Northern Gas Networks

30 June 2011

Investor Update

Northern Gas Networks

Content

	Page
Executive Summary	3
Changes at NGN	6
Progression Towards the Vision	14
Financial Performance	16
Financing and Liquidity	21
Operational Performance	25
Regulatory Performance and Developments	28
Outlook	38
Appendices	40

Executive Summary

Northern Gas Networks

Executive Summary

The Future:

> NGNs business model continues to evolve following the acquisition of Northern Gas Networks Operations Limited (NGNOL) back in October 2010 and as we prepare for the 2013 – 2021 price control submission (RIIO GD1) to Ofgem.

> Our new business model will better place us to achieve a strong RIIO GD1 outcome and continue to progress with reaching our vision.

Financial Performance – half year to 30 June 2011:

> Strong financial performance:

- Revenue and EBITDA both up on 2010 half year by £1.3m and £0.5m respectively;
- Operating cash flows up by £4.6m on 2010 half year;
- Dividends of £18.0m paid (2010 – £14.3m); and
- S&P reinstated “stable” outlook on our BBB+ corporate rating in January and Moody’s reaffirmed our Baa1 (with “stable” outlook) rating in June 2011.

Executive Summary (Continued)

Operational Performance to 30 June 2011:

> During the first half of 2011 NGN has continued to progress towards its vision to be benchmarked consistently by Ofgem and the Health & Safety Executive (HSE) in the top two comparable utilities on safety, efficiency and customer service:

- Safety - lost time injuries (LTIs) and injuries to members of the public (MOPs) are significantly better than internal target levels at the half year;
- Efficiency – we continue to be benchmarked as the most efficient gas distribution network by Ofgem; and
- Customer service - customer service KPIs are an area of significant management focus and targeted action moving forward.

> Despite challenging operational performance conditions during the 2010/11 winter giving rise to a high level of outstanding gas escapes at the start of the year, NGN expect to achieve all but 3 of our internal operational KPI targets by the end of 2011.

Changes at NGN

Northern Gas Networks

Introducing Mark Horsley

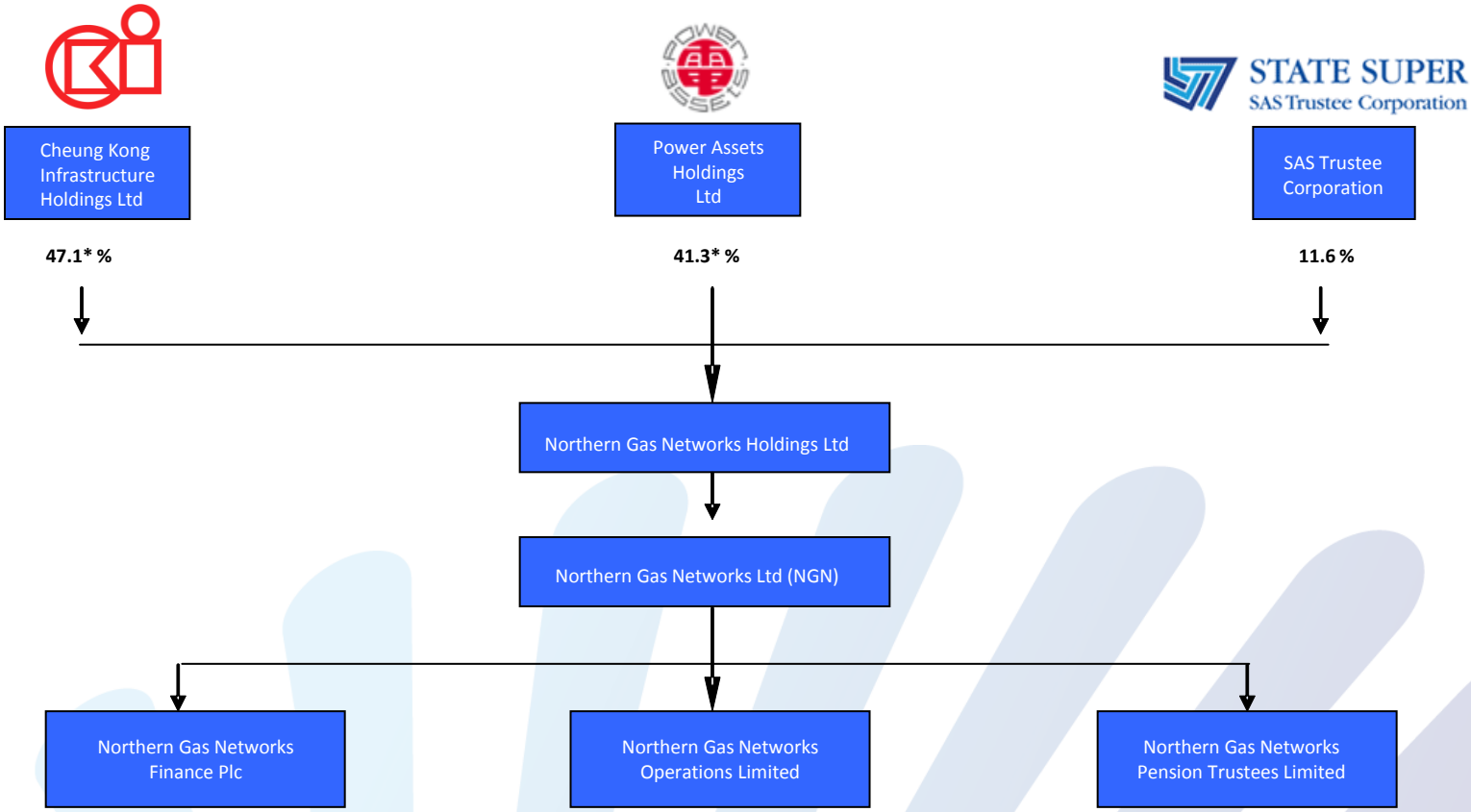
> Mark Horsley was appointed CEO of NGN in January 2011. Mark has more than 30 years experience in the energy industry and was previously a Partner at EC Harris, leading the power sector of the International Built Asset Consultancy.

