S&P Global Ratings

Research

Summary:
Electricity Supply Board

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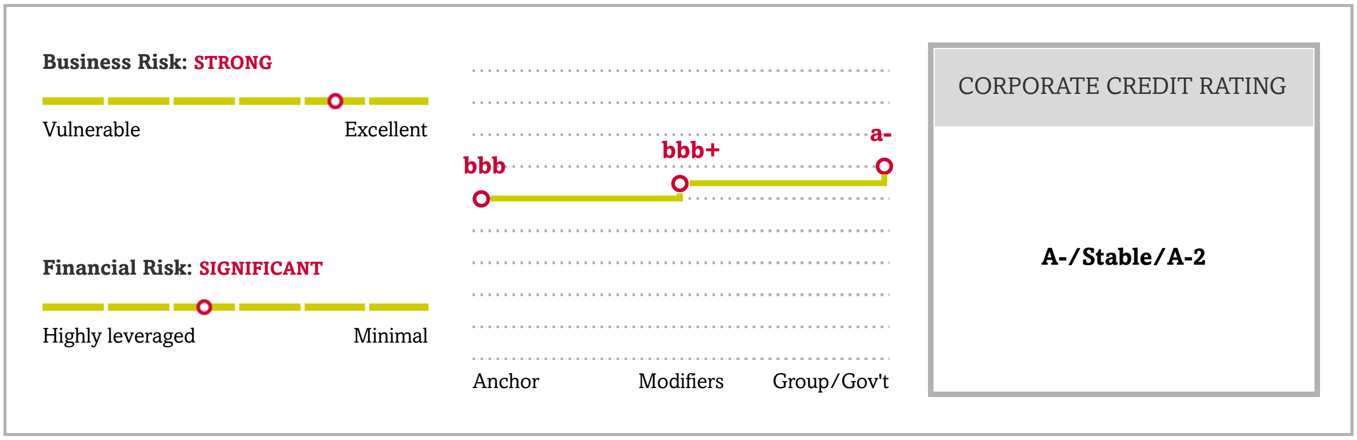

Rationale

Business Risk: Strong	Financial Risk: Significant
• Monopoly market position in regulated network areas and leading position in the Irish electricity market. • Significant proportion of stable and predictable cash flows from low-risk regulated network operations. • Vertically integrated power generation and supply operations. • Increasing regulatory-reset risk scheduled for 2020 in the Republic of Ireland. • Exposure of nonregulated activities to competition and merchant risk. • Uncertainty in generation business due to structural redesign of the Irish Single Electricity Market into the Integrated Single Electricity Market (I-SEM).	• Relatively high financial leverage. • Stable and predictable operating cash flows within regulatory periods. • Diversified funding sources with strong liquidity. • Sizable capital investment plan.

Outlook: Stable

The stable outlook on Irish 95% state-owned utility Electricity Supply Board (ESB) reflects the stable outlook on Ireland. It also reflects our view that ESB's funds from operations (FFO) to debt will remain above 17%, on average, over the medium term, and that any negative consequences arising from the implementation of the Irish Single Electricity Market redesign will not be material at an ESB Group level.

Downside scenario

We could lower the rating on ESB if we took a similar action on Ireland. If earnings became more volatile or if the group's profitability weakened, we could revise down ESB's stand-alone credit profile (SACP). This could be due to lower returns from the regulated network businesses because of underperformance against regulatory allowances, or falling profitability in the supply and generation business due to the introduction of the I-SEM; increasing competition in the Irish power and gas supply markets; or further material reductions of capacity payments as consulted by the regulator.

The SACP could also come under pressure if the group's debt increased without a simultaneous increase in FFO generation. This could be caused by an unexpected increase in capital expenditure (capex), debt-financed acquisition, or higher-than-anticipated dividend payout levels. At the current sovereign rating level, if we revised down the SACP by one notch, we would also lower the rating on ESB by one notch according to our government-related entity (GRE) methodology.

Upside scenario

We cap our ratings on ESB at the level of the sovereign rating because the Irish government owns 95% of ESB, and a significant proportion of the group's earnings are regulated in, and originate from, Ireland. If we raised the rating on Ireland by one notch, the rating on ESB would not change, all else being equal.

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.

