Electricity Supply Board

Update

Ratings

Electricity Supply Board
Foreign Currency

Long-Term IDR	BBB+
Short-Term IDR	F2
Senior unsecured	A-

ESB Finance Limited

Senior unsecured guaranteed notes (EMTN) programme	A-

Outlook

Foreign-Currency Long-Term IDR	Stable

Financial Data

Electricity Supply Board

	31 Dec 15	31 Dec 14
Revenue (EURm)	3,335.4	3,257.9
Operating EBITDA (EURm)	1,347.2	1,301.4
Operating EBITDA margin (%)	40.4	39.9
Funds from operations (EURm)	915.5	859.1
Cash flow from operations (EURm)	872.8	957.0
Free cash flow (EURm)	-173.0	-223.4
FFO gross interest coverage (x)	4.3	4.3
Total debt with equity credit (EURm)	5,109.1	4,783.0
Gross lease-adjusted debt/EBITDAR (x)	3.8	3.7
FFO adjusted net leverage (x)	4.3	4.3

Related Research

Fitch Affirms Electricity Supply Board at 'BBB+'; Outlook Stable (April 2016)

Fitch Affirms Northern Ireland Electricity Networks at 'BBB+'; Outlook Stable (April 2016)

2016 Outlook: EMEA Utilities (December 2015)

Electricity Supply Board - Ratings Navigator(June 2015)

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Key Rating Drivers

Regulated and Supported Earnings: Electricity Supply Board's (ESB) ratings are supported by the majority of its EBITDA over the next five years being derived from regulated businesses. In addition, around 50% of ESB's generation gross margin benefits from the support of SEM's (single electricity market) capacity payments, wind margin supported by REFIT/ROC regimes, and peat plants with a fixed return under a Public Service Obligation contract to 2019.

Limited Leverage Headroom: Fitch forecasts average funds from operations (FFO) adjusted net leverage at 4.4x (2016- 2020), with limited headroom compared with our negative guideline of 4.5x. We project average FFO interest cover at 4.7x which is above the agency's guideline of 4x, and calculated net-debt-to-RAB is strong at around 55% for the forecast period. We treat ESB's one-off pension payments related to the 2010 staff agreement as non-recurring.

Regulatory Price Review (PR4): In our view, the final determination from 1 January 2016 to 31 December 2020, is more challenging than the prior price control but we expect the company to be able to deliver the required regulatory outputs within the regulatory allowances of capex and opex in spite of the efficiency challenge included in the final determination. Real pre-tax weighted-average cost of capital (WACC) of 4.95% (vanilla WACC of 4.53%) is lower than the allowed WACC for PR3 of 5.95%, which was later revised to 5.2%.

Generation Reduced Revenues: We expect lower system marginal prices (SMPs) and electricity spreads for the generation segment, resulting in reduced revenues. ESB's diversified generation portfolio by fuel helps it to optimise its plants operation to maximise returns during peak periods. We forecast a slow recovery of the supply business over the forecast period.

Capacity Additions Supports Generation: The Carrington 880MW CCGT plant in the UK will enter commercial operation in 3Q16 with an expected positive contribution to EBITDA over the period 2017-2020 (including capacity income). The two peat plants are due to be decommissioned by 2019 but we see this being offset by a total of at least 250MW supported wind farms to be added to existing capacity through to 2020.

Transition to I-SEM Potentially Negative: In our view, some of ESB's plants could be disadvantaged, depending on their ability to compensate lower capacity payments with ancillary services' earnings. The overall timing and magnitude of the impact is uncertain.

Rating Sensitivities

Regulatory Uncertainty: A significant deterioration in the operating environment in Ireland due to adverse political decisions or structural changes in the generation market (introduction of I-SEM) or supply markets could be credit negative. Business underperformance with an increase in debt leading to an FFO adjusted net leverage well above 4.5x, FFO interest coverage below 4.0x and gearing above 60% on a sustained basis could also lead to a negative rating action.

Liquidity and Debt Structure

Comfortable Liquidity: As of 31 December 2015 ESB had EUR1.39bn of undrawn committed credit facilities (EUR1.19bn syndicated revolving credit facility and EUR0.2bn EIB capex facility) and EUR101.5m of non-restricted cash and cash equivalents. Short-term debt maturities totalled EUR0.42bn. Fitch expects ESB to report negative FCF in 2015-2019. However, liquidity is sufficient to cover scheduled debt maturities, capex, operating requirements and dividends for over 24 months.

