National Grid (NGG)

Updated September 7th, 2022 by Prakash Kolli

Key Metrics

Current Price:	$62	**5 Year CAGR Estimate:**	8.5%	**Market Cap:**	$45.48B
Fair Value Price:	$60	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	12/03/22[1]
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.9%	**Dividend Payment Date:**	01/17/23
Dividend Yield:	6.0%	**5 Year Price Target**	$73	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Rating:**	Hold

Overview & Current Events

National Grid plc is a diversified electricity and natural gas utility with operations in the UK and US. In the UK, National Grid owns and operates the electric and natural gas transmission network. In the US, 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 US 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 (NGV), 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[2].

National Grid reported full year results on May 19th, 2022. Companywide operating profit surged 107% to $4,308M from $2,083M and earnings per share jumped 64% to $0.76 from $0.46 in comparable periods. Operating profits rose due to contributions from acquisitions and startup of JVs. Operating profit for UK Electricity Transmission was up 10% to $1,439M from $1,314M, UK Electricity Distribution was $1,108M, and UK ESO was down (-23%) to $67M from $87M on a year-over-years basis. US Regulated operating profit rose 12% in New England to $1,107M from $908M and fell (-2%) to $882M from $902M in New York in the prior year. NGV and Other increased 162% to $383M from $146M in comparable periods.

In the UK, the utility acquired Western Power Distribution (WPD) for $9.9B. NGG is selling 60% of its Gas Transmission business to Macquarie Asset Management and British Columbia Investment Management Corporation and 50% of the St. Williams JV to The Berkeley Group. In the US, the utility is selling Narragansett Electric Company in Rhode Island.

The utility is investing ~$8.4B to upgrade the WPD network, UK transmission, and a NY offshore wind JV in fiscal 2022. NGG plans to invest ~$37B to ~$44B through 2026 to drive mid-single digit asset and EPS growth.

Growth on a Per-Share Basis

Year[3]	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$3.73	$4.15	$4.72	$3.85	$3.65	$3.20	$6.81	$2.95	$3.85	$3.82	***$3.98***	***$4.84***
DPS	$3.18	$3.48	$3.32	$2.99	$3.08	$3.09	$3.09	$3.14	$3.44	$3.59	***$3.73***	***$4.54***
Shares[4]	685	693	700	703	695	693	695	680	696	729	***736***	***774***

National Grid's top and bottom line are facing diverging fortunes in the UK and US. In the UK, the utility had a large cut in base return on equity when the RIIO-2 price control mechanism took effect in April 2021. In the US, National Grid had historically 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 US. 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 US 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 US.

[1] National Grid has not yet announced the next dividend. These dates are projected based on prior history.

[2] National Grid plc reports results in GBP. This report will use USD at the prevailing exchange rate.

[3] National Grid's fiscal year ends in March. The values in the tables are in fiscal year.

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

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	11.9	16.8	17.2	16.3	19.7	17.4	18.4	7.0	21.2	15.3	***15.7***	***15.0***
Avg. Yld.	6.2%	5.5%	4.8%	4.9%	4.8%	5.1%	4.9%	6.5%	4.9%	5.8%	***6.0%***	***6.2%***

National Grid's stock price is down again since our last report. Our fair value estimate is a price-to-earnings ratio of 15X earnings, below the long-term average after we account for lower anticipated return on equity in the UK. Our updated earnings estimate matches consensus. Our fair value estimate is $60 per share. Our 5-year price target is $73 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	85%	84%	70%	78%	84%	96%	45%	106%	89%	94%	***94%***	***94%***

