - Finance Director

Yes. Let me give you that. The -- on the incentives, actually the incentives were done marginally this year, but we're talking about a couple of million pounds year on year. I think it depends where you -- we always start the year with assuming a certain level of incentive return, but we continue to outperform. I think that's one of the things that Nick and his team have done a great job on as far as that's concerned.

As far as the US ROE's concerned, remember neither of these are US-GAAP numbers for timing. This is one time I will actually talk about the merits of US GAAP over IFRS timing. Makes life much more complex for a CFO. But then obviously timing is stripped out of the US-GAAP numbers so it doesn't have any impact. There is some volume where there was some decoupling. But again, if it's anything, we're talking about decimal places on the return. So again it's a very -- relatively small proportion of that total. And given what we're going to be doing in 2011/12 with the cost base and also with the full effect of full-year rate plans in, we still expect progression to be made as we move into '11/12.

Steve Holliday - National Grid plc - Chief Executive

Going back on the first one -- hi. It's Steve again. Worth always putting these incentives in context there. We have had another good year on incentives, but this benefits customers too. We are driving down the cost of balancing these systems, gas and electricity, which means that

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customer bills are low as well. That system's worked very well in the UK. We can earn some small extra money from doing that, but it's also helped by actually keeping the customer bills down.

We'll go across to Jose.

Jose Ruiz Fernandez - Exane BNP Paribas - Analyst

Thank you. Just going back to the US and talking about my favorite slide, which is number 11, which is the classification of the returns, just two questions on this. Last year gas distribution upstate New York you classified as too early to say. And this year you are classifying it as underperforming. It's a little bit surprising because I know you have been active on the rest of the three other businesses, Rhode Island and of course New York upstate electric. But my question is why are you --- is that negative this year regarding gas distribution in New York upstate and what steps are you taking if you are going to refile?

And the second question about this graph is can you reassure us that Massachusetts Electric, which started to generate in 2010, and now you're classifying as on track, will not be classified as underperforming next year because this year is underperforming? Thank you.

Steve Holliday - National Grid plc - Chief Executive

Yes, a very fair question. I think, as we've talked haven't we, about going through the first cycle in the package. Very clear about where we are not delivering against the allowed returns today, the program that we've announced, the \$200m of cost savings, it's apportioned across all of those so we'll drive all of those returns up. The ones that sit in the unsatisfactory today box, if you will, are the ones that equally have to do another filing. And there's a whole host of reasons around why we haven't got the right cost of service in there or the debt, for example, in upstate New York which has gone up substantially hasn't been covered today. So there are different reasons, rate base by rate base.

I think we have a clear view today, though, Tom, about what the agenda is and whether to add any comment on that?

Tom King - National Grid plc - Executive Director

Nothing more to add, other than, just as you described it, the \$200m will definitely have a positive impact on every operating company across the US. Number one. Number two is it's very clear that the upstate gas and electric, which is Niagara Mohawk gas and electric, need to go back in in 2012, and the Rhode Island both businesses, electric and gas. So it's very clear of what the agenda needs to be and where we're going. And we're trying to make sure that we get clarity on the cost reduction and how those are apportioned across the operating company so when we go in with the new case we represent those cost savings.

Steve Holliday - National Grid plc - Chief Executive

Peter? I was going to make this the penultimate, if not the last, yes?

Peter Atherton - Citigroup - Analyst

Actually quite a big picture question. What is your thought on security of supply at the moment both across gas and electricity? I guess short term's reasonable, but so much going on at EMR, nuclear getting delayed because of Fukushima etc., fourth carbon budget came out the other day and has been signed off by the government, amazingly enough. What are you saying to the government about meeting their targets? Can you keep the light on? Can you keep enough gas flowing into the country?

Steve Holliday - National Grid plc - Chief Executive

These are open questions and big questions so let me just give a couple of headlines. And you're quite right actually, we are in a healthy position today. There's a lot of new generation that has come on the course of the last 18 months, so generation capacity today against the expected demand, if we think it's going to be fairly flat electricity year on year, we're in good shape. Gas, the infrastructure's in place. Isle of Grain phase

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III is up and running. We can bring in half the gas for the UK and house LNG. Of course it's still got to be provided and economic, but if the infrastructure's in place, we should be okay.

You're absolutely right of course there's a big question. LCPD has shut down plants from 2015. What's going to get built? There's a lot of connection agreements out there. As Mark said, next year is a crucial year for this country, getting EMR sorted, getting the right incentives in so that those that want to invest in generation have the clarity around it is very important. Is there still time? There absolutely is. I think the industry as a whole has been very clear with government. We need to get that clarity in the course of the next year or so to make sure the investments do get made.

Anyone got one last final question? Okay. Thank you very much for coming this morning. Appreciate it.

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