> Prior to that Mark was an Executive Director at Scottish Power with responsibility for the £500m capital delivery programme in the transmission and distribution division. He was also responsible for a business transformation plan to deliver outperformance in the current price review period.

> He began his career as an apprentice with the North Eastern Electricity Board. He rose through the ranks to become the President and Chief Operating Officer of CE Electric UK in 2003, running the Yorkshire and Northern power distribution businesses, gas operations in Poland and Australia and a power contracting business in the UK and Ireland.

Ownership update

> On 31 October 2010 NGN acquired NGNOL and Northern Gas Networks Pensions Trustee Limited from United Utilities, effectively bringing the operation and maintenance of the network 'in-house'. Our business plans now include the costs of separation from United Utilities Plc (UU) and an integrated business model approach moving forward.



* Shareholdings are held through wholly owned subsidiaries.

Our Evolving Business Model

Our Challenge for 2011

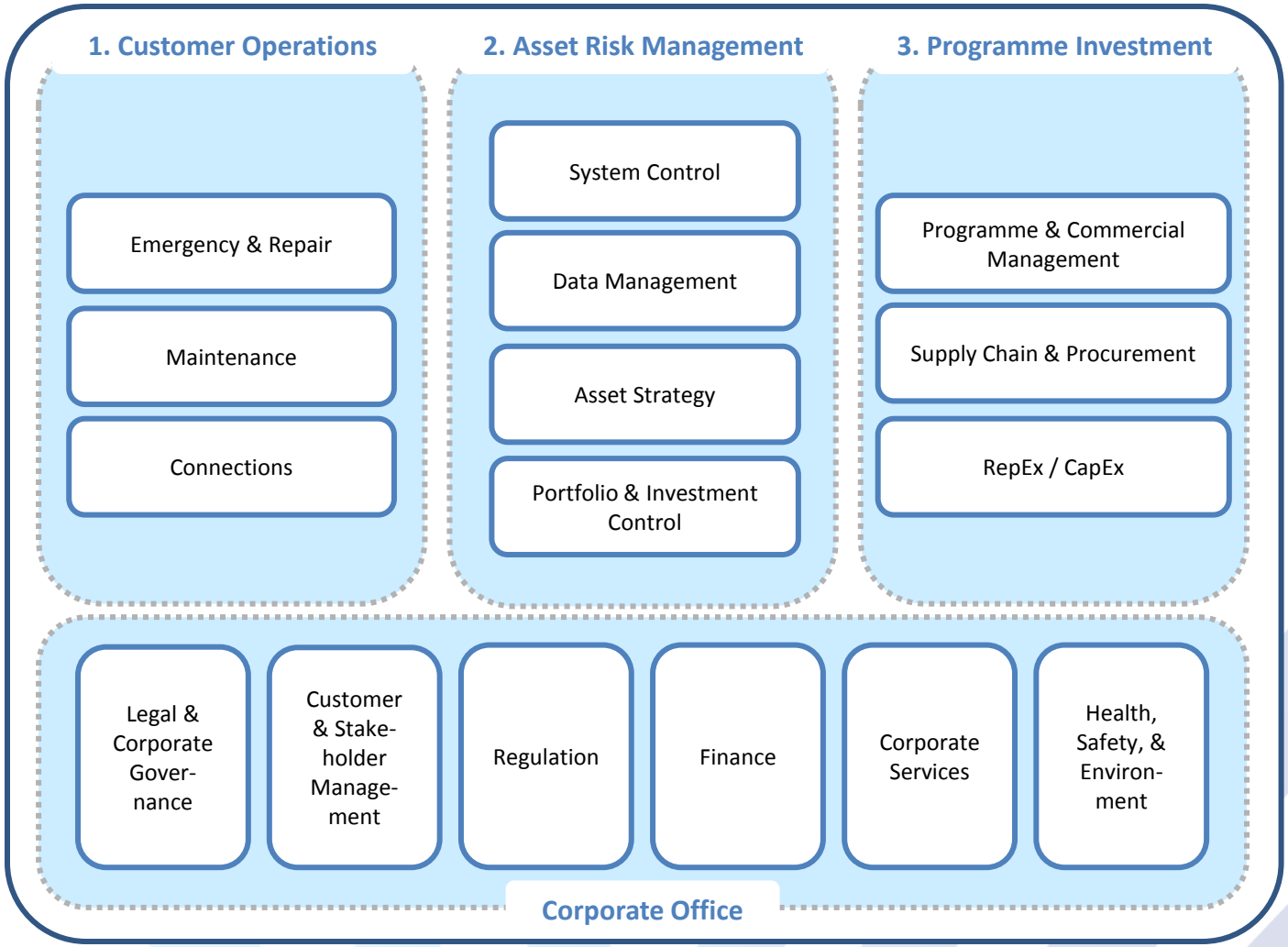
- Integrate successfully:
  - Fully integrate NGN and NGNOL;
  - Systems, teams, processes, and delivery; and
  - Improve our combined capability.
- Step our performance up against other GDN's.
- Continue to outperform against our targets:
  - Back on track with delivery – clearing work from the winter.
- Set ourselves up for success in RIIO GD1.

Our Plans

- Implementation of our new integrated business model.
- Improve our delivery processes.
- Deliver performance improvements identified in our recent business review.
- Get the organisation structure right:
  (Placing our people in the areas they can be most effective)
- Ready for the next regulatory period.

Our Evolving Business Model (Continued)

> The new integrated model has three core targeted areas supported by our corporate office.