Peer Group

Issuer	Country
BBB+	
Iberdrola, S.A.	Spain
SSE plc	United Kingdom
BBB-	
EDP - Energias de Portugal, S.A.	Portugal

Issuer Rating History

Date	LT IDR (FC)	Outlook/Watch
27 Apr 16	BBB+	Stable
7 Mar 16	BBB+	Stable
11 May 15	BBB+	Stable
6 Nov 14	BBB+	Stable
20 Aug 14	BBB+	Stable
10 Feb 14	BBB+	Stable
13 Mar 13	BBB+	Stable
31 Jan 13	BBB+	Stable
1 Nov 12	BBB+	Negative
22 Dec 11	BBB+	Negative
4 Aug 11	BBB+	Negative
15 Apr 11	BBB+	Negative
1 Apr 11	BBB+	RWN
27 Jan 11	BBB+	Stable

"RWN" denotes Rating Watch Negative

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

The Irish Single Electricity Market (SEM) regulators are working on a detailed design of the new all-island electricity market, I-SEM, which will be compatible with the electricity markets of continental Europe. I-SEM introduction is planned for 4Q17. We expect greater electricity price convergence between Ireland and continental Europe, with SMP approaching European levels in the medium term. We also expect lower capacity payments, which will be allocated based on a competitive auction. In addition to capacity payments, a larger pool of ancillary payments will be introduced (increased from EUR40m-EUR50m up to potentially EUR250m), including payments for operating reserve or voltage support. The impact of a market redesign could be significant for the players.

Financial Risks

Retail businesses actively compete for industrial customers, while residential accounts are less likely to always chase the cheapest deal. Generation businesses are to varying degrees exposed to SMP, commodity price and volume risk, depending on the technology and fuel type. Renewable generation is generally supported by various state subsidies and partially insulated from market risk. Regulated networks generally exhibit stable and predictable cash-flow characteristics. A combination of these businesses determines exposure to financial risks.

Peer Group Analysis

FY15	ESB BBB+/Stable	Iberdrola[a] BBB+/Stable	SSE BBB+/Stable	EDP[a] BBB-/Stable
Focus of activity	Republic of Ireland, N. Ireland	Spain, UK, US, Brazil, Mexico	UK, Ireland	Portugal, Spain, US, Brazil
Regulated EBITDA (%)	61	51	45	37
Competition in main market	Medium	Medium	Medium	Low
Renewables/nuclear (%)	19	54/8	32	37/1
Conventional thermal (%)	81	38	68	62
Electricity production (TWh)	16	139	27.6	60
Carbon intensity (gCO_2/KWh)	590	212	607	280
FFO interest coverage (x)	4.3	5.3	4.1	4.0
FFO adjusted net leverage (x)	4.3	4.4	3.9	4.8
Normalised free cash-flow trend	Negative	Neutral	Negative	Positive
Negative rating guidelines[a]				
FFO Interest coverage (x)	<4.0	<4.0	<2.5	<3.5
FFO adjusted net leverage (x)	>4.5	>4.5	>4.5	>5.0

[a] Year end 2014
Source: Fitch, companies

Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

Rating factor	Status[a]	Trend
Operations	Strong	Neutral
Market position	Average	Neutral
Finances	Average	Neutral
Governance	Average	Neutral
Geography	Weak	Neutral

[a] Relative to peer group
Source: Fitch

Key Credit Characteristics

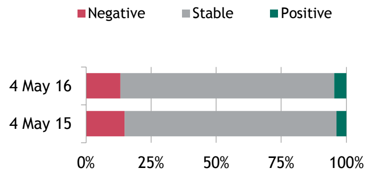
The level of asset diversity, risk attitude of management in terms of hedging/trading strategy, market position, government energy policies as well as support from regulated cash flows are major credit drivers for integrated utilities in Europe. Financial factors such as M&A, capex, funding strategy and dividend policy can have a visible impact on the ratings.

