National Grid (NGG)

Updated May 28th, 2021 by Prakash Kolli

Key Metrics

Current Price:	$67	**5 Year CAGR Estimate:**	6.7%	**Market Cap:**	$47.63 B
Fair Value Price:	$60	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	06/03/21
% Fair Value:	113%	**5 Year Valuation Multiple Estimate:**	-2.4%	**Dividend Payment Date:**	08/18/21
Dividend Yield:	5.4%	**5 Year Price Target**	$72	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	N/A

Overview & Current Events

National Grid plc is a 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 $20.95B in FY2021[1].

National Grid reported full year results on May 20th, 2021. Companywide operating profit fell -5% to $4,646M from $4,888M and underlying earnings per share fell -7% to $0.77 from $0.82 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 -4% to $1,588M from $1,662M and UK Gas Transmission operating profit was up 9% to $620M from $569M on a year-over-years basis. US Regulated operating profit was down -9% to $2,103M from $2,315M in the prior year. NG Ventures operating profit was down -2% to $335M compared to $343M 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 took effect in April 2021. National Grid earned 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. The utility is acquiring Western Power Distribution in the UK and will sell the majority of its Gas Transmission business. The company is investing in unregulated projects including the North Sea Link, Viking Link, Qatar LNG facility, and 1,000+ MW of renewable power generation in the U.S.

Growth on a Per-Share Basis

Year[2]	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$4.43	$3.73	$4.15	$4.72	$3.85	$3.65	$3.20	$6.81	$2.95	$3.85	***$3.97***	***$4.83***
DPS	$3.27	$3.45	$3.43	$3.77	$3.63	$3.26	$2.91	$3.12	$3.10	$3.45	***$3.59***	***$4.37***
Shares[3]	650	685	693	700	703	695	693	695	680	696	***703***	***738***

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 RIIO-2 price control mechanism that took effect on April 2021. 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.

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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. The values in the tables are in fiscal year.

[3] ADR share count in millions. One ADR equals five ordinary shares.

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Valuation Analysis

Year	2010	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2027
Avg. P/E	11.9	16.8	17.2	16.3	19.7	17.4	18.4	7.0	21.2	15.3	***16.9***	***15.0***
Avg. Yld.	6.2%	5.5%	4.8%	4.9%	4.8%	5.1%	4.9%	6.5%	4.9%	5.8%	***5.4%***	***6.0%***

National Grid's stock price is up since our last report. The stock is trading above our fair value estimate, which is a price-to-earnings ratio 15 times earnings. Our fair value estimate is $60 per share. Our 5-year price target is $72 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	74%	92%	83%	80%	94%	89%	91%	46%	105%	90%	***90%***	***90%***

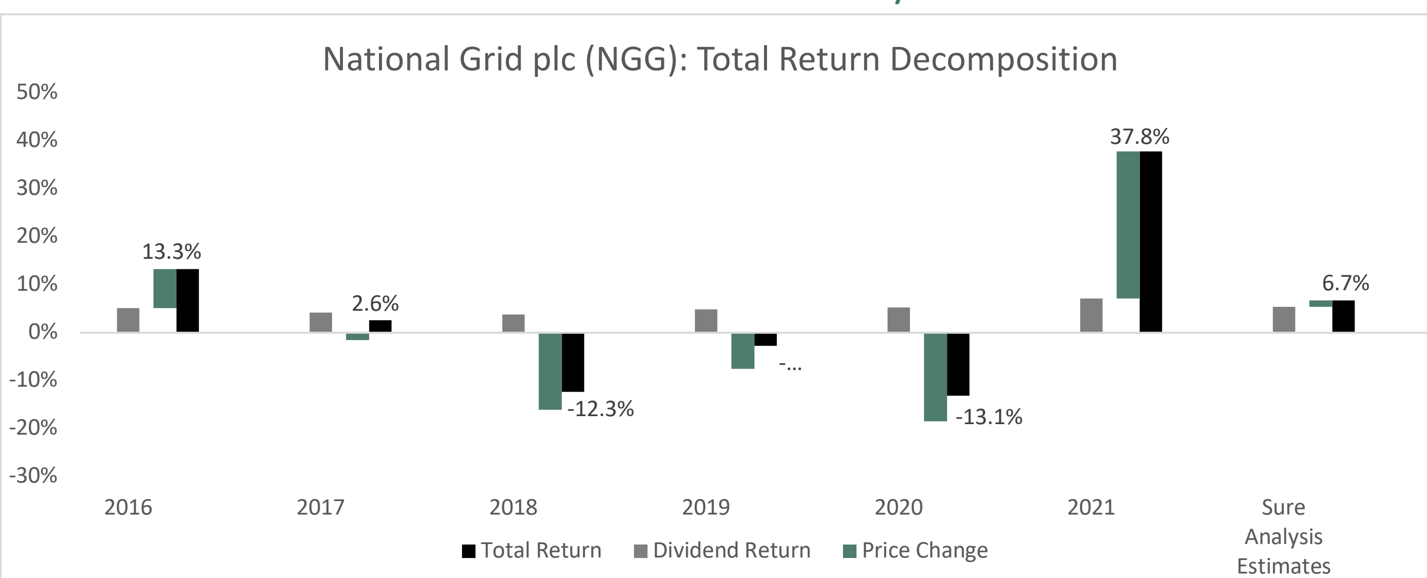
In the UK, National Grid owns and operates the electric and natural gas transmission network essentially giving it a monopoly. In the U.S., the utility has the advantages of most regulated utilities in that it is a monopoly in its service area. That said, there is risk in that National Grid is faced 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 $37,962M offset by $3,540M in cash, equivalents, and short-term investments. Interest coverage is 3.4x and the leverage ratio is elevated at about 6.3x.

