

Transmission Price Control Review 2007-2012 Initial Proposals Analyst Presentation - 26th June 2006

The conference call, which this presentation accompanies, will be recorded.
To access this recording after the call dial **+44 (0)20 8515 2499** and enter the pin **630025#**
The recording will be available until Thursday 29 June 2006.

Disclaimer: The information contained in these slides is a summary of the initial proposals for the transmission price control. Full details of GEMA's initial proposals (the "initial proposals") for the price control are set out in the publication "Transmission Price Control Review: Initial Proposals". The information contained in these slides is intended to summarise some aspects of the key features of the initial proposals but neither GEMA nor Ofgem represent or warrant that the information contained in these slides constitutes an accurate or complete summary of the initial proposals.

Note: All figures quoted are in £m 04/05 Real, unless otherwise stated

Key themes for this review

- Efficient investment for infrastructure renewal and growth
 - Baseline capital expenditure of £4.25bn
 - New load related investment will be funded using revenue drivers – potentially an extra £1.25bn based on company forecasts
- Still scope for increased operating efficiencies
- Financial stability during period of increasing investment
 - Pensions deficits being addressed in line with established principles
 - Cost of capital – consistent approach using longer-term historical averages

Capital Expenditure – Load Related

- Load related expenditure – driven by network users
- Allowance comprises
 - Baseline allowance
 - Revenue drivers to respond to additional requirements for capacity
- Gas entry
 - Baseline covers capacity available or committed on 1/4/07
 - All incremental capacity funded by revenue drivers
- Electricity entry
 - Baseline includes significant allowance for investment in anticipated network growth
 - Revenue drivers can flex up or down from baseline level

Capital Expenditure – Load Related

Company forecast, 2007-12	£3382m
Adjustments:	
Baseline definition	-£1252m
Other (chiefly unit costs)	-£257m
Proposed baseline allowance	£1873m
Alternative “possible” scenario	£2600m

Capital Expenditure – Non-load Related

- Non-load related expenditure – asset replacement
- Substantial step-up in activity allowed, but adjustments to:
 - Proposed volumes
 - Unit costs
 - Procurement efficiencies

Company forecasts 2007-12	£3375m
Adjustments – cost categorisation	-£101m
Adjustments – volume & unit costs	-£901m
Proposed allowance	£2373m

RAV roll forward

- Period to 2004/05
 - No adjustments to electricity licensees
 - Consulting on potential £75m disallowance for NGG relating to excess investment in St. Fergus entry capacity
- 2005/06 & 2006/07 – Load related
 - Some exclusions
 - Subject to further review
- 2005/06 & 2006/07 – Non-load related
 - Consultants' assessment covered 2005-2012
 - Company profile applied to consultants' total figure
 - Some exclusions pending
 - Assessment of 2005/06 actual data
 - Further assessment of 2006/07 forecasts

RAV roll forward

	NGET	SHETL	SPT	NGG
2005/06 Opening RAV £m	5062	234	557	2395
06/07 Closing RAV £m	5199	282	746	2873
- Additions to RAV*	859	80	309	651
- Excluded pending further assessment	187	2	25	23

*Includes Plugs, BETTA, TSS and other adjustments for electricity, Milford Haven and other adjustments for gas

Operating Expenditure

- Four stage approach
 - Normalise 2004/05 base year
 - Consider scope for efficiency improvement (items identified by consultants)
 - Consider specific upward cost pressures
 - Consider scope for continuing efficiency improvement
- Non-op capex & quasi-capex
- IFI

Cost of Capital

- Post-tax cost of capital, with specific tax allowance
 - Cost of debt 3.4%
 - Cost of equity 7.0%
 - Gearing (Net debt/RAV) 60%
 - Post-tax WACC of 4.2%
- Continuing evidence of low real interest rates
- Strong evidence that UK utility equities exhibit risk which is significantly below market average