1. Customer Operations

Customer Operations

- Right in front of the customer – the most visible part of our business.
  - ***Visibly being the best.***
- Preventing network failures (sophisticated maintenance).
- Managing escapes and customer emergencies.
- Connections excellence supporting customer perception.
- Combined scheduling.
- High performance delivery teams (NGN direct labour).
  - Better quality, effective and, more productive than any contracting organisation could be for NGN.

2. Asset Risk Management

Asset Risk Management

- Being smart about how we operate our assets.
- Strong asset management.
- System control.
- Building performance information about our network.
- Making the right decisions – balancing spend on operations and capital investment (Totex).
- Creating our maintenance strategy, the basis of how we respond to emergencies.
- Identifying the investment we need to make in the network.
- Controlling investment expenditure in line with asset strategy.

3. Programme Investment

Programme Investment

- Delivering the investment we are making in our network.
- Driving value for money from our investment in the network.
- Managing the programme of work – change, risk, schedule and commercials.
- Getting the best supplier relationships in the market – sharing success and obtaining best value.
- Managing the performance of our suppliers.
- Partnering with the supply market (real partnerships that deliver us value).

Progression Towards the Vision

Northern Gas Networks

Vision

> To be benchmarked consistently by Ofgem and the HSE, in the top two comparable utilities on:

EFFICIENCY

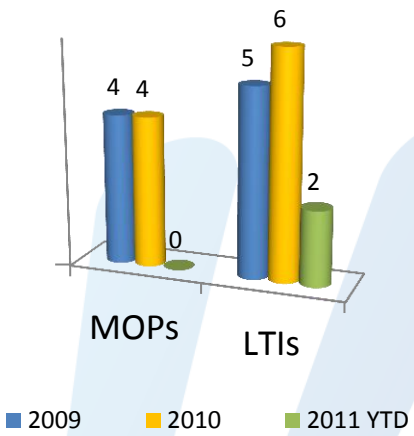
Ofgem continue to rank NGN as the most efficient GDN

Cost Assessment (2009/10) (1 = most efficient)	NGN Ranking
Totex (Ofgem's single model)	1
Totex (Capex+Opex+Repex)	1
Total Opex	1
Total Repex	1

Source: Ofgem

SAFETY

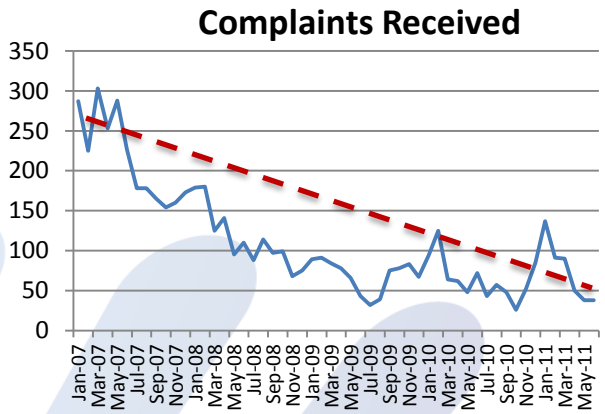
NGN's safety performance in 2011 continues to be strong and we continue to be viewed by the HSE as one of the best performing GDNS



- MOPs – injuries to members of the public
- LTIs – lost time injuries to our employees and contractors

CUSTOMER SERVICE

Customer complaints show a downward trend but customer satisfaction scores have been disappointing



Ofgem surveys rankings (2010/11):

- Repair – 7th /8
- Replacement – 3rd /8
- Connections – 3rd /8
- Target – Consistently in Top two

Financial Performance

Northern Gas Networks

Financial Results Summary

	6 Mths June 10 (£m)	6 Mths June 11 (£m)
PROFIT		
Revenue	169.1	170.4
EBITDA	64.4	64.9
PAT	3.9	9.4
CASH FLOW		
Dividends	(14.3)	(18.0)
Operating cash flows (before tax & interest & capex)	78.0	82.6
Cash capex	(16.4)	(15.4)

PAT is up by £5.5m on last year mainly due to:

>EBITDA improvement of £0.5m;

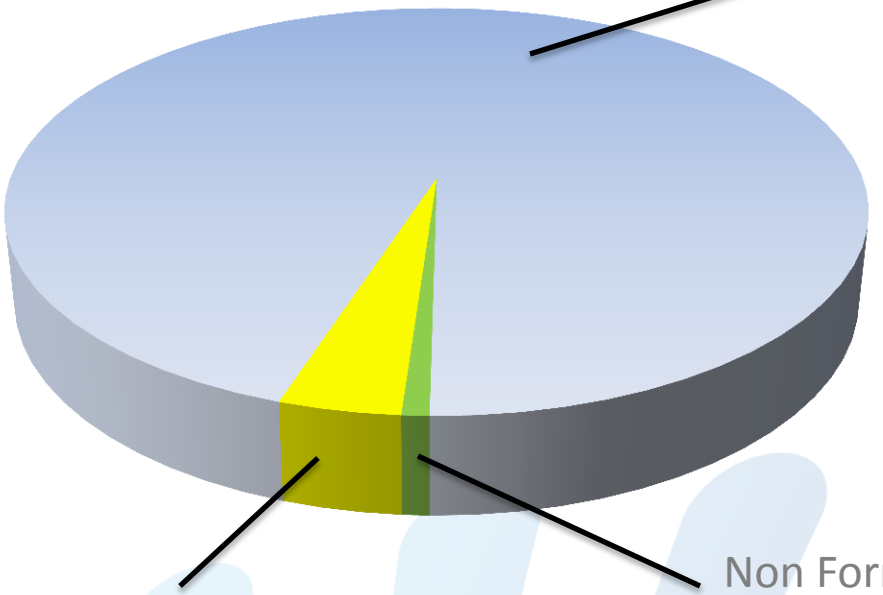
>Interest savings of £0.5m reflective of market rates; and

>Reduced tax of £4.2m due to the corporation tax rate reduction and resulting deferred tax liability restatement.