Our Base-Case Scenario

Assumptions	Key Metrics

Assumptions

- Ireland's real GDP growth will average 2.2% over 2018-2020.
- Euro-to-pound sterling exchange rate of 0.88 and euro-to-dollar rate of 1.18.
- We assume continued regulatory visibility and high predictability of earnings from ESB's Ireland-based network operations as well as subsidiary Northern Ireland Electricity Networks Ltd. (NIE).
- We expect dividend payouts of 40% of normalized profits after tax, in line with the agreed dividend policy.
- Exposure of nonregulated activities to competition and merchant risk, although ESB has been able to retain its market share.
- Solid plant availability in the Republic of Ireland and at the Carrington power plant near Manchester in the U.K.
- No major impact on Irish wholesale electricity prices from the new market design.
- No major impact on the Irish Electricity Market from the U.K.'s vote to leave the EU.

Key Metrics

	2017A	2018E	2019E
EBITDA margin	41.2	37-39	38-40
FFO/debt	19.0	17-18	18-19
DCF/debt	2.9	4-5	(1)-0

A--Actual. DCF--Discretionary cash flow. E--Estimate. FFO--Funds from operations.

Company Description

ESB is an integrated utility predominantly operating in the Republic of Ireland and Northern Ireland, where it has a leading market position across the island. ESB's activities span power generation, the transmission and distribution of electricity, and power supply. The group has also entered the gas supply market--although its activity in this segment remains limited--and is expanding its presence abroad, in particular in the U.K. ESB is the monopoly owner of the transmission and distribution grids in the Republic of Ireland and Northern Ireland. ESB was established in 1927 and is 95% government owned. During 2017, ESB achieved an EBITDA of roughly €1.28 billion.

Business Risk: Strong

ESB's business risk profile is underpinned by the stable and predictable cash flows from its low-risk regulated electricity transmission and distribution network operations, which contributed almost 67% of consolidated EBITDA in 2017. This contribution is typically higher than peers' contribution from stable and predictable regulated network activities at the same business risk levels. The regulatory reset risk in ESB's network activities in the Republic of

Ireland is increasing slightly because the new regulatory period is due to start in January 2021. On the other hand, regulatory reset risk is currently at its lowest in Northern Ireland following the publication of the final revenue determination for NIE covering the six-and-a-half-year period from October 2017 to March 2024.

ESB also benefits from its leading market position in the Irish electricity market. ESB's well-balanced power generation and supply operations offset, to some extent, the risk stemming from competition and price volatility. Power generation will start to operate under the I-SEM from October 2018, which is a new wholesale electricity market arrangement for the Republic of Ireland and Northern Ireland. We believe ESB is well-positioned with a significant proportion of its energy margin expected to continue to benefit from capacity payments and quasi-regulated regulatory supports. ESB will also benefit from the raising of the ancillary services market revenue cap to €235 million by 2020, from €75 million in 2016.

Peer comparison

Table 1

Electricity Supply Board -- Peer Comparison

Industry Sector: Electric

	--Fiscal year ended Dec. 31, 2017--			--Fiscal year ended Sept. 30, 2017--	--Fiscal year ended March 31, 2017--
	Electricity Supply Board	**Scottish Power Ltd.**	**EnBW Energie Baden-Wuerttemberg AG**	**Energie AG Oberoesterreich**	**SSE PLC**
(Mil. €)					
Revenues	3,229.0	6,351.9	21,974.0	1,739.0	33,951.1
EBITDA	1,331.4	1,627.4	2,277.1	324.5	3,086.5
Funds from operations (FFO)	1,014.1	1,290.3	1,704.6	256.3	2,527.3
Net income from cont. oper.	(31.9)	629.3	2,054.1	157.0	1,870.1
Cash flow from operations	1,056.5	1,491.7	(1,225.7)	288.8	3,101.7
Capital expenditures	788.5	1,866.4	1,413.5	177.8	2,585.4
Free operating cash flow	268.0	(374.7)	(2,639.2)	111.0	516.3
Discretionary cash flow	152.2	(790.5)	(2,761.1)	57.1	(202.2)
Cash and short-term investments	380.4	220.3	3,213.3	243.0	1,668.4
Debt	5,338.2	7,222.9	7,339.9	519.4	9,693.0
Equity	3,712.5	5,466.7	6,842.7	1,279.4	5,921.6
Adjusted ratios					
EBITDA margin (%)	41.2	25.6	10.4	18.7	9.1
Return on capital (%)	5.4	8.4	9.4	11.2	8.8
EBITDA interest coverage (x)	4.8	6.3	5.4	9.8	5.8
FFO cash int. cov. (X)	6.3	6.3	5.4	10.8	9.4
Debt/EBITDA (x)	4.0	4.4	3.2	1.6	3.1
FFO/debt (%)	19.0	17.9	23.2	49.4	26.1

Table 1

Electricity Supply Board -- Peer Comparison (cont.)

