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National Grid Electricity Distribution – the local electric revolution

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Good afternoon, everyone.

It's great to be standing here as the CFO of the largest Electricity Distribution business in the UK at such a pivotal time, and it's really exciting to be able to tell you all about our plans for the ED2 period.

Today, I will explain:

- how the ED2 framework differs from the last price control;
- the drivers which will grow our investment by more than 30% in ED2; and
- what we will do to deliver 100 to 125 basis points of operational ROE outperformance.

Turning first to the ED2 framework. There are four parts to the regulatory framework which need to be optimised to deliver well within the price control:

- totex allowances;
- incentives;
- financial framework; and
- uncertainty mechanisms.

We're confident about the opportunity we have in each of these aspects to deliver great outcomes for our customers, and outperformance for our shareholders.

- Totex allowances are more than 30% higher than ED1 spend, with the up-front baseline allowances of £5.9 billion in 2020/21 prices equivalent to £8 billion in nominal prices.
- There's a new incentives package which extends customer and reliability incentives from ED, and includes new incentives around the Distribution System Operator and customer vulnerability – areas where we have great experience and a proven track record.
- The allowed equity return of circa 5.3% is indexed annually to risk free rates, and there is a rebased debt mechanism which tracks the prevailing market interest rate.
- And finally, we have a broad package of uncertainty mechanisms which flex our revenue based on external factors or level of customer outputs delivered.

ED2 is different to ED1, which is a fact reflected in our delivery plans for the period. It is worth me focusing on three of the changes:

- Firstly, totex efficiency now has a bigger emphasis than incentives. The high-powered incentives package from ED1 has been reduced in size and rebased to recent performance levels. A sharper focus has been placed on efficient delivery of growth, with sharing factors for totex efficiency remaining high. We're leveraging the wider group's engineering and asset management capabilities to respond to this change.
- Secondly, our real return is now linked to CPIH inflation rather than RPI which increases cash return in the ED2 period. The equity return is now also indexed annually to changes in the risk-free rate, with a 1% change in gilt rates producing a 20 basis point change in return on equity.

- Thirdly, we have greater protection to changes in our external environment via uncertainty mechanisms. Of the 38 mechanisms, more than half are automatic. For example, we now have revenue indexation for equipment, labour and contractor prices when they move differently to CPIH inflation.
- The remainder of the uncertainty mechanisms are reopeners where we can trigger additional funding during the period, many of which just act as insurance policies against changes.

Whilst there are changes in the framework, the fundamentals of delivering outputs efficiently for our customers remain the same. These are fundamentals we have responded to well over ED1, and it will be the same in ED2.

Looking at our spend in more detail, our total expenditure is broadly split into 15% operating costs and 85% capital investment.

Operating costs include regular inspections and maintenance activities, responding to faults on the network, and operational support such as work scheduling. Looking forward, while we will minimise unit costs of delivery, there is marginal cost growth as we deliver a higher volume of work.

We are forecasting capital investment in ED2 of £7.5 billion, which is more than 30% higher annual investment than we delivered in RIIO-ED1. 95% of this is funded by our baseline totex allowances. And all of this is green capex, aligned to the EU Taxonomy.

Looking at our investment under the four main drivers:

- We have £2.1 billion of connection work, which represents sustained annual growth of 10% from FY23 levels. Of the projected spend, 75% is expected to be demand connections mainly related to electric vehicle charging, domestic housing growth and heat pumps. And the remaining 25% is expected to be generation related, with solar and battery storage driving the majority.

- £1.0 billion of our investment plan is to reinforce the network to accommodate the growth in connections. Over the ED2 period, total electricity demand across our networks is projected to grow by at least 10% and we need to increase capacity on our networks to meet this increase and enable local connections. As a result, annual investment in reinforcement will more than double from ED1 levels.
- £3.6 billion of our investment is to maintain asset health which is 50% of our investment and a 15% step up from ED1. This will be critical in helping us maintain reliability at over 99.99% and also includes climate change adaptation investment including increased resilience to flooding.
- And the remaining £0.8 billion of our planned investment is for IT, digital and cyber work, which is more than double ED1 levels as we look to digitise our operations and build resilience in our IT.

This investment growth underpins the Group's 8 to 10% nominal RAV growth to FY26 in the five-year frame, with our figures at the top end of this range, reflecting strong progress since the acquisition.

The investment growth keeps our networks reliable and resilient, whilst also progressing the energy transition. But we have to do this whilst being mindful of affordability and the impact on our customers. Today, our charges are just £100 of a typical annual household energy bill and our plans keep this flat in real terms whilst still delivering an appropriate return for our shareholders.