Related Criteria

Corporate Rating Methodology(August 2015)

Electricity Supply Board — Utilities Median — Developed BBB+ Median —
Source: Company data; Fitch

Distribution of Sector Outlooks
Directional Outlooks and Rating Watches



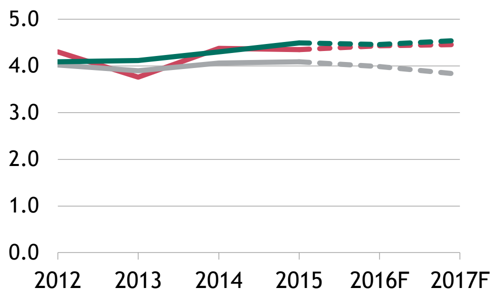
Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

- EBITDA for ESB's Irish networks in line with final determination, and lower income from incentives;
- reduced EBITDA for generation business due to lower energy gross margins assumptions (SMP and spark spread) and reduced SEM's capacity payments from 2018;
- lower EBITDA contribution from Northern Ireland Electricity due to lower assumptions for WACC for price control starting in October 2017;
- capex on average EUR1bn a year;
- average negative free cash flow (FCF) of EUR170m a year;
- cash interest adjusted for the pay-down provisions related to index-linked swaps;
- dividend policy of 30%-40%; payout
- funding access 100bp higher than

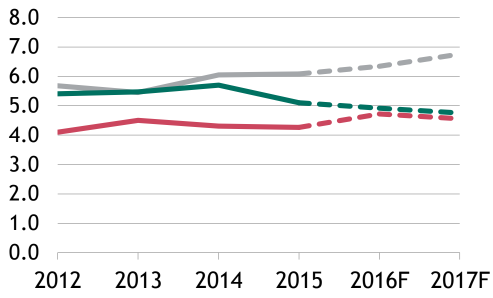
Definitions

- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover: FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "*Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format*" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

Leverage
including Fitch expectations



Interest Cover
including Fitch expectations

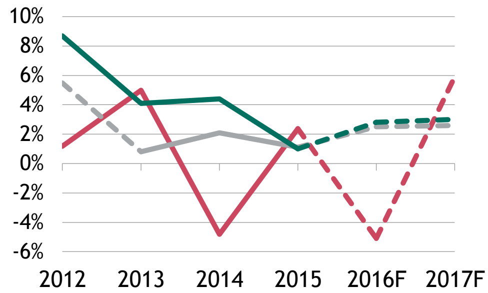


Debt Maturities and Liquidity at 31 December 2015

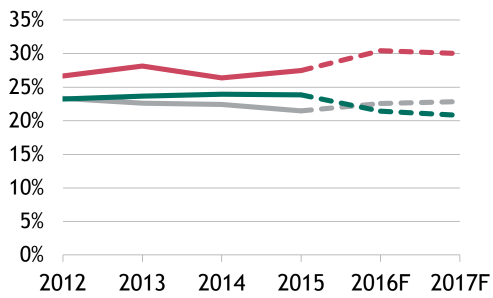
Debt maturities	(EURm)
2016	415.0
2017	474.0
2018	436.0
2019	827.0
After 2019	2,957.0
Cash and equivalents	101.5[a]
Undrawn committed facilities (expiry)	1,390.0
Syndicated revolving credit facility maturing 2020	1,190.0
EIB capex facility maturing April and June 2016	200.0

[a] EUR32.4m of restricted cash held at the end of 2015 referred to cash held by subsidiary companies which are not part of the centralised cash pooling system Source: Fitch

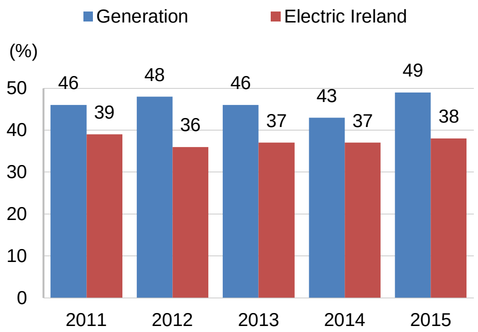
Revenue Growth
including Fitch expectations