Industry Sector: Electric

	--Fiscal year ended Dec. 31, 2017--			--Fiscal year ended Sept. 30, 2017--	--Fiscal year ended March 31, 2017--
	Electricity Supply Board	**Scottish Power Ltd.**	**EnBW Energie Baden-Wuerttemberg AG**	**Energie AG Oberoesterreich**	**SSE PLC**
Cash flow from operations/debt (%)	19.8	20.7	(16.7)	55.6	32.0
Free operating cash flow/debt (%)	5.0	(5.2)	(36.0)	21.4	5.3
Discretionary cash flow/debt (%)	2.9	(10.9)	(37.6)	11.0	(2.1)

Financial Risk: Significant

ESB's financial risk profile reflects our view that the ESB group will still generate gradually increasing FFO over the medium term, mainly because of sizable investments in networks driven by network reinforcement for increased renewables. We expect FFO to debt will remain above 17%, on average, for the remainder of the ESB network's regulatory period, through to 2020. Furthermore, even though final determination for the current regulatory period (2015-2020) is somewhat challenging for its network activities (53% of EBITDA in 2017)--particularly in terms of operating-cost efficiencies--we believe the company should be able to achieve its regulatory targets. That said, the final determination for NIE, covering the period from October 2017 to March 2024, is challenging. However, we believe that with cost efficiency measures, NIE will be able to maintain its credit metrics (NIE contributed 13% of group EBITDA in 2017; please see "Northern Ireland Electricity Networks Ltd.," published May 16, 2018).

Lastly, we see a risk to the level of capacity payments that ESB earns. The level of potential remuneration under the I-SEM capacity mechanism is likely to fall as part of the redesign of the Irish electricity market to more closely align energy trading with the EU. These I-SEM reforms are being jointly led by the Irish Regulatory Authorities--the Commission for Regulation of Utilities in the Republic of Ireland, and the Utility Regulator in Northern Ireland. The first capacity auction covering the period from the commencement of I-SEM to the end of September 2019 was held in December 2017. This resulted in lower capacity payments for all Irish generators, as expected. However, ESB was awarded 91% of the capacity that it bid in the auction. That said, we expect payments for ancillary services (needed to manage increasing intermittent renewable generation) will increase. The I-SEM reforms are due to be fully implemented from October 2018. We will have more clarity on the impact of the I-SEM reforms once they are implemented from their commencement in October 2018. The financial impact is still unclear, but we will monitor what effect it might have on ESB. As explained above, our base case is that, due to ESB's diversified power plant portfolio mix, its focus on taking advantage of additional revenue opportunities, cost efficiency, and investment in low carbon and renewable generation, the effect should be manageable at group level.

Financial summary

Table 2

Electricity Supply Board -- Financial Summary					
Industry Sector: Electric					
	--Fiscal year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
Rating history	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
(Mil. €)					
Revenues	3,229.0	3,211.8	3,335.4	3,258.0	3,422.5
EBITDA	1,331.4	1,354.7	1,370.6	1,319.7	1,382.3
FFO	1,014.1	1,027.4	981.4	951.8	1,038.7
Net income from continuing operations	(31.9)	187.8	289.5	215.3	510.2
Cash flow from operations	1,056.5	1,143.8	954.4	1,022.8	1,000.9
Capital expenditures	788.5	760.6	773.0	896.7	727.7
Free operating cash flow	268.0	383.2	181.4	126.1	273.1
Dividends paid	115.8	86.5	272.7	283.8	146.8
Discretionary cash flow	152.2	296.7	(91.3)	(157.7)	126.3
Debt	5,338.2	5,528.5	5,980.7	5,701.3	5,442.3
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	3,712.5	3,923.7	3,858.6	3,889.0	4,122.5
Debt and equity	9,050.7	9,452.2	9,839.3	9,590.3	9,564.8
Adjusted ratios					
EBITDA margin (%)	41.2	42.2	41.1	40.5	40.4
EBITDA interest coverage (x)	4.8	4.5	4.1	4.1	4.2
FFO cash int. cov. (x)	6.3	6.3	5.2	5.4	5.2
Debt/EBITDA (x)	4.0	4.1	4.4	4.3	3.9
FFO/debt (%)	19.0	18.6	16.4	16.7	19.1
Cash flow from operations/debt (%)	19.8	20.7	16.0	17.9	18.4
Free operating cash flow/debt (%)	5.0	6.9	3.0	2.2	5.0
Discretionary cash flow/debt (%)	2.9	5.4	(1.5)	(2.8)	2.3
Net cash flow/capex (%)	113.9	123.7	91.7	74.5	122.6
Return on capital (%)	5.4	5.9	5.1	5.4	7.0
Return on common equity (%)	(0.8)	4.8	7.5	5.4	12.9
Common dividend payout ratio (un-adj.) (%)	(362.8)	46.0	94.1	131.8	13.4

FFO--Funds from operations.

