National Grid (NGG)

Updated September 9th, 2023 by Prakash Kolli

Key Metrics

Current Price:	$63	**5 Year CAGR Estimate:**	11.4%	**Market Cap:**	$62.91B
Fair Value Price:	$72	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	11/23/23
% Fair Value:	87%	**5 Year Valuation Multiple Estimate:**	2.7%	**Dividend Payment Date:**	01/11/24
Dividend Yield:	5.7%	**5 Year Price Target**	$88	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 and New York. National Grid acquired Keyspan in 2007, entering the US market. It divested its UK natural gas distribution business in 2019. In 2022, it sold the Rhode Island electricity business. 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 $27.0B in FY2022/2023[1].

National Grid reported full year results on May 18th, 2023. Companywide operating profit rose 12% to $6,075M from $5,442M and earnings per share climbed 22% to $4.60 from $3.82 in comparable periods. Operating profits rose due to contributions from a strong UK Electricity Distribution performance, a rate increase in NY, and the North Sea Link, but offset by the sale the Narragansett Electric Company. Operating profit for UK Electricity Transmission was down (-4%) to $1,378M from $1,434M, UK Electricity Distribution was up 39% to $1,531M from $1,104M, and UK ESO was fell (-43%) to $39M from $67M on a year-over-year basis. US Regulated operating profit dropped (-17%) in New England to $1,020M from $1,223M and increased 68% to $610M from $362M in New York in the prior year. NGV and Other increased 68% to $610M from $362M in comparable periods because of joint venture starts.

In the UK, NGG sold 60% of its Gas Transmission business to Macquarie Asset Management and British Columbia Investment Management Corporation, 50% of the St. Williams JV to The Berkeley Group, and the Millennium pipeline. In the US, the utility sold the Narragansett Electric Company in Rhode Island to PPL Corporation.

The utility invested ~$9.6B to upgrade Isle of Grain expansion, Smart Path Connect, Viking Interconnect, London Power Tunnels in fiscal 2023. NGG plans to invest ~$50B through 2026 to drive mid-single digit asset and EPS growth.

Growth on a Per-Share Basis

Year[2]	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$4.15	$4.72	$3.85	$3.65	$3.20	$6.81	$2.95	$3.85	$3.82	$4.60	***$4.82***	***$5.86***
DPS	$3.48	$3.32	$2.99	$3.08	$3.09	$3.09	$3.14	$3.44	$3.12	$3.45	***$3.59***	***$4.37***
Shares[3]	693	700	703	695	693	695	680	696	729	736	***744***	***782***

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.

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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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	17.2	16.3	19.7	17.4	18.4	7.0	21.2	15.3	17.5	14.5	***13.1***	***15.0***
Avg. Yld.	5.5%	4.8%	4.9%	4.8%	5.1%	4.9%	6.5%	4.9%	4.7%	5.2%	***5.7%***	***5.0%***

National Grid's stock price is up slightly 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. We set our earnings estimate at consensus. Our fair value estimate is now $72 per share. Our 5-year price target is $88 per share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	84%	70%	78%	84%	96%	45%	106%	89%	82%	75%	***74%***	***74%***

