National Grid (NGG)

Updated February 3rd, 2020 by Prakash Kolli

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	7.8%	**Market Cap:**	$42 B
Fair Value Price:	$57	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	11/25/20
% Fair Value:	105%	**5 Year Valuation Multiple Estimate:**	-1.0%	**Dividend Payment Date:**	01/13/21
Dividend Yield:	5.3%	**5 Year Price Target**	$69	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	N/A

Overview & Current Events

National Grid plc is diversified electricity and natural gas utility with operations in the UK and U.S. In the UK, National Grid owns and operates the electric and natural gas transmission network. In the U.S., the company serves 7.1 million electricity and natural gas customers in Massachusetts, Rhode Island, and New York. National Grid acquired Keyspan in 2007 entering the U.S. market and divested its UK natural gas distribution business in 2019. Today, the utility operates in five business segments: UK Electricity Transmission, UK Gas Transmission, US Regulated, National Grid Ventures, and Other. The stock trades on the LSE and as an ADR on the NYSE. The utility had revenue of over $14.54B in FY2019[1].

National Grid reported half-year results on November 12th, 2020. Companywide operating profit was down -11% to $1,564.6M from $1,765.2M and underlying earnings per share was down -14% to $0.23 from $0.27 in comparable periods. National Grid continues to be negatively impacted by the COVID-19 pandemic in both the UK and U.S. UK Electricity Transmission operating profit was down -10% to $714.8M from $795.3M and UK Gas Transmission operating profit was up 64% to $147.3M from $90M on a year-over-years basis. US Regulated operating profit was down -23% to $549.7M from $716.2M in the prior year. NG Ventures operating profit was $193.7M compared to $174.6M last year.

In the U.S., National Grid continues with a robust capital investment program and is pursuing rate cases in New York and Massachusetts. In the UK, the RIIO-2 price control mechanism set by Ofgem will take effect in April 2021. National Grid was able to earn a 7% real rate of return in 2011 – 2020 plus incentives. This will be cut to 4.3% for electricity transmission and 3.6% for gas transmission from 2021 – 2026. This cut combined with divestment of the gas distribution business will result in US Regulated assets generating more than half of operating profit.

Growth on a Per-Share Basis

Year[2]	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$3.44	$4.43	$3.73	$4.15	$4.72	$3.85	$3.65	$3.20	$6.81	$2.95	***$3.78***	***$4.60***
DPS	$3.05	$3.27	$3.45	$3.43	$3.77	$3.63	$3.26	$2.91	$3.12	$3.10	***$3.14***	***$3.82***
Shares[3]	643	654	672	684	686	687	688	671	682	702	***709***	***745***

National Grid's earnings have been volatile over the past decade due to the effects of the sub-prime mortgage crisis, COVID-19, regulatory changes, and the divestment of UK gas distribution assets. The top and bottom line are facing diverging fortunes in the UK and U.S. In the UK, the utility is faced with a large cut in base return on equity in the next RIIO-2 price control mechanism that takes effect on April 2021. This will lead to a lower return on capital. In the U.S., National Grid has historically had lower returns of capital than in the UK. This will likely reverse after RIIO-2 due to declines in the UK and improving trends in the U.S. We are forecasting a 4% average annual increase in earnings-per-share and dividends. The dividend has grown in GBP but has been volatile for the U.S. ADR after accounting for currency exchange rates. The payout ratio is elevated and there is risk of a dividend cut if earnings in the UK fall and are not offset by gains in the U.S. Note that one ADR share equals five ordinary shares.

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[1] National Grid plc reports results in GBP. This report will use USD at the prevailing exchange rate.
[2] National Grid's fiscal year ends in March of the following year. The values in the table are in fiscal year.
[3] Share count in millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2020
Avg. P/E	14.0	11.9	16.8	17.2	16.3	19.7	17.4	18.4	7.0	21.2	***15.7***	***15.0***
Avg. Yld.	6.3%	6.2%	5.5%	4.8%	4.9%	4.8%	5.1%	4.9%	6.5%	4.9%	***5.3%***	***5.5%***

National Grid's stock price is flat year-to-date. The stock is trading above our fair value estimate, which is a price-to-earnings ratio 15 times earnings. Our fair value estimate is $57 per share. Our 5-year price target is $69 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	89%	74%	92%	83%	80%	94%	89%	91%	46%	105%	***83%***	***83%***

