Q&A

Keynote session

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John: As Andy said, we're going to take the opportunity now to take some questions on what you've heard from Andy and myself. And then later on this afternoon, you get an opportunity to have another question and answer session with myself and Andy and the president of the businesses. Why don't we just put hands up and take the first question, and we'll bring a mic around.

Hi, it's Martin Young at Investec.
If I could ask two questions, please. The first relates to the equity return, return on equity that you might be hopeful to get in the ED2 process. On one hand, the distribution companies in their draft business plans have pitched for something that's significantly higher than Ofgem had put out as their working assumptions. And there are obviously a number of reasons why we need to make sure the appropriate incentives are there to get those heat pump connections, to get those EV connections, etc in place. On the other hand, you've got the CMA that has come out and said, "Look, Ofgem was not wrong in what it did in the T1 process." So how do we square the circle on those opposing views as we go through the ED2 process? And then this one's just for Andy, point of clarification on the 100 bps outperformance that you expect in the UK business. Is that solely on the operational side of things and excludes anything that you might do on financing and tax?

John: Well, why don't I take the first one and the second over to Andy. Obviously we're a couple of weeks away from submitting the final business plan for our distribution in the UK, WPD. Our approach to it will be, first of all, we'll look at the fundamentals, as you'd expect, in terms of the capital asset pricing model and update that to reflect the latest views on risk free rates, and so on. We will clearly be, and we are, spending quite a lot of time looking at the detail of what the CMA said, and obviously that will feed into our assessment. But fundamentally what you'll see in the business planning is what we believe is an appropriate return for the risk that we're taking, whilst also trying to incentivize the energy transition. Ofgem have already said quite clearly that they see distribution leading the energy transition in the UK, and therefore it will need an appropriate return to encourage that.

And then the final thing I would say is, as I said when we did the transmission business plan, actually what's important is not just the base returns, but also making sure that the overall financial package is right. So base returns are really, really important, but we need to make sure we get the right incentive package to give us the opportunity to drive innovation and efficiency. And also that the cash characteristics of that business are right as well. So things like fast and slow money, and whether that's at a natural rate or something different. So we are just finalizing all that at the moment, putting that together, and making sure that what we do submit is something that we believe that we can fully defend with Ofgem going forward. Andy, second question.

Andy: In terms of the 100 basis points then, absolutely, that is from operational performance. So a combination of things like TotEx or CapEx, OpEx outperformance, the incentive portfolio, what we can deliver against that. Anything we are able to achieve on a financing perspective, we'll be over and above that.

John: So we go to Dominic.

Hi, thank you. Yes, it's Dominic Nash from, Barclays.
Just following up again on this £400m number, and the ROE in the UK, the 100 bps outperformance. How much of that... Or, how much of that £400m is coming from OpCo performance, and how much of it will be coming from the holding company synergy benefits? I know we talked about synergies this morning on the call as well. And does that then mean that the ROE outperformance that your... The 100 bps that you're talking about, is that the total outperformance, or have we got more above that that sits outside the regulatory ring fence?

John: So if I just break it down, so the £400m of outperformance the target we set this morning is broke down. £300m will come from the US, £100m from the UK through our ET business. None of it is covered by WPD UK electricity distribution. In terms of that, that will help to contribute to the 100 basis points of operational performance that Andy's just described. So that outperformance will come from either direct operations within ET, or the functions that support ET that make up the ET business. Over and above that, what we haven't included in that 100 basis points is any outperformance for finance. So that would be over and above. So the 100 basis points is just the operational outperformance. So over and above that depends on how we do on the financial incentives.

Dominic;
Sorry. Apologies, following up here. It's not the financial outperformance I'm actually asking. Is operational outside of the regulatory company?

Andy: I think to answer that specific point, the element to the £100m, the portion that is focused in the UK, ultimately will all turn up within electricity transmission or the functions that support, so ultimately within the operating company. So there won't be savings outside of electricity transmission, if that's what the question is. But it's part of delivering the 100 basis points. Yeah.

Dominic:
Again, and the same in the US is 300 as well?