Final Thoughts & Recommendation

At present we are forecasting a 6.7% annualized total return through FY 2027. National Grid is faced with a more challenging future in the UK after the RIIO-2 price control mechanism. The company is acquiring Western Power Division and will sell the majority of Gas Transmission in the UK. The utility has a robust capital investment plan that should support growth. The dividend yield is more than double the market average, but the payout ratio is elevated. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	22693	23537	24534	19911	19647	20299	19611	18492	19323
Gross Profit	18813	18421	19529	16460	16532	16521	15477	15193	
Gross Margin	82.9%	78.3%	79.6%	82.7%	84.1%	81.4%	78.9%	82.2%	
D&A Exp.	2151	2252	2411	1976	1935	2037	2085	2086	2186
Operating Profit	10807	10364	10465	4844	6993	4611	4520	4207	3826
Op. Margin	47.6%	44.0%	42.7%	24.3%	35.6%	22.7%	23.0%	22.8%	19.8%
Net Profit	3403	3935	3259	3905	10186	4725	1984	1608	2144
Net Margin	15.0%	16.7%	13.3%	19.6%	51.8%	23.3%	10.1%	8.7%	11.1%
Free Cash Flow	571	1424	2782	3492	2235	788	495	-359	-428
Income Tax	880	451	996	644	489	-1183	445	610	578

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	83130	87193	81576	84694	82149	82390	82123	82989	92390
Cash & Equivalents	1020	589	176	180	1421	461	329	90	216
Acc. Receivable	2013	2667	2322	1834	1985	2346	2477	1919	4012
Inventories	442	446	503	628	503	478	483	679	603
Goodwill & Int.	8536	8760	8806	8913	8758	8890	9069	9312	8290
Total Liabilities	67578	67354	63845	65200	56715	55975	56860	58764	65092
Accounts Payable	3089	3232	3036	2929	2664	2771	3136	2728	4834
Long-Term Debt	42397	42911	38067	40384	35347	36935	37120	37183	42913
Total Equity	15544	19826	17713	19480	25413	26393	25237	24198	27269
D/E Ratio	2.73	2.16	2.15	2.07	1.39	1.40	1.47	1.54	1.57

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.3%	4.6%	3.9%	4.7%	12.2%	5.7%	2.4%	1.9%	2.4%
Return on Equity	22.5%	22.3%	17.4%	21.0%	45.4%	18.2%	7.7%	6.5%	8.3%
ROIC	6.2%	6.5%	5.5%	6.8%	16.9%	7.6%	3.2%	2.6%	3.3%
Shares Out.	685	693	700	703	695	693	695	680	696
Revenue/Share	32.75	33.64	35.08	28.66	25.99	29.20	28.83	26.58	27.42
FCF/Share	0.82	2.04	3.98	5.03	2.96	1.13	0.73	-0.52	-0.61

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