Operating cash flows are £4.6m up on 2010 mainly due to improved EBITDA and reduced supplier payments in line with cost savings, partially offset by reduced shipper receipts due to prepayment timing differences between the two periods which will be caught up in the second half of the year.

Revenue Stability

> Total revenue of £170.4m for the half year (2010 - £169.1m).



Capacity Revenue £162.2m
(2010 - £159.5m)

- Price increase effective from 1 April 2011 has increased capacity revenue

Commodity Revenue £6.7m
(2010 - £7.9m)

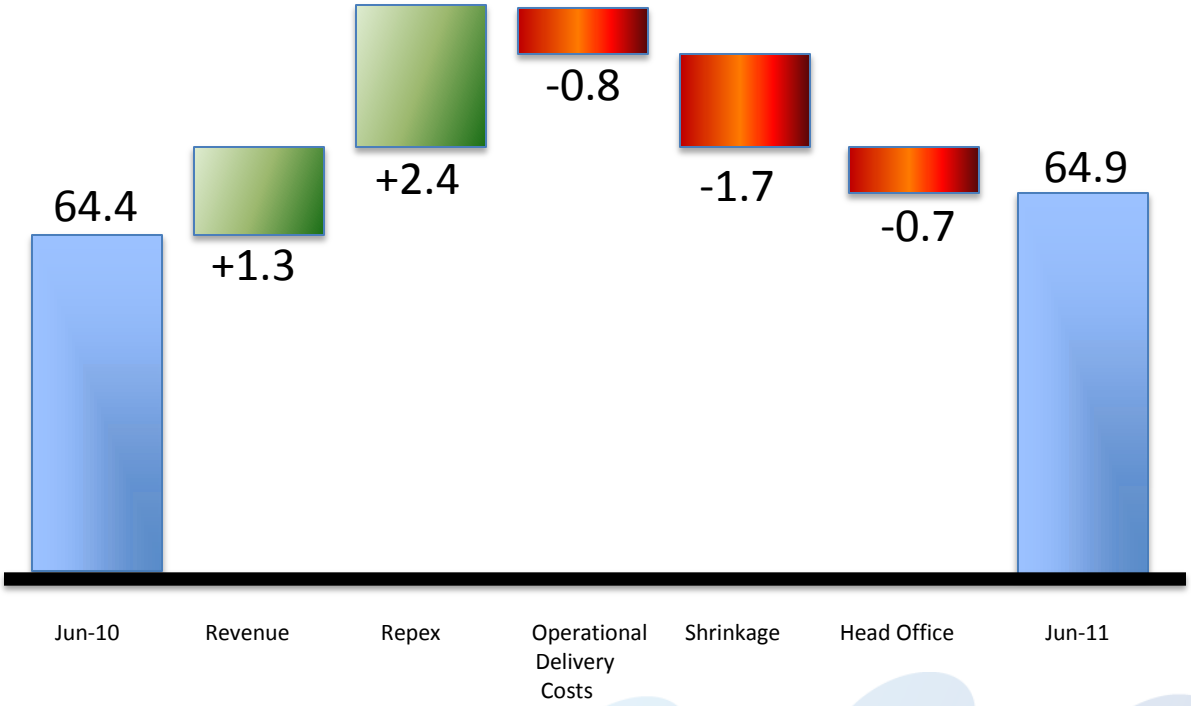
- The first half of 2010 was colder than the first half of 2011, hence a relative revenue decline in 2011

Non Formula Revenue £1.5m
(2010 - £1.7m)

- Loss of some metering contracts has seen non formula revenue decline compared to 2010 levels

EBITDA Profit Growth

> EBITDA improvement of £0.5m on same period last year.



> £1.3m revenue increase – see prior slide.

> £2.4m repex reduction due to workload mix changes

> £0.8m higher operational delivery costs due to the clearing of a high number of gas escapes resulting from the severe 2010/11 winter weather.

> £1.7m higher shrinkage gas costs reflective of wholesale gas price increases year on year.

> £0.7m higher head office costs due to £1.5m of one-off costs associated with NGN's system control going live, partially offset by £0.8m of cost reductions following the implementation of cost saving strategies in early 2011.

Strong Credit Metrics

> NGN continue to maintain key financial ratios above target levels reflecting strong financial performance and prudent leverage.

Measure	6 Mths June 10	6 Mths June 11
LEVERAGE RATIOS		
RAV (£m)	1,562.5	1,658.9
Consol net senior debt: RAV (%)	65.3	63.7
FFO : average debt (%)	12.8	12.6
P&L RATIOS		
EBITDA interest cover	2.1x	2.1x
EBITDA margin (%)	38.1	38.1
PMICR	1.9	1.8

Continued RAV growth reflective of NGNs ongoing investment into our asset base.

The RAV balance at 30 June 2011 reflects actual RPI to March 2011 of 5.3% and prudent forecast RPI of 3.7% to March 2012.

Resulting Debt: RAV of 63.7% shows NGNs prudent leverage position.

PMICR remains comfortably above bank covenant levels.