Andy: It will turn up ultimately within the operating companies within the US. Again, it's part of delivering the 95% of allowance that we've talked about previously.

Dominic:
Thank you.

Hi , it Mark Freshney from Credit Suisse.
I have three quick questions. Firstly, further to the returns, the 100 bps, clearly that's ET in isolation, it's usually commercially sensitive, because WPD is being price controlled. But presumably there are synergies between WPD and ET, which may come through over a longer period. So is it fair to assume that where the businesses may benefit from coming together, that could be upside to the 100 bps? And secondly, just on the CapEx, I mean the 30 to 35 billion was something that you put together, I guess, April, May this year. The world's moved on since then, Ofgem have been agile in and they seem to be moving things forward a lot more quickly. Is that a conservative number and could it go up? And finally... No, I think I'll just leave it at two, actually.

John: All right. Well, in terms of the second, I don't think it's a conservative number. It's our best fee, and that hasn't changed. So it's 30 to 35 billion. Within that, we've assumed around about eight billion for ET, electricity transmission. And that assumes a significant number of projects that are progressing the energy transition. So, we remain confident with that number as a good guide for the next five years.

In terms of your question around synergies, as you can imagine, our absolute focus at the moment is making sure that we put the very best business plan in at the end of this month, beginning of December. As you heard from Phil earlier on, I think the team have done a fantastic job. There's a huge amount of detail in it. They've gone out and I think it's over 20,000 stakeholders that have now been discussed. So, we're very confident. It's a plan that reflects what customers are asking from us and what stakeholders need.

As I said when we did the acquisition, I'm hugely excited by the opportunity of bringing the capabilities that WPD has. They've got a fantastic track record, as you heard today, around customers and about delivering on short-term incentives. Putting that together with the capabilities we have in National Grid around engineering and asset management, given the energy transition, I think is something that we are hugely excited about. But at the moment, our focus is very much on making sure we get the best possible business plan in.

Deepa Venkateswaran from Bernstein.
I have two questions. Andy, you mentioned there is some headroom in the plan. Can you quantify that, whether it's extra CapEx or headroom to the FFO ratio? And the second question, John, on the uncertainty mechanisms. So you've shown those two different clusters, re-openers and something else. So, are you seeing Ofgem move fast enough on whatever should be automatic? And then have you seen any change versus RIIO-1 in terms of the other uncertainty mechanism processes moving faster?

John: So, let me do the second one and then hand to Andy to do the first. I mean, I think in terms of the uncertainty mechanisms, we have seen reaction from Ofgem since RIIO-2 started. I think, I mean, Chris Bennett will talk when you do ET later on today. I think we've already submitted, I think, three applications and got a response from Ofgem on one of them already. So, we've got some uncertainty mechanisms which are automatic as you know, and then we've got some for the bigger projects where we have to make a submission. I think the first one we did was on Cyber. We got a good reaction from Ofgem with regards to that. So, it's early days because we've got a lot of these uncertainty mechanisms as you know, as the energy transition unfolds. But initially we're seeing the response that we need, but we need to see that continue.

Andy: And Deepa, I think you're referring to the overall financial framework that I set out towards the end of my presentation, and I think the point we're making there is, as John said, the best view we have today is the 30 to 35. And that's the level of CapEx that delivers the 6% to 8%, and delivers the 5% to 7% of earnings growth. The point I was making is we have further optionality within that. Firstly within the five years, but certainly as we look ahead at the waves of growth beyond the next five years, as that frame continues to grow with the size of the balance sheet. But the precise scale of the headroom, as you say, will depend ultimately on our performance over the next five years.

Sam Arie, UBS:
Thank you. Thanks very much for this, it's very helpful. I have a couple of questions and you probably won't like either of them, I'm afraid, so I apologize in advance. But John, I think I'm right in saying that you had your five year anniversary as CEO earlier this year, is that right?

John: Yes.

Sam:
And so congratulations on that, but I think we're talking about a five year plan here, so I just wondered if there's an opportunity for you to just confirm for us if you're eager and willing to stay and deliver the next five years on the board. We've had a few CEO surprises in the sector before, so it'll be helpful to have your answer on that.

