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Research Update:

Ireland-Based Multi-Utility Electricity Supply Board Upgraded To 'A-' On Sovereign Upgrade; Outlook Stable

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Overview

- We consider Ireland-based, state-owned vertically integrated utility Electricity Supply Board (ESB) to be a government-related entity with a "moderately high" likelihood of extraordinary government support in the event of financial distress.
- We recently upgraded Ireland and therefore consider that the government's ability to support ESB has strengthened.
- We are maintaining ESB's stand-alone credit profile (SACP) at 'bbb+'.
- We are raising our rating on ESB to 'A-' from 'BBB+' as a result of the sovereign upgrade.
- The stable outlook on ESB reflects the outlook on Ireland and our expectations that ESB will maintain solid funds from operations-to-debt ratios of about 15%-20%.

Rating Action

On June 9, 2015, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Ireland-based, 95% state-owned, utility Electricity Supply Board (ESB) to 'A-' from 'BBB+'. At the same time, we affirmed our 'A-2' short-term rating on ESB. The outlook is stable.

In addition, we raised our issue rating on ESB's senior unsecured debt to 'A-' from 'BBB+'.

Rationale

The upgrade follows our upgrade of Ireland to 'A+' from 'A' on June 5, 2015 (see "Ireland Long-Term Rating Raised To 'A+' On Government Debt Reduction; Outlook Stable"). We consider ESB to be a government-related entity (GRE), and believe there is a "moderately high" likelihood that the Irish government would provide extraordinary support in the event of financial distress. We consider that the government's ability to support ESB has strengthened.

We base our ratings on ESB on its stand-alone credit profile (SACP), which we continue to assess at 'bbb+', reflecting its "strong" business risk profile and "significant" financial risk profile. In accordance with our criteria for GREs, our view of a "moderately high" likelihood of extraordinary government support is based on our assessment of ESB's:

- "Important" role as the monopoly owner of the national electricity transmission grid and the owner and operator of the electricity distribution network. The group has a leading position in the Irish energy market; and

- "Strong" link with the Irish government, based on our view that the government will remain a majority shareholder and has no plans to privatize or divest a minority stake. ESB is 95% state-owned; the remainder is held through an employee share ownership plan. Although ESB has an independent management team that makes autonomous business decisions, the government has a strong influence on the group's strategy and business plan.

Our assessment of ESB's business risk profile as "strong" is underpinned by the group's leading market position in the Irish electricity market and the stable and predictable cash flows from its low-risk regulated electricity transmission and distribution network operations, which contributed almost 65% of consolidated EBITDA in 2014 (excluding exceptional items). In addition, ESB has well-balanced power generation and supply operations. Power generation is operated under the Single Electricity Market framework, which covers the Republic of Ireland and Northern Ireland. ESB's well-balanced portfolio--which includes coal, gas, peat, wind, and hydropower--and its relatively modern plants enable the group to withstand difficult market conditions. We see a fairly high degree of certainty that ESB's power plants will remain in demand due to the plant's high ranking in the merit order and as such we expect it to benefit from capacity payments under an established mechanism. We consider that integration of generation and supply provides some long-term natural hedge against volatile commodity prices. ESB's competitive position is further supported by the predictability of earnings under government subsidy schemes that support renewable energy generation in Ireland and the U.K.

These strengths are partly offset by the high share of coal energy in the group's generation mix. We also see pressure from intensifying competition in retail and the merchant risk in generation--power prices are affected by decreasing fuel commodity prices and volatile demand. ESB's supply business was damaged by deregulation of the Irish energy market--the group's market share has fallen to 37% in 2014 from more than 50% in 2010.

The group also faces regulatory reset risk in its network activities in the Republic of Ireland. This is currently at its highest level because ESB is awaiting the regulator's final decision on tariffs for the regulatory period 2016-2020, which starts in October 2015. Furthermore, we see a risk that the capacity payments to which ESB is entitled (about 40% of the capacity pot in Ireland) could be reduced by about 20%, based on consultations by the regulator announced recently.

ESB's "significant" financial risk profile reflects our view that the group will generate gradually increasing funds from operations (FFO) over the medium term. This is based on regulated tariff increases in the electricity network business in Ireland; a stable customer base in the energy supply segment; and solid growth in the generation segment, given ESB's diverse power plant portfolio and gradual build-out of wind farms. Our opinion reflects our view that ESB's partly debt-financed capex program will result in negative discretionary cash flow through the two-year rating horizon, leading to elevated debt levels. That said, we expect ESB's adjusted FFO to debt will remain solid at about 15%-20% over the medium term.