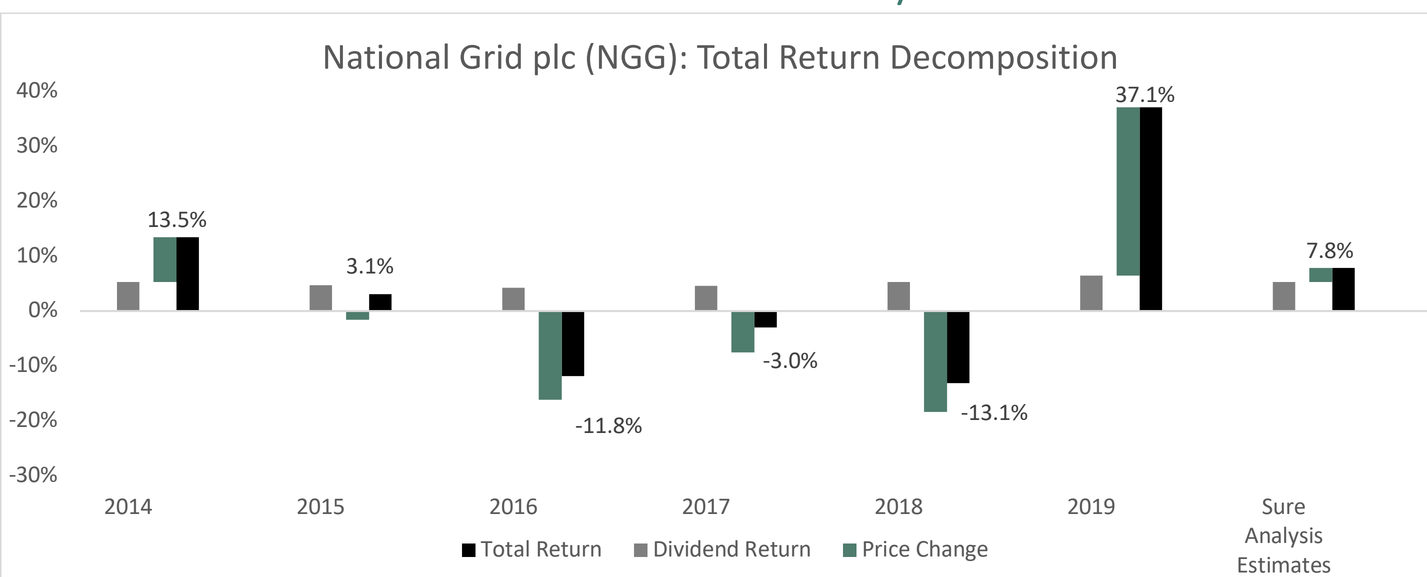
In the UK, National Grid owns and operates the electric and natural gas transmission network essentially giving it a monopoly. In the U.S., the utility has the advantages of most regulated utilities in that it is a monopoly in its service area. That said, there is risk in that National Grid is faced with a declining rate of return in the UK after April 2021. It is unlikely that efficiency incentives and inflation adjustments will make up the decline. There is also a risk of nationalization of transmission assets. In the U.S., National Grid faces risk from tough regulatory environments that could lead to low rates of return. Furthermore, U.S. regulators do not allow inflation adjustments or efficiency incentives.

Long-term debt is now at $29,809M offset by $1,479M in cash, equivalents, and short-term investments. Interest coverage is 2.7x and the leverage ratio is elevated at about 8.3x.

Final Thoughts & Recommendation

At present we are forecasting a 7.8% annualized total return through 2025. National Grid is faced with a more challenging future in the UK due to the impending RIIO-2 price control mechanism. In the U.S., the utility is seeing improved fortunes, but it will probably not be enough to offset the declines from the UK. Hence, we are wary about this utility. The dividend yield is more than twice the market average, but the payout ratio is elevated, and we believe there is risk of a cut if earnings fall and the payout ratio trends higher. At the current price, we rate this stock a hold.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	22,221	22,072	22,693	23,537	24,534	19,911	19,647	20,299	19,611	18,492
Gross Profit	16,795	17,336	18,813	18,421	19,529	16,460	16,532	16,521	15,477	15,193
Gross Margin	75.6%	78.5%	82.9%	78.3%	79.6%	82.7%	84.1%	81.4%	78.9%	82.2%
D&A Exp.	1,929	2,046	2,151	2,252	2,411	1,976	1,935	2,037	2,085	2,086
Operating Profit	9,312	9,462	10,807	10,364	10,465	4,844	6,993	4,611	4,520	4,207
Op. Margin	41.9%	42.9%	47.6%	44.0%	42.7%	24.3%	35.6%	22.7%	23.0%	22.8%
Net Profit	3,345	3,059	3,403	3,935	3,259	3,905	10,186	4,725	1,984	1,608
Net Margin	15.1%	13.9%	15.0%	16.7%	13.3%	19.6%	51.8%	23.3%	10.1%	8.7%
Free Cash Flow	2,671	1,401	571	1,424	2,782	3,492	2,235	788	495	(359)
Income Tax	714	739	880	451	996	644	489	-1,183	445	610

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	74,565	75,523	83,130	87,193	81,576	84,694	82,149	82,390	82,123	82,989
Cash & Equivalents	617	530	1,020	589	176	180	1,421	461	329	90
Acc. Receivable	1,869	1,489	2,013	2,667	2,322	1,834	1,985	2,346	2,477	1,919
Inventories	514	600	442	446	503	628	503	478	483	679
Goodwill & Int.	8,480	8,491	8,536	8,760	8,806	8,913	8,758	8,890	9,069	9,312
Total Liabilities	59,991	60,771	67,578	67,354	63,845	65,200	56,715	55,975	56,860	58,764
Accounts Payable	2,764	2,441	3,089	3,232	3,036	2,929	2,664	2,771	3,136	2,728
Long-Term Debt	36,955	36,406	42,397	42,911	38,067	40,384	35,347	36,935	37,120	37,183
Total Equity	14,559	14,741	15,544	19,826	17,713	19,480	25,413	26,393	25,237	24,198
D/E Ratio	2.54	2.47	2.73	2.16	2.15	2.07	1.39	1.40	1.47	1.54

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	4.8%	4.1%	4.3%	4.6%	3.9%	4.7%	12.2%	5.7%	2.4%	1.9%
Return on Equity	32.0%	20.9%	22.5%	22.3%	17.4%	21.0%	45.4%	18.2%	7.7%	6.5%
ROIC	7.0%	6.0%	6.2%	6.5%	5.5%	6.8%	16.9%	7.6%	3.2%	2.6%
Shares Out.	643	654	672	684	686	687	688	671	682	702
Revenue/Share	34.20	32.21	32.75	33.64	35.08	28.66	25.99	29.20	28.83	26.58
FCF/Share	4.11	2.04	0.82	2.04	3.98	5.03	2.96	1.13	0.73	(0.52)

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.