FFO Profitability
including Fitch expectations

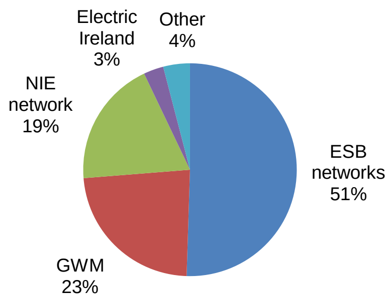


Market Share Evolution



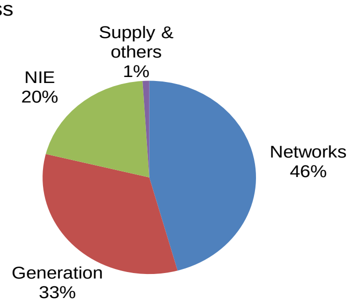
Source: Fitch/ESB

FY15 Assets (Total Assets: EUR13.2bn)
By business



Source: ESB/Fitch

FY15 EBITDA
By business

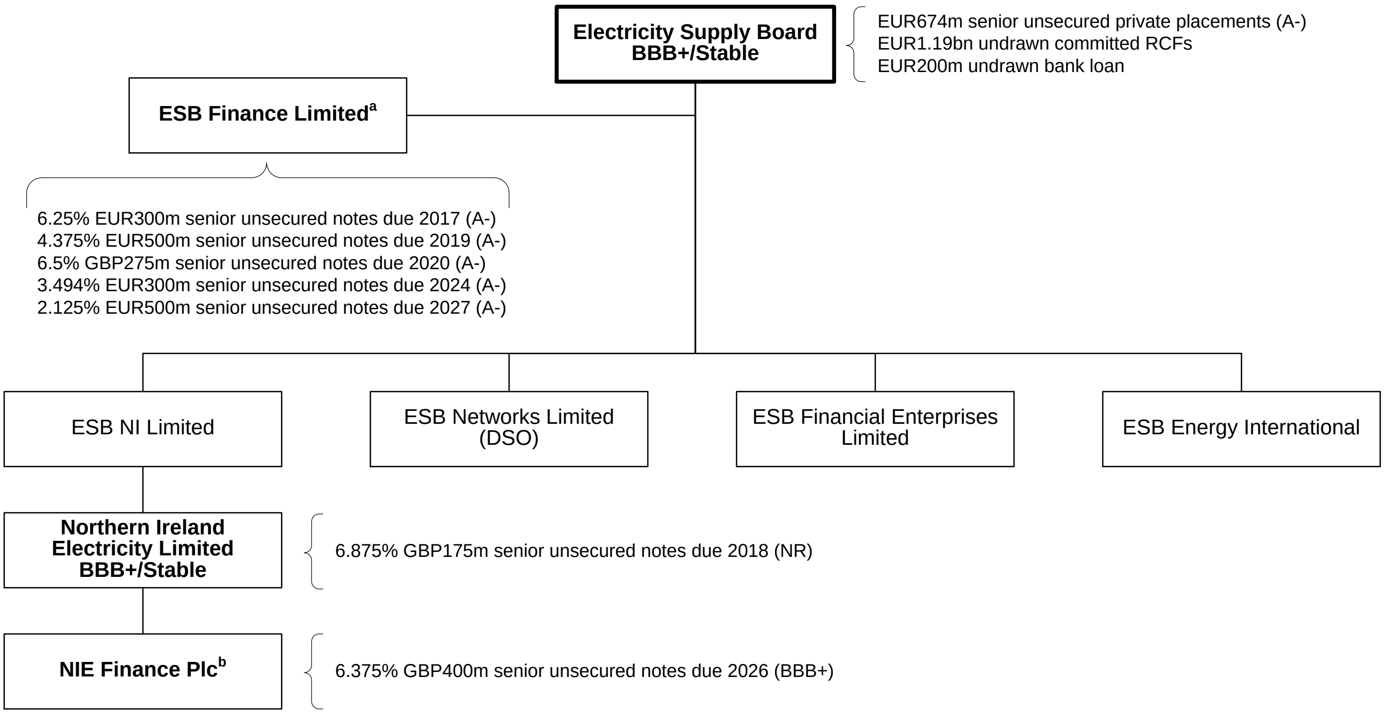


Source: ESB/Fitch

Figure 1

Group Structure Diagram

As at 31 December 2015



NR: Non Rated

[a] Obligations of ESB Finance Limited as issuer and borrower are fully guaranteed by ESB