We use our positive comparable rating analysis modifier to reflect ESB's higher than peers' contribution from stable and predictable regulated network activities.

We assess ESB's group credit profile as 'bbb+', based on the consolidated cash flows and debt at the ESB level. We view ESB's subsidiary Northern Ireland Electricity (NIE) as "core" to the group because its activities are aligned with the group's strategic focus on regulated networks. Even though we assess NIE's SACP at 'a-', we do not think that regulatory or other protections are sufficient to insulate its credit quality from that of its parent. Accordingly, we rate NIE at the level of the group credit profile.

Our base case assumes:

- That foreign direct inflows, including into the labor-intensive services sector, will bolster Ireland's real GDP growth, which we forecast will average 3.6% over 2015-2018.
- Continued regulatory visibility and high predictability of earnings from ESB's Ireland-based network operations. Our figures are based on ESB's submitted business plan to the regulator.
- Unchanged assumptions on capacity payments because the proposal to reduce these is under consultation.
- Dividend payouts will increase gradually to 40% of net income in 2017 and beyond from 35% in 2015.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted FFO to debt deteriorating to about 16.0% in 2015 but rebounding thereafter due to new capacity commissioning and continued high investments in the regulated networks in Ireland.
- Discretionary cash flow (DCF) to debt of about -5%, rising to about -1% in 2017 due to the completion of a special dividend.

Liquidity

The short-term rating on ESB is 'A-2'. We assess ESB's liquidity position as "strong," as defined in our criteria, reflecting our view that the group's liquidity resources will exceed its funding needs by more than 1.5x in the next 12 months and by more than 1x in the next 24 months. Our assessment is further supported by the group's ongoing and proactive liquidity and debt management, solid relationships with banks, and ample and proven access to capital markets, even under dire market conditions.

We estimate ESB's principal liquidity sources between Dec. 31, 2014, and Dec. 31, 2015, as:

- An available cash balance of about €107 million as of Dec. 31, 2014.
- An undrawn committed credit facility of about €1.4 billion that matures in February 2018.

- Access to €200 million available through a bank loan from the European Investment Bank, which ESB can use to fund investments.
- Close to £160 million in funds from a bank syndicate to fund the construction of a power plant in the U.K.
- Annual FFO of about €1 billion as of Dec. 31, 2014.

We estimate ESB's principal liquidity uses over the same period to include:
- Capital expenditure (capex) of almost €1 billion.
- Debt maturities of about €325 million.
- A special dividend of €214 million related to asset disposal proceeds and regular dividend payments of about €80 million.

Outlook

The stable outlook on ESB reflects the stable outlook on Ireland. It also reflects our view that the group's FFO to debt will remain securely in the 15%-20% range over the medium term, which is in line with our guidance for the current SACP of 'bbb+'.

Downside scenario

We could lower the rating on ESB if we take a similar action on Ireland. We could revise downward ESB's SACP if earnings become more volatile or if the group's profitability weakens. This could be caused by an unfavorable regulatory price control outcome, reduction of the capacity payments as consulted by the regulator, or increasing competition in the Irish power and gas supply markets.

The SACP could also come under pressure if the group's debt increases without a simultaneous increase in FFO generation. This could be caused by an unexpected increase in capex, a debt-financed acquisition, or higher dividends. At the current sovereign rating level, if we lower the SACP by one notch, the rating on ESB would also be one notch lower according to our GRE methodology.

Upside scenario

ESB's SACP is unlikely to rise over the two-year rating horizon, mainly because of the group's high leverage due to its sizable and partly debt-financed capex program. We cap our ratings on ESB at the level of the sovereign rating given that the Irish government owns 95% of ESB and because a significant proportion of the group's earnings are regulated in and originate from Ireland. If we raise the rating on Ireland by one notch, the rating on ESB will not change, all else being equal.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/A-2

Business risk: Strong
- Country risk: Low Risk
- Industry risk: Low Risk
- Competitive position: Strong

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bbb

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+
- Sovereign Rating: A+/Stable/A-1
- Likelihood of government support: Moderately High (+1 notch)

Related Criteria And Research

Related Criteria
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Corporate Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research
- Country Risk Assessments Update: May 2015, May 29, 2015
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013

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Ratings List

Upgraded; Ratings Affirmed

	To	From
Electricity Supply Board		
Corporate Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
Senior Unsecured(1)	A-	BBB+
ESB FINANCE Ltd.		
Senior Unsecured(2)	A-	BBB+

(1)Guaranteed by ESB FINANCE Ltd.
(2)Guaranteed by Electricity Supply Board.

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