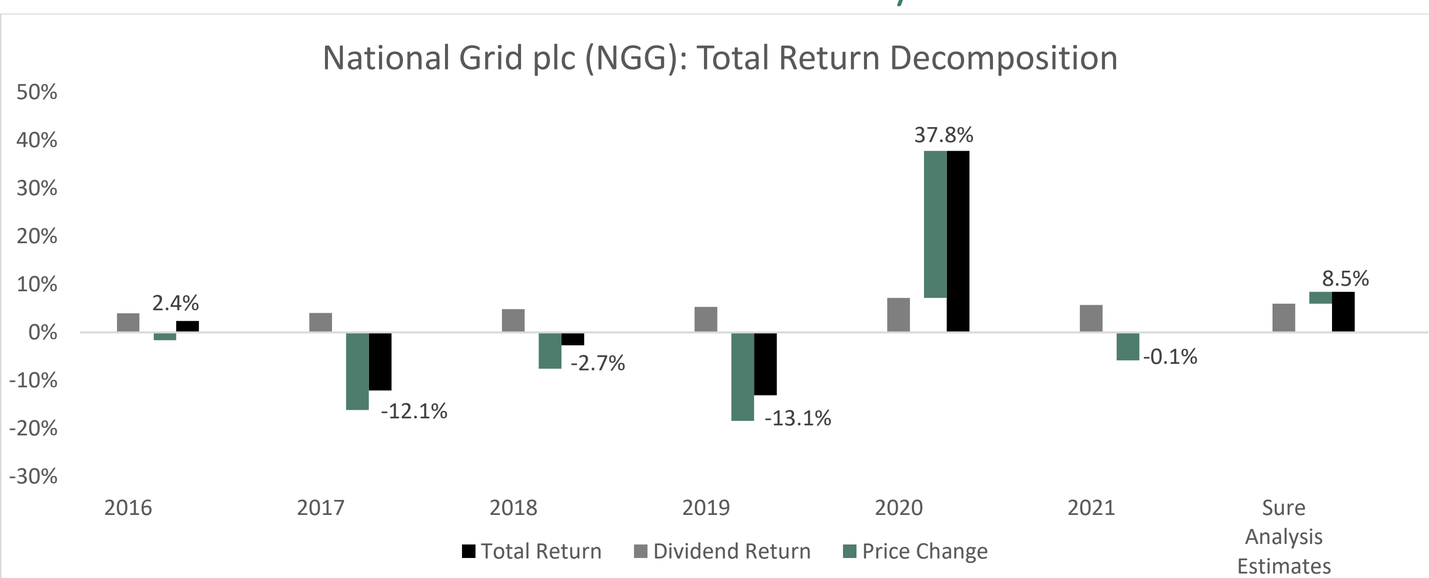
In the UK, National Grid owns and operates the electric and natural gas transmission network essentially giving it a monopoly. In the US, the utility has the advantages of most regulated utilities in that it is a monopoly in its service area. That said, National Grid is faced with a declining rate of 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 US, National Grid faces risk from tough regulatory environments that could lead to low rates of return. Furthermore, US regulators do not allow inflation adjustments or efficiency incentives.

Long-term debt is now at $53,643M offset by $4,197M in cash, equivalents, and short-term investments. Interest coverage is 3.8x and the leverage ratio is elevated at about 7.5x.

Final Thoughts & Recommendation

At present we are forecasting an 8.5% annualized total return through FY 2027 from a dividend yield of 6.0%, 4.0% EPS growth, and (-0.9%) P/E multiple contraction. The utility acquired Western Power Division and will sell 60% of Gas Transmission in the UK. The Rhode Island operations and 50% of the St. William JV are for sale too. The dividend yield is high, 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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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	23537	24534	19911	19647	20299	19611	18492	19323	25212
Gross Profit	18421	19529	16460	16532	16521	15477	15193	16210	16879
Gross Margin	78.3%	79.6%	82.7%	84.1%	81.4%	78.9%	82.2%	83.9%	66.9%
D&A Exp.	2252	2411	1976	1935	2037	2085	2086	2186	2501
Operating Profit	10364	10465	4844	6993	4611	4520	4207	3799	5662
Op. Margin	44.0%	42.7%	24.3%	35.6%	22.7%	23.0%	22.8%	19.7%	22.5%
Net Profit	3935	3259	3905	10186	4725	1984	1608	2144	3216
Net Margin	16.7%	13.3%	19.6%	51.8%	23.3%	10.1%	8.7%	11.1%	12.8%
Free Cash Flow	1424	2782	3492	2235	788	495	-359	-428	995
Income Tax	451	996	644	489	-1183	445	610	578	1720

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	87193	81576	84694	82149	82390	82123	82989	92390	124608
Cash & Equivalents	589	176	180	1421	461	329	90	216	250
Acc. Receivable	2667	2322	1834	1985	2346	2477	1919	2066	3495
Inventories	446	503	628	503	478	483	679	603	516
Goodwill & Int.	8760	8806	8913	8758	8890	9069	9312	8290	16819
Total Liabilities	67354	63845	65200	56715	55975	56860	58764	65092	93270
Accounts Payable	3232	3036	2929	2664	2771	3136	2728	2976	4089
Long-Term Debt	42911	38067	40384	35347	36935	37120	37183	41970	58989
Total Equity	19826	17713	19480	25413	26393	25237	24198	27269	31307
LTD/E Ratio	2.16	2.15	2.07	1.39	1.40	1.47	1.54	1.54	1.88

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	4.6%	3.9%	4.7%	12.2%	5.7%	2.4%	1.9%	2.4%	3.0%
Return on Equity	22.3%	17.4%	21.0%	45.4%	18.2%	7.7%	6.5%	8.3%	11.0%
ROIC	6.5%	5.5%	6.8%	16.9%	7.6%	3.2%	2.6%	3.3%	4.0%
Shares Out.	693	700	703	695	693	695	680	708	723
Revenue/Share	33.64	35.08	28.66	25.99	29.20	28.83	26.58	27.29	34.86
FCF/Share	2.04	3.98	5.03	2.96	1.13	0.73	-0.52	-0.60	1.38

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