Financing and Liquidity

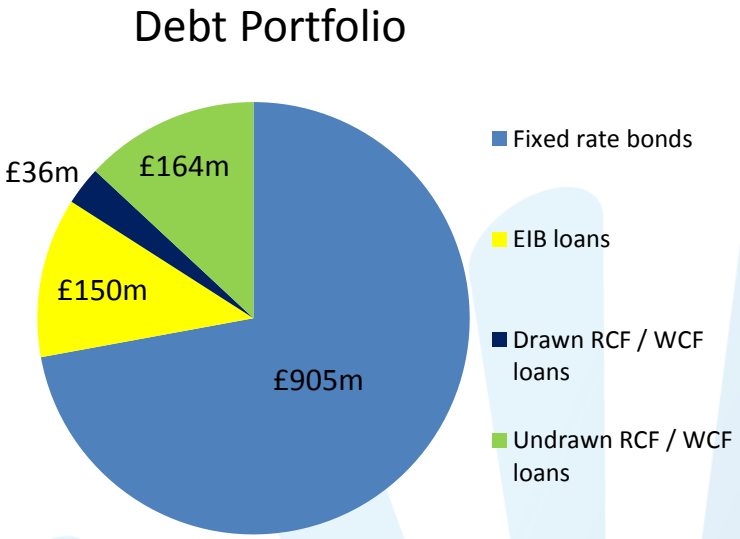
Northern Gas Networks

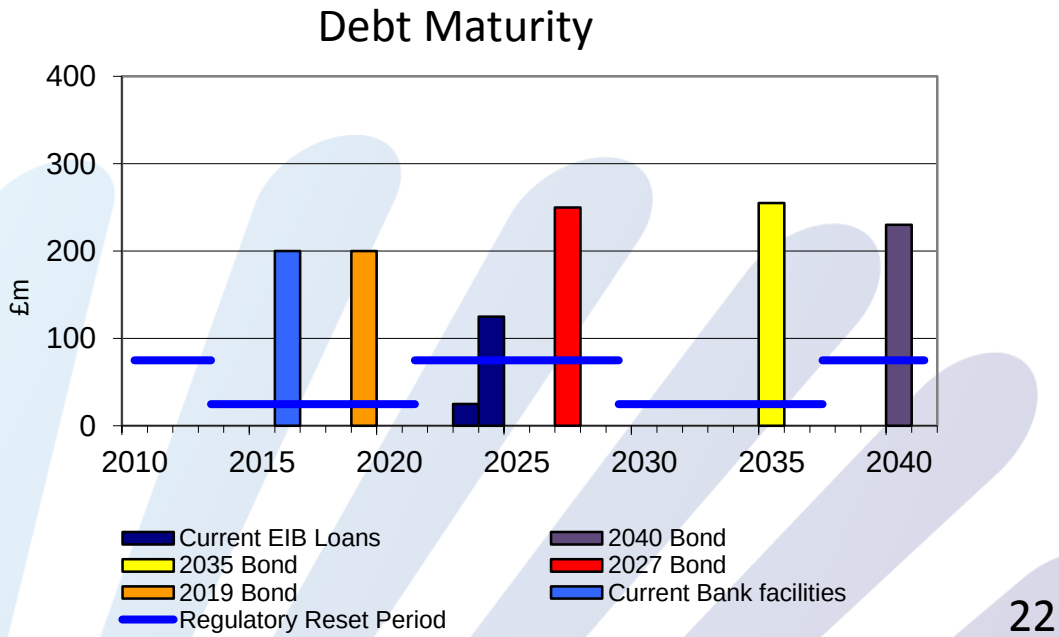
Debt Portfolio

> NGN's debt portfolio comprises:

- £505m fixed rate bonds 2027 / 2035, swapped into floating rate for life, currently re-fixed to the end of the current Price Control at March 2013;
- £400m fixed rate bonds 2019 / 2040;
- £150m 14-year EIB loan of which £50m fixed to 2020, £100m currently at floating rates; and
- £200m revolving credit / working capital facility of which £36.0m is drawn at 30 June 2011.

> Facilities are staggered to mature over a timeframe of up to 30 years avoiding excessive concentrations in any 12 month period as well as removing refinancing risk where possible if such timeframes coincide with a Regulatory reset date.





Prudent Financial Strategy

> NGN remains committed to maintaining leverage at about 70% of RAV. NGN believes that this level of debt is sustainable and prudent due to:

- Stable, predictable cash flow from a privatised regulated entity;
- Regulatory environment from a well established regulator;
- Flexible dividend distribution policy; and
- Experienced management team.

> All 2005 acquisition bank debt has now been refinanced with long-term debt.

- Other than a revolving bank facility the earliest debt maturity is a £200.0m bond in 2019.
- In July 2011 NGN refinanced a £200.0m bank facility with a lower-cost, longer maturity (2016) replacement facility.
- £60.0m of additional EIB funding is now available with a further £75.0m credit-approved in principle for 2012.

> Ongoing capital and replacement expenditure will be funded out of bank facilities and EIB funding and periodically refinanced with capital markets issues when favourable conditions pertain.

> Our Effective management of the financial risk profile results in:

- Adequate cash generation;
- Capacity to deliver steady dividend growth; and
- Low liquidity and refinancing risk.

Highly Supportive Credit Ratings

Standard & Poor's

> In February 2011 Standard and Poor's reinstated the outlook on NGN's BBB+ rating to Stable from Negative.

> The positive change reflected "stronger EBITDA and cash flow generation following cost-saving initiatives and lower funding costs".

Moody's

> NGN's Baa1 rating with Stable outlook was reaffirmed by Moody's in June 2011.

> The rating "reflects the company's strong business risk profile underpinned by its natural monopoly position and the predictable cash flows generated by its regulated activity".

> Moody's stated that their methodology grid maps NGN to an A3 rating based on historical financial metrics but the actual ratings incorporate Moody's view that we may want to keep the ability to increase gearing marginally over time so that the credit metrics are more commensurate with a Baa1 rating.

Operational Performance

Northern Gas Networks

Continued Strong Operational Performance

> We have encountered the most challenging operational performance period since incorporation following the extreme weather encountered during the 2010/11 winter. Following this period the number of outstanding gas escapes reached record levels and we redeployed resource to reduce the number of gas escapes as quickly as possible.