John: Okay.

Sam:
And then secondly, I think the other thing I want to sort of wrestle with is not RIIO-2, but RIIO-3. And Andy's started sort of looking ahead to this, but if I list everything you're saying, CapEx is going to be higher in the future. Arguably, returns are going to need to be higher in the future as well. And I wonder if sometimes we fall in the trap of valuing your very long-term assets on a very short-term view of allowed return. So, is there anything you could share with us that will help us think about where returns might go in RIIO-3 and four and five? I mean, you must think about that when you're valuing assets like WPD or even your gas assets that you're selling. So I'd just love to hear your thoughts on the longer term return outlook.

John : Okay. Thank you for those questions. I'm going to answer one and a half of them and then I'm going to hand over half to Andy. So in terms of the first question, look, I am loving this job. Anybody that's in the sector at the moment who's not excited about the energy transition and what's going on is in the wrong sector. So I have no intentions of leaving or going anywhere. As long as the board wants me, I'm here to stay. So, that answers your first question.

In terms of the second, I'll leave it to Andy to do his crystal ball on numbers in RIIO-2, three and beyond. What I would say is I do think there is a real opportunity, actually, as we look at the energy transition over the next 10, 20, 30 years, and to stand back, which is a conversation I think that we're starting to have, and I referenced it in my keynote speech, about what is the right regulatory framework that is really going to encourage and incentivize innovation to deliver what is a massive task. It's a one in a generation task.

So I think the regulatory framework. Have we got the right market mechanisms? Have we got the right institutional framework? So, the discussion around the future of system operator is a small element of that. But I do think there is an opportunity now that we're out of the price control on transmission, and we'll soon be out to the price control on ED2, just to start a broader conversation about what's needed for the next 30 years. What we've had has been great, but I do think there is an opportunity there. There's nothing more in that, other than I do think it is a sensible conversation to be had given the levels of investment and infrastructure that's going to be needed over the next several decades.

Andy.

Andy: I think what I would say in terms of returns around whether it's ED2, 3, 4, or T3 is we've always said, and consistently, that what matters is the overall financial framework and the allowed return is a part of that. But so are the cash characteristics, whether ... now we've seen it's the change in the capitalization rate, the RPI to CPIH switch, the opportunity for incentives, the opportunity to drive efficiencies, and outperform and share that with consumers. And we feel overall for T2, certainly, we've got a package now that, as I said, it's going to be challenging, but we believe we can continue to deliver. And I've no reason to assume that won't be the case. I'm not going to try and second guess what returns might be. Of course, I'd love them to go up slightly. But I think for me, what's important is the overall package. We've got a good package now to work with for T2, confident that we'll work with Phil and Ofgem to achieve the right package for ED2, and that we'll continue to do that as we look ahead.

Richard Alderman, from BTIG.
Three questions, starting maybe just with the bigger picture one, John. You said you were up at COP26 for a large period of the time. When you came back and gave feedback to your senior colleagues, how would you summarize what you learned there that you didn't know and how would you take that knowledge into perhaps future business plans and things that might adjust your thinking going forward on the CapEx plan, both at high voltage and low voltage?

And then maybe a question for either of you. On the £100m number, you talked about in the UK, in terms of OPEX savings, you talked about digitalization. What are you doing from a practical point of view that you've not been doing in the last three or four or five years on digitalization? Can you give us some examples of that?

And then the age old problem of US storm costs, and you talked on the slide about how to speed up or improve the collection of storm costs. It's always been an issue for yourselves and other US utilities, can you give us some practical examples about how you might deal with that? How would you persuade the regulators? Is it just cost assessment and quicker rate cases? Or is there something more detailed?

John: Okay. Why don't I cover the first two and let Andy do storm costs?