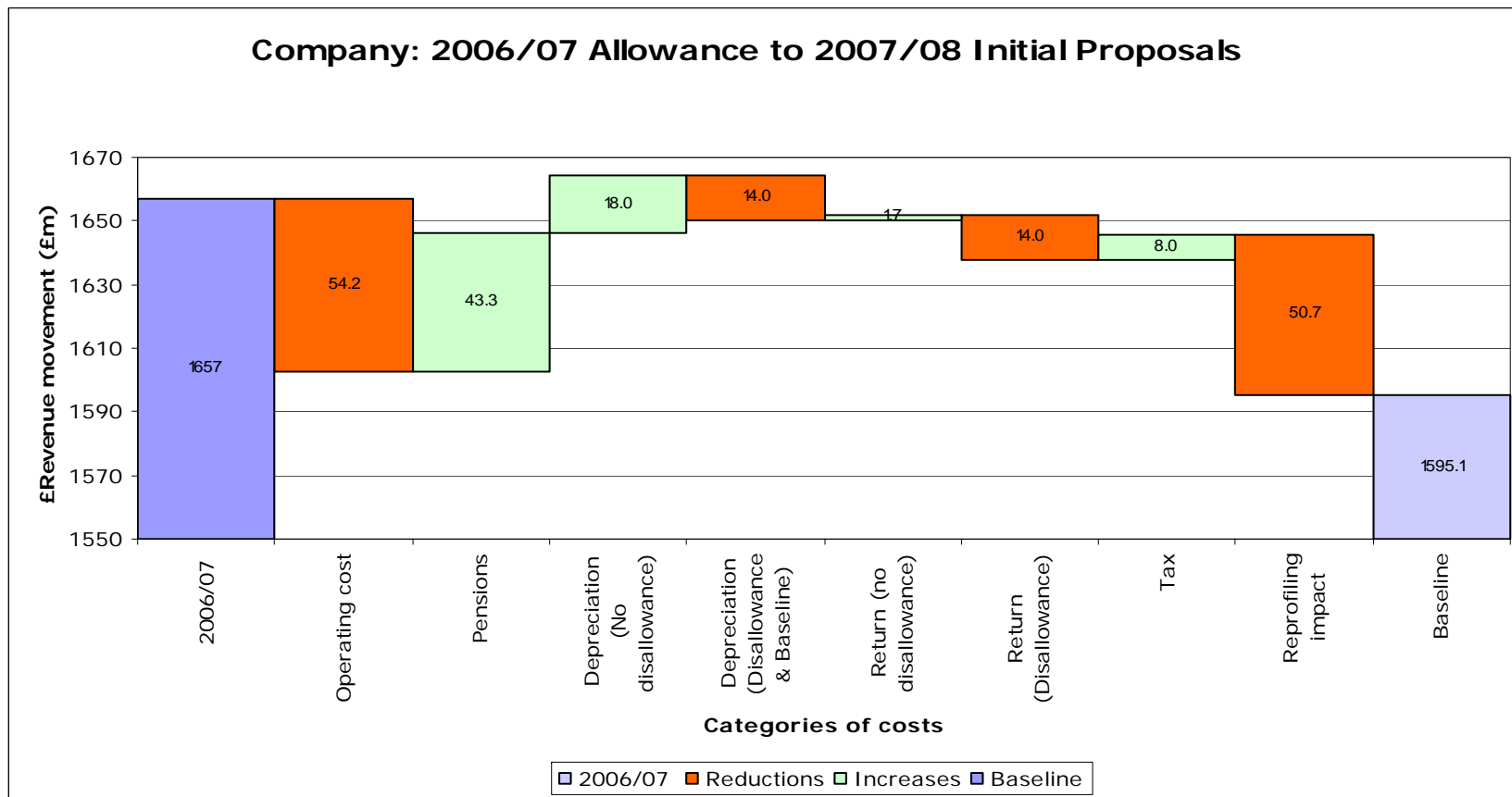
Other Financial Issues

- Pensions
 - ERDCs disallowed
 - “Centrica Liability” disallowed
- Depreciation “cliff edge”
 - Preferred approach is “depreciation tilting” – not yet applied in these proposals
- Other “financeability” issues
 - Potential strain caused by capex increases
 - Assume companies can raise equity (and allow for costs)

Proposed Revenue Allowances

	2006/07 allowance (£m)	Proposed 2007/08 allowance (£m), $X = 0$
NGET	1005	940
SPT	160	136
SHETL	51	49
NGG	442	471

2006/07 allowance to Initial Proposals



Next steps

- Workshop on 5 July to discuss Initial Proposals
- Financial modelling issues workshop on 7 July
- Discussions with companies will continue
- Responses to Initial Proposals due by 24 July
- September Update due for publication on 25 September
- Final Proposals to be published late November/early December

A large, central ofgem logo is positioned in the middle of the slide. It features the word "ofgem" in white lowercase letters on a red rounded rectangular background. The background of the slide is a faded, blue-tinted image of electrical components, including a three-pin plug and a fuse box, which are visible on the left side.

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