[b] Obligations of NIE Finance Plc as issuer are fully guaranteed by Northern Ireland Electricity Limited

Source: Fitch/company– May 2016

Figure 2

Electricity Supply Board — Forecast Financial Information

	Historical			Fitch forecast		
(EURm)	**31 Dec 13**	**31 Dec 14**	**31 Dec 15**	**31 Dec 16**	**31 Dec 17**	**31 Dec 18**
Summary income statement						
Revenue	3,422	3,258	3,335	3,166	3,351	3,419
Revenue growth (%)	5.0	-4.8	2.4	-5.1	5.9	2.0
Operating EBITDA	1,336	1,301	1,347	1,323	1,378	1,478
Operating EBITDA margin (%)	39.0	39.9	40.4	41.8	41.1	43.2
Operating EBITDAR	1,347	1,312	1,361	1,337	1,392	1,492
Operating EBITDAR margin (%)	39.4	40.3	40.8	42.2	41.5	43.6
Operating EBIT	679	553	531	568	555	628
Operating EBIT margin (%)	19.8	17.0	15.9	18.0	16.6	18.4
Gross interest expense	-243	-247	-260	-240	-275	-273
Pretax income	526	215	307	325	287	376
Summary balance sheet						
Readily available cash	371	107	101	68	68	68
Total debt with equity credit	4,515	4,783	5,109	5,331	5,626	6,012
Total adjusted debt with equity credit	4,605	4,870	5,221	5,437	5,738	6,127
Net debt	4,145	4,676	5,008	5,264	5,558	5,945
Summary cash flow statement						
Operating EBITDA	1,336	1,301	1,347	1,323	1,378	1,478
Cash interest	-274	-256	-278	-257	-279	-284
Implied interest cost (%)	6.1	5.5	5.6	4.9	5.1	4.9
Cash tax	-6	-65	-51	-43	-38	-53
Associate dividends less distributions to NCI	20	1		1	1	8
Other Items before FFO	-116	-122	102	-61	-56	-39
Funds flow from operations	959	859	915	964	1,006	1,109
FFO margin (%)	28	26	27	30	30	32
Change in working capital	-35	98	-43	38	-18	50
Cash flow from operations (Fitch defined)	924	957	873	1,002	988	1,159
Total non-operating/non-recurring cash flow						
Capital expenditure	-728	-897	-773			
Capital intensity (capex/revenue) (%)	21.3	27.5	23.2			
Common dividends	-147	-28	-273			
Net acquisitions & divestitures	174	37	-6			
Capex, dividends, acquisitions & oth. items before FCF	-701	-1,143	-1,052	-1,289	-1,282	-1,466
Free cash flow after acquisitions & divestitures	223	-186	-179	-287	-294	-308
Free cash flow margin (after net acquisitions) margin (%)	6.5	-5.7	-5.4	-9.1	-8.8	-9.0
Other investing and financing cash flow items	0	-129	7	31	0	-79
Net debt proceeds	-58	268	166	222	294	387
Net equity proceeds				0	0	0
Total change in cash	211	-264	-5	-34	0	0
Coverage ratios (x)						
FFO interest coverage	4.5	4.3	4.3	4.7	4.6	4.8
FFO fixed charge coverage	4.4	4.2	4.1	4.5	4.4	4.7
Operating EBITDAR/gross interest expense + rents	5.3	5.1	5.0	4.9	4.7	5.0
Operating EBITDA/gross interest expense	4.9	5.1	4.8	5.1	4.9	5.2
Leverage ratios (x)						
Total adjusted debt/operating EBITDAR	3.4	3.7	3.8	4.1	4.1	4.1
Total adjusted net debt/operating EBITDAR	3.1	3.6	3.8	4.0	4.1	4.1
Total debt with equity credit/operating EBITDA	3.4	3.7	3.8	4.0	4.1	4.1
FFO adjusted leverage	3.7	4.4	4.3	4.4	4.5	4.4
FFO adjusted net leverage	3.4	4.3	4.3	4.4	4.4	4.4

How to interpret the forecast presented

The forecast presented is based on the agency's internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch's rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch's forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch's own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch's own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