Liquidity: Strong

The short-term rating on ESB is 'A-2'. We assess ESB's liquidity position as strong, reflecting our view that ESB's liquidity resources will exceed its funding needs by more than 1.5x in the next 12 months and by more than 1.0x 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, proven access to capital markets, even under dire market conditions.

Principal liquidity sources as of Dec. 31, 2017	Principal liquidity uses over the same period
• Available cash balance of about €380 million as of Dec. 31, 2017. • An undrawn committed credit facility of about €1.44 billion maturing in January 2022. • Access to €723 million available through a bank loan from the European Investment Bank maturing on a phased-out basis up to 2032, which ESB can use to fund investments. The unused amount under this facility was €83 million as of Dec. 31, 2017. • Annual FFO of about €1.1 billion.	• Capex of about €1 billion. • Debt maturities of about €430 million in the next 12 months. • Dividend payment of about €50 million annually. • Working capital outflows of about €145 million.

Group Influence

We assess ESB's group credit profile (GCP) at 'bbb+', based on the consolidated cash flows and debt at the level of ESB. We view NIE as a core group entity 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.

Government Influence

We base our ratings on ESB on its SACP, which we continue to assess at 'bbb+', reflecting ESB's 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.

Ratings Score Snapshot

Corporate Credit Rating

A-/Stable/A-2

Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb

Modifiers

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

Stand-alone credit profile : bbb+

- **Likelihood of government support:** Moderately high (+1 notch from SACP)

Issue Ratings--Subordination Risk Analysis

Capital structure

ESB's debt structure comprises €3 billion senior unsecured debt issued by ESB itself or its finance vehicle, and €1.8 billion unrated debt.

Analytical conclusions

ESB's debt is rated 'A-', the same level as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Reconciliation

Table 3

Reconciliation Of Electricity Supply Board Reported Amounts With S&P Global Ratings Adjusted Amounts

	--Fiscal year ended Dec. 31, 2017--						
Electricity Supply Board reported amounts							
(Mil. €)	**Debt**	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	4,757.78	3,716.26	1,309.03	213.98	188.10	1,309.03	916.62

Table 3

Reconciliation Of Electricity Supply Board Reported Amounts With S&P Global Ratings Adjusted Amounts (cont.)

S&P Global Ratings adjustments							
Interest expense (reported)	--	--	--	--	--	(188.10)	--
Interest income (reported)	--	--	--	--	--	6.60	--
Current tax expense (reported)	--	--	--	--	--	(25.77)	--
Operating leases	133.25	--	16.90	9.08	9.08	7.82	7.82
Postretirement benefit obligations/deferred compensation	463.76	--	2.01	2.01	26.63	(42.72)	126.71
Surplus cash	(380.41)	--	--	--	--	--	--
Capitalized interest	--	--	--	--	23.46	(23.46)	--
Dividends received from equity investments	--	--	3.78	--	--	3.78	--
Asset retirement obligations	228.14	--	--	--	1.61	(1.74)	0.87
Nonoperating income (expense)	--	--	--	(1.70)	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	4.46
Noncontrolling interest/minority interest	--	(3.74)	--	--	--	--	--
Debt - accrued interest not included in reported debt	79.68	--	--	--	--	--	--
Debt - other	56.00	--	--	--	--	--	--
EBITDA - gain/(loss) on disposals of PP&E	--	--	(1.38)	(1.38)	--	(1.38)	--
EBITDA - Other	--	--	1.03	1.03	--	1.03	--
D&A - impairment charges/(reversals)	--	--	--	279.36	--	--	--
D&A - other	--	--	--	32.77	--	--	--
EBIT - other	--	--	--	3.03	--	--	--
Interest expense - other	--	--	--	--	31.00	(31.00)	--
Total adjustments	580.42	(3.74)	22.33	324.19	91.77	(294.95)	139.87
S&P Global Ratings adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	5,338.20	3,712.52	1,331.36	538.17	279.87	1,014.08	1,056.49

Related Criteria

- General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015

- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Northern Ireland Electricity Networks Ltd., May 16, 2018
- Why We See The Republic of Ireland's Electricity And Gas Regulatory Framework As Supportive, May 8, 2018

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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