> Despite these efforts which has seen outstanding gas escape numbers return to seasonal normal levels at 30 June 2011, not all operational KPIs have been achieved in the six months to 30 June 2011 as shown in the table overleaf. Our repair gas escapes within 7 days / 28 days and restore supply within 24 hours are not expected to be recovered by the end of the calendar year. Our efforts however have ensured that 20 out of our 23 key operational KPIs are forecast to be achieved in 2011.

> Steps have been taken to ensure we are able to respond more effectively to future extreme weather conditions.

> Resulting customer service measures following on from the difficult winter are disappointing and remain a key area of management focus.

> Safety performance has been excellent during the first half of 2011 with no MOPs and only 2 reported LTIs.

Operational Performance Table

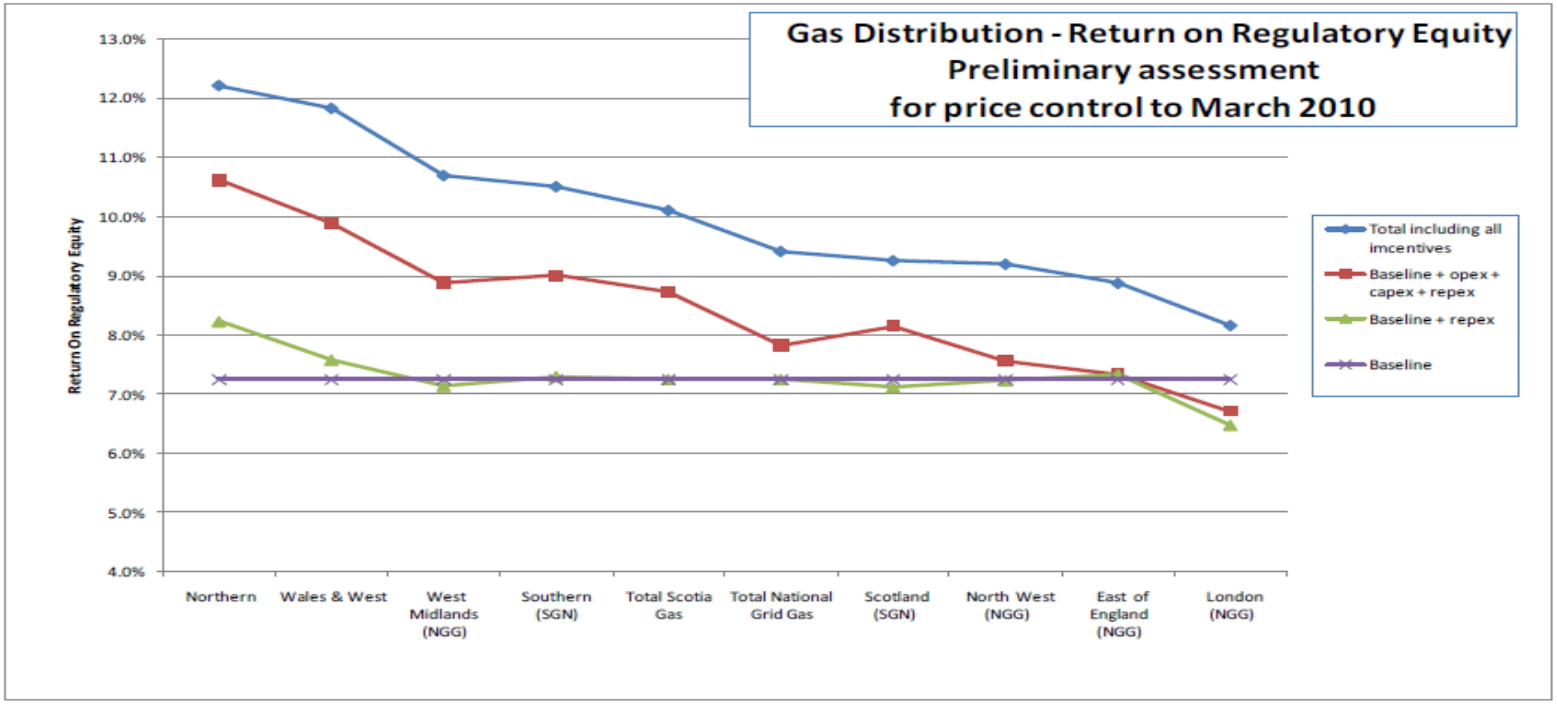
KPI	Licence Conditions/Regulatory Standard/2011 Full Year Target	6 Months to June 2011
GAS ESCAPES:		
Attend gas escape: uncontrolled <1hr	97.3%	97.6%
Attend gas escape: controlled <2hrs	98.0%	98.7%
Repair gas escapes: <7days	85.5%	72.0%
Repair gas escapes: <28days	98.8%	92.3%
CUSTOMER SERVICE:		
Restore supply with 24hrs (<250 properties)	98.1%	94.4%
All connection Guarantee Standards of Service	96.3%	99.3% - 100.0%
Customer satisfaction surveys	Benchmarked in top 2	3rd/3rd/7th (2010/11)
SAFETY:		
Lost Time Injuries	≤ 5	2
Injuries to Members of the Public	≤ 5	0

Regulatory Performance and Developments

Northern Gas Networks

Performance under GDPCR1

> NGN's strong performance over the period is reflected in Ofgem's assessment of Return on Regulatory Equity (RORE).



> It should be noted that all networks have outperformed base returns including those deemed to be inefficient by Ofgem.

Performance under GDPCR1

> NGN has been a consistent frontier performer in Ofgem's efficiency benchmarking of the 8 GDNs.