So, we were the principal partners up at COP26, which we were very proud to be. And actually, I was there for the whole of the first week personally, and my whole team was there for the whole duration of the second week, including many of the senior team that are here today. When I left at the end of the first week, I have to say, it was with a sense of relative optimism. I think some of the commitments that had been made at COP26, including deforestation, reduction in methane, the coal commitments, it goes on... I think there was a sense of progress was being made and is being made. There are many people who think that more progress should have been made, but nonetheless, there were significant commitments.

What was really interesting, I think, being at COP was one, and I'm certainly not a COP aficionado, but there were many people that seemed to have been to the prior 25, is that it just felt very different. It felt very different in terms of the energy that was there, the makeup of the people who were there. There were way more businesses being represented. I mean, you couldn't shake a stick to hit into a CEO. I mean, I think every CEO from the FTSE 100 and the Fortune 500 was there. And they were there and they were seriously engaging in the conversation about what needs to be done. And I think that was the sense of COP, which was, it wasn't a debate around the size of the commitment. Actually, it was about what do we need to do and what barriers need to be removed?

What I found quite interesting was I sat in a meeting for one breakfast with John Kerry, which was quite fascinating, and the topic of the conversation was what are the barriers that need to be removed? And it was really pertinent because I sort of learned from it that the things that we're grappling with in our country are very similar in every other country. And to bring that to life, planning is one of those things. So, in the UK, we've got a commitment to build 40 gigawatts of offshore wind by 2030. So we've got nine years to do it. Over the last 10 years, we've built 10. And everybody, whichever country they were representing, was saying, if we don't get the planning process right, then we're not going to be able to achieve this target, even if we've got the right financing and the right engineering and the right commitments in place. And it's good that in the UK, BEIS is doing a consultation on that, but there are lots of those types of areas.

So I came away with a sense of optimism. And actually, although there was some sort of dampening of some of the commitments right at the end, I was also optimistic given the commitment to come back next year to Egypt, rather than wait five years to re-look at those commitments. But my expectation is now going forward, which is there is a lot of conversation at COP around commitments, but actually, turning those commitments into actions is going to require a tsunami of policy, not just in the UK, but right across the globe. So it'll be really interesting to see what happens over the next 12 months to see whether that commitment actually translates into policy and ultimately into action. And for me, we will be working with BEIS and working with Ofgem about what are the actions that now need to be put in place? And by when, if we're going to deliver on the commitments that the UK has made?

In terms of digitization. Well, great question. And I'm trying not to preempt, because what you're going to see today is lots and lots of examples of where we are delivering innovative and digital solutions to actually deliver on the £400m commitment we talked about, but actually, to serve our customers better. And I'll just give one example and it's a very simple one. Through some of the work we've been doing with National Grid partners in Silicon Valley, we are working with a company that's got military grade satellite imagery that allows us to more directly manage vegetation management. It might sound very straightforward, but if you manage your vegetation really well, you improve reliability of your customers. And it is the single largest OPEX number in any distribution company. So, we're using that digital technology to fundamentally change the way that we manage all the trees that put our networks at risk. And that's just one simple example that will save money and improve reliability. That type of technology wasn't there 10 years ago. It's there today and National Grid's embracing it.

Andy: So, on storms, I'll start where John finished, which is the first thing we've done is we have to make sure that our storm performance continues to deliver best in class and deliver what our regulators and customers expect. And the vegetation management example is one that we have invested in to make sure that the impact of storms is mitigated as best we can, as well as obviously our storm readiness. And that, if you like, is the key to then have the right regulatory debates around the recovery mechanisms.

So the reference I had earlier on was we were facing potentially perverse incentives that actually, the ability to recover storm costs was linked to how bad the storm was, how long people were off, which is completely counter to the real incentive, which is to get people back on as quickly as possible. So we've done some great work as part of current or new rate cases to try and shift that, to make sure the incentive matches what we want to do, which is get customers back on. And we've made some good strides in that, which gives me confidence that recovery of those costs better matches how we incur them.

John: Thanks, Andy. We've run out time for this segment, and partly because I'm really keen to get you to the breakout so you can actually see some of the great work that's going on right across National Grid. There is going to be another opportunity for Q&A at the end of this afternoon.

Thank you.