As investment grows, we want to beat Ofgem's efficiency benchmarks and deliver more for our customers through incentives. Our strong track record of delivery throughout RIIO-ED1 and our new efficiency plans give me confidence that we will do just that. Delivering for our customers, whilst also delivering ROE outperformance of between 100 and 125 basis points.

This outperformance will be delivered through three main levers:

- totex efficiency;
- synergy benefits; and
- incentives.

Around 70% of our performance will be driven through totex efficiency. We have developed a targeted programme of efficiency work which is being rolled out and scaled up through the period. The common systems and operations structure across our regions offers us the ability to trial approaches in individual areas before rolling out across the organisation.

Using a data driven approach, we have high visibility to unit costs, by job type and under each team leader. Within a matter of seconds, we can drill down to compare the unit costs of pole replacement in the centre of Birmingham to those in Bristol and Cardiff.

- This means we can be surgical in removing unnecessary spend on labour, materials and unwieldy end-to-end processes;
- A new drumbeat on performance execution is being led by Graham Halladay, our Director of Field Operations, who is here today; and
- We're also implementing changes to our third-party contracts model, how we triage, organise and schedule work, how we structure local teams and embed new monitoring technology to give better visibility to asset health.

I'm confident that we'll see unit cost reductions over the period, with more jobs per day, less overtime, and reduced contracted labour spend.

As an example of one of the small, but powerful changes we're making today. Around 10% of line faults reported into our call centres don't relate to National Grid lines and are instead supplier meter issues. Our contact centre operatives triage many of these, but we still have over 2,000 call outs per month where our engineers arrive at site to find there's nothing to do.

We are implementing new technologies to this process, including the ability to switch to video on mobile phones so customers can show the operative what they are seeing, and be led through basic tests. This will reduce the number of non-productive callouts we have to attend and increase the information available to our engineers when work is required.

The second category where our ROE performance will come from is synergy benefits. We are targeting £100 million of benefits in the next three years across the Group. One third of this benefit is in ED, which contributes to our totex efficiency plans.

This includes:

- Procurement savings from utilising the broader scale and category management capability of National Grid. For example in the latest tender for our High Voltage cables we have reduced costs by over £4m per annum.
- Leveraging National Grid's asset management and maintenance best practices, including implementing more condition rather than time-based maintenance techniques to reduce opex but maintain reliability.
- And reviewing our property strategy to leverage shared sites and personnel where possible. Through our Future of Work programme, we will be assessing a consolidation of offices and depots, and investigating new operations and maintenance shared sites.

With totex efficiency underpinned by synergies expected to deliver 70% of the performance, the remainder is forecast to be delivered through incentives.

We enter the ED2 period as the top performing network group in terms of our reliability incentives – customer minutes lost and customer interruptions. We will build on this performance through investment in areas such as automated reclose equipment to restore power almost immediately after a trip and reduce minutes lost.

From a customer satisfaction perspective, we are aiming to push our frontier performance as far as we can, to achieve at least 9.3 out of 10.

This will be aided by:

- digital developments in our contact centre to better inform customers of fault information;
- reforming our connections approach to improve our customers' experience;
- and introducing a new customer excellence team who will lead improvements to our customer touch points.

We are also early on in a trial of using GenAI in our contact centre to handle calls and give customer updates.

The incentives package is completed by new incentives in ED2 around Distribution System Operator and Customer vulnerability – activities where we are already ahead of the curve in areas of strength for National Grid.

In addition to the 100 to 125 basis points of operational outperformance, we see further outperformance opportunity on financing. The debt funding tracker gives us good cover for current and future interest rates. And with National Grid's broad debt market reach and track record of financial outperformance, we're confident that we can deliver further upside beyond our operational outperformance target.

So, to summarise the next five years:

- the ED2 framework is different to ED1, but the fundamentals remain the same with our revenue better adjusting for external uncertainties;
- our investment levels are forecast to grow by more than 30%, driven mainly by energy decarbonisation; and
- we have developed plans to deliver 100 to 125 basis points of ROE outperformance across the period

When this operational outperformance is added to a base return of circa 5.3%, and an assumed long run CPIH of 2%, we are targeting an operational ROE of at least 8.3%.

This demonstrates our attractive mix of yield and growth, and it's just one of the reasons I'm so excited to be a part of this business. And the growth opportunities don't stop after five years. The continued and accelerating connections of distributed renewable generation, electric vehicles, and heat pumps means that we have good line of sight to continued waves of investment over the next decade and beyond.

Thank you.