	2006/07	200708	2008/09	2009/10
Opex	**1st**	**2nd**	**1st**	**1st**
Repex	**1st**	**1st**	**1st**	**1st**

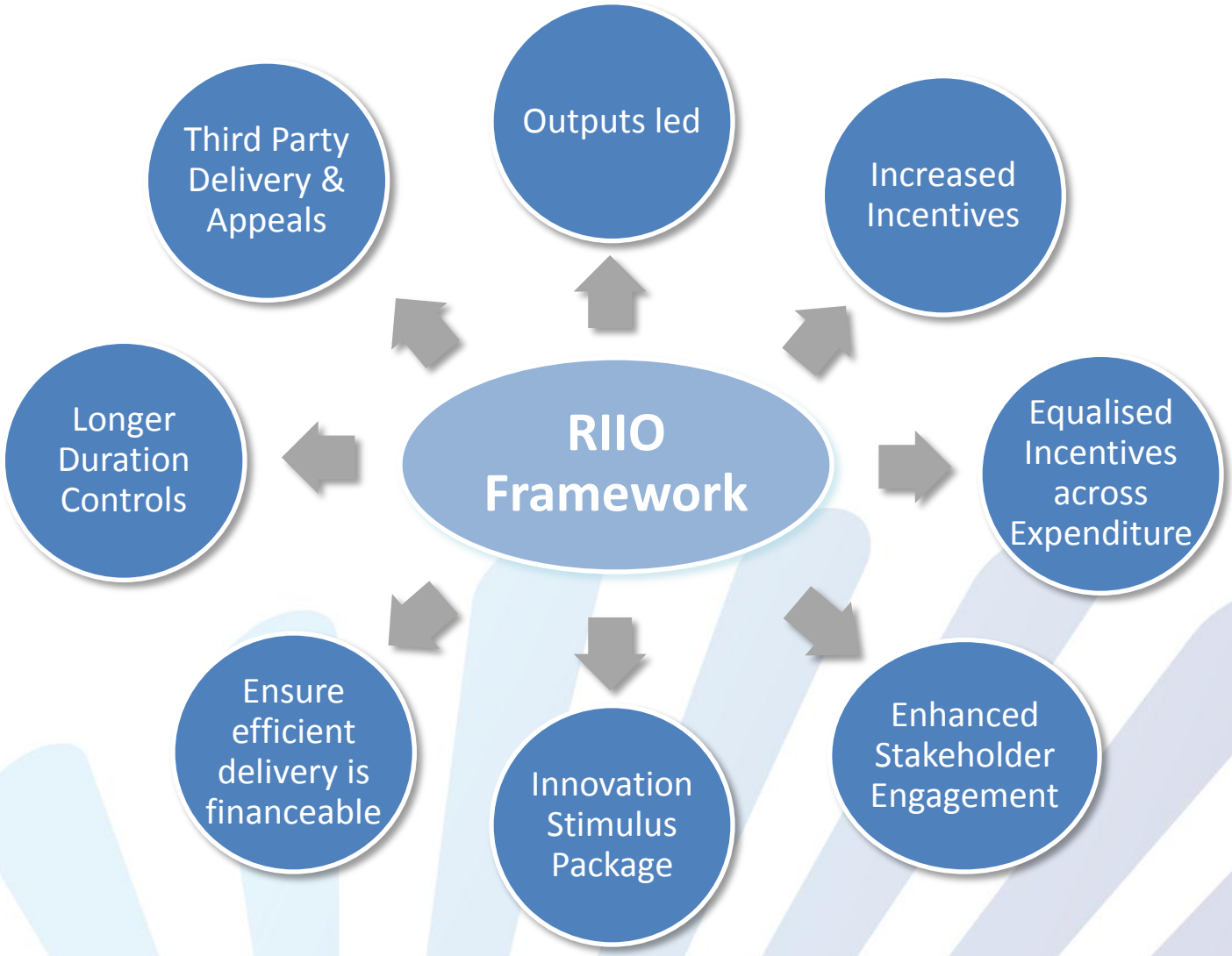
> Under Ofgem's new total expenditure (Totex) benchmarking methodology. NGN is still seen as the frontier performer on efficiency.

Repex & Capex

2009/10 Performance
2008/09 Performance

1st quartile (top 25%)		**WW**	WM	**Northern** Northern
2nd quartile (between 25% and 50%)	**NW** NW	WW **EA**		
3rd quartile (between 50% and 75%)		EA	**WM**	**SC** SC
4th quartile (bottom 25)	**LON** LON		**SO** SO	
	4th quartile (bottom 25)	3rd quartile (between 50% and 75%)	2nd quartile (between 25% and 50%)	1st quartile (top 25%)

RIIO – Key Features



RIIO – Key Features (Continued)

> The period of the price control will increase to 8 years from 5 years.

> Incentive mechanisms are yet to be finalised.

> Some of the key features of the RIIO proposals which could have a potential financial impact on NGN if not addressed by transitional arrangements are:

- Change in the treatment of funding Repex;
- Capitalisation policy and 'Totex' with incentives equalised across Opex/Capex/Repex as well as the split of Fast/Slow money; and
- Changes to the calculation of Cost of Capital (cost of equity, cost of debt and indexation thereof).

(these 3 areas are discussed in more detail on the following 3 slides)

> NGN is actively engaged with Ofgem to ensure that the outcome represents an acceptable balance of risk and reward and continues to reward NGN for continuing to drive the efficiency frontier.

RIIO – Change in the Treatment of Funding Repex

> Ofgem is proposing a change to the current capitalisation rate of Repex from 50% to 100%, which has potentially material P&L and cash flow consequences for NGN if not addressed by transitional arrangements.

> It is within the control of NGN to evaluate within our business plan the level to which transitional arrangements may be necessary to address any financeability issues raised by this change, and the changes outlined on previous slides.

> The primary options identified for transitional arrangements included:

- Shortening asset lives;
- Front end loaded depreciation profiles; and
- Increasing the Fast:Slow Money split.

However, Ofgem after consulting have stated there will be no change to the asset lives of GDN assets which will remain at 45 years.