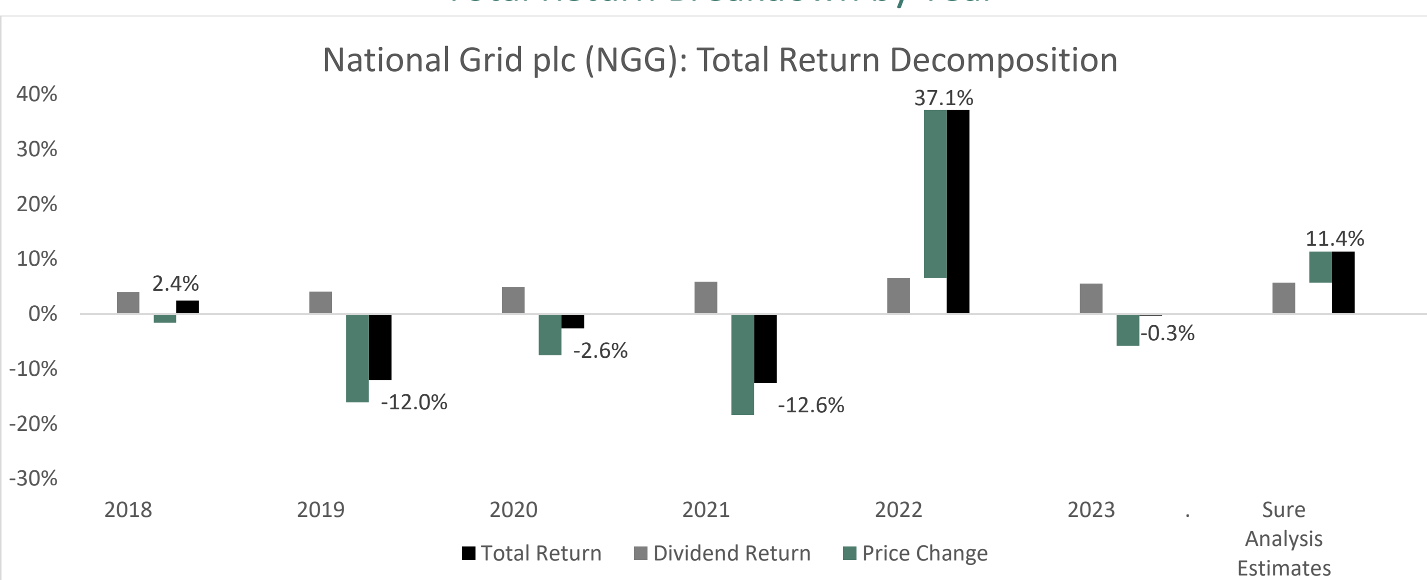
In the UK, National Grid owns and operates the electric and natural gas transmission network essentially giving it a monopoly. In the US, the utility has the advantages of most regulated utilities in that it is a monopoly in its service area. That said, National Grid is faced with a declining rate of return in the UK after April 2021 because of RIIO-2. 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 $49,839M offset by $3,446M in cash, equivalents, and short-term investments. Interest coverage is ~2.5X and the leverage ratio is elevated at about 7.2X.

Final Thoughts & Recommendation

At present we are forecasting a 11.4% annualized total return through FY 2029 from a dividend yield of 5.7%, 4.0% EPS growth, and 2.7% P/E multiple expansion. The utility has repositioned for growth by acquiring Western Power Division and selling 60% of Gas Transmission in the UK. The Rhode Island operations and 50% of the St. William JV were also sold. The utility is investing significant amounts in its assets to grow its return. The dividend yield is high, but the payout ratio is elevated. We maintained our buy rating.

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	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	24534	19911	19647	20299	19611	18492	19323	25212	26132
Gross Profit	19529	16460	16532	16521	15477	15193	16210	16879	15728
Gross Margin	79.6%	82.7%	84.1%	81.4%	78.9%	82.2%	83.9%	66.9%	60.2%
D&A Exp.	2411	1976	1935	2037	2085	2086	2186	2501	2394
Operating Profit	10465	4844	6993	4611	4520	4207	3799	5662	5887
Op. Margin	42.7%	24.3%	35.6%	22.7%	23.0%	22.8%	19.7%	22.5%	22.5%
Net Profit	3259	3905	10186	4725	1984	1608	2144	3216	9407
Net Margin	13.3%	19.6%	51.8%	23.3%	10.1%	8.7%	11.1%	12.8%	36.0%
Free Cash Flow	2782	3492	2235	788	495	-359	-428	995	7
Income Tax	996	644	489	-1183	445	610	578	1720	1057

Balance Sheet Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	81576	84694	82149	82390	82123	82989	92390	124608	114806
Cash & Equivalents	176	180	1421	461	329	90	216	250	202
Acc. Receivable	2322	1834	1985	2346	2477	1919	2066	3495	2506
Inventories	503	628	503	478	483	679	603	516	916
Goodwill & Int.	8806	8913	8758	8890	9069	9312	8290	16819	16659
Total Liabilities	63845	65200	56715	55975	56860	58764	65092	93270	78193
Accounts Payable	3036	2929	2664	2771	3136	2728	2976	4089	4024
Long-Term Debt	38067	40384	35347	36935	37120	37183	41970	58989	52353
Total Equity	17713	19480	25413	26393	25237	24198	27269	31307	36583
LTD/E Ratio	2.15	2.07	1.39	1.40	1.47	1.54	1.54	1.88	1.4311

Profitability & Per Share Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.9%	4.7%	12.2%	5.7%	2.4%	1.9%	2.4%	3.0%	7.9%
Return on Equity	17.4%	21.0%	45.4%	18.2%	7.7%	6.5%	8.3%	11.0%	27.7%
ROIC	5.5%	6.8%	16.9%	7.6%	3.2%	2.6%	3.3%	4.0%	10.5%
Shares Out.	700	703	695	693	695	680	708	723	735
Revenue/Share	35.08	28.66	25.99	29.20	28.83	26.58	27.29	34.86	35.54
FCF/Share	3.98	5.03	2.96	1.13	0.73	-0.52	-0.60	1.38	0.01

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