> Ofgem have now front-end loaded depreciation by applying a sum of digits methodology to assets from 2002/03 (still over a 45 year asset life). This will result in 'catch up' depreciation for assets added to RAV between 2002/03 and 2012/03, to be recovered over the next Price Control.

RIIO – Capitalisation Policy & 'Totex'

- Ofgem proposes to adopt a RAV methodology whereby a set percentage of total costs (Totex) goes into RAV each year.
- Totex will be all controllable costs (Opex, Capex, Repex) relating to the licensed activities (with the exception of pension deficit repair payments relating to the established deficit and related party margins, rates, shrinkage).
- A fixed proportion of Totex would be added to the RAV each year (Slow Money) with the remainder being allowed to be recovered in the year of expenditure (Fast Money).
- The split of Fast:Slow money will need to be set so as to deliver sufficient returns to GDNs and this matter is one which the GDNs have to address within our individual business plan submissions.

RIIO – Potential Changes to the Calculation of Cost of Capital

> The RIIO proposals currently highlight a potential range for the Cost of Capital of 3.44% to 4.64% (based on the notional gearing remaining at 62.5%) down from 4.94% in GDPCR1 (DPCR5 had 4.25% but with 65% notional gearing).

> Ofgem are still consulting on several key changes to the calculation of the Cost of Capital:

- Companies' Business Plans will be required to propose the notional capital structures in the business plan. Ofgem's assumed notional gearing will be based on an assessment of the risk of companies' cash flows.
- The cost of debt assumption included in the allowed return will be based on a trailing average of an iBoxx cost of debt index, with revenues updated annually to reflect changes in the index.

> NGN will be arguing for notional gearing to stay at 62.5%, and a cost of equity at the top of Ofgem's range.

Regulatory Business Plan

- NGN seeking to build upon a good relationship with Ofgem and track record for delivery during GDPCR1.

- Our Business Plan will be ‘compliant’ with Ofgem’s confirmed policy decisions.

- NGN will seek to address financeability concerns through those areas where Ofgem has not made committed policy decisions and left itself flexibility (Repex transition, fast:slow money Split, IQI).

- Expenditure forecasts based on maintaining a frontier performance whilst providing some opportunities for future outperformance and demonstarting value for money.

Regulatory Summary and Next Steps

- The new RIIO framework presents some challenges when compared to current price control.
- NGN are however in an excellent position to address these challenges within a well justified business plan underpinned by extensive stakeholder engagement.
- Business Plan to be submitted during early November 2011.
- Initial feedback from Ofgem in early 2012 with final decision in December 2012.

Outlook

Northern Gas Networks

Outlook

> Committed and settled management team with a new CEO aligned to the vision of the company and instrumental in driving the new evolving integrated business model into the heart of the business.

> NGN continues to perform well against opex, repex and capex regulatory allowances and we believe we continue to drive the efficiency frontier in Ofgem's official benchmarking. We are ready to deliver a business plan to Ofgem for the 2013 – 2021 price control period which will address all the proposed regulatory changes.

> Recent successful refinance of c£400m in 2009 and 2010; an imminent new five year £200m bank facility and recent EIB loan approvals put us in a strong liquidity position.

> Prudent asset management plans underpin all our investment strategies.

> Strengthened financial standing by virtue of our prudent gearing strategy and strong credit rating.

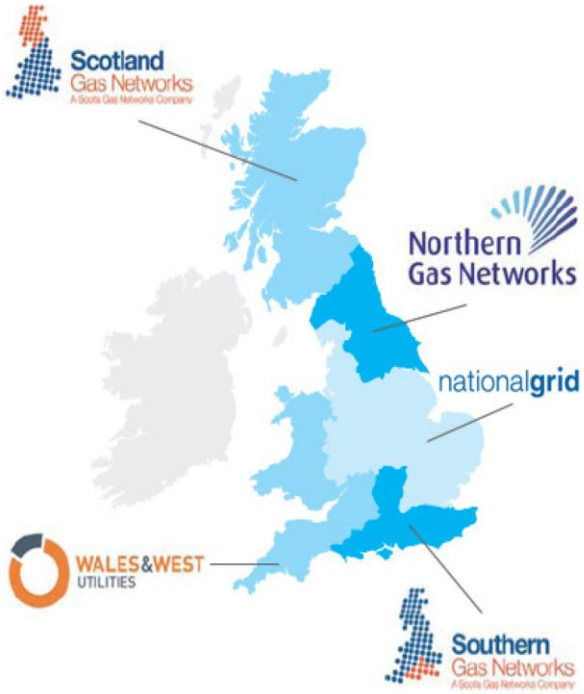
> Strong financial performance delivered for 2010 and strong half year results show that we remain on track to deliver our forecasts for 2011.

> Shareholders remain committed to UK infrastructure investments as evidenced by the recent UK acquisition activity.

Appendices

Northern Gas Networks

Organisation Background



NGN bought the North of England gas distribution network (GDN) from National Grid Plc (NG) in June 2005 for £1.4bn.

The DN is primarily rural but has four urban areas — Leeds, Bradford, Newcastle and Middlesbrough. Population served of 6.7m.

NGN owns and manages a gas distribution system of 37,000km supplying gas to 2.6m users.

Governed by the Gas Act 1986 (Gas Act). NGN's Licence is regulated by Ofgem, the gas and electricity regulator.

NGN is responsible to the Health & Safety Executive (HSE) for health and safety matters, with detailed operational policies and procedures to ensure compliance with safety standards.

Consumer interests are now monitored by ombudsman scheme.

Our Network Assets

We distribute gas to 2.6m users:

- Gas comes into the network from the National Transmission system at 23 offtake sites
- 172 pressure reduction stations
- 47 block valve sites
- 2,355 district governors
- 43 low pressure gas holders on 31 sites
- 2 high pressure storage sites
- 1,879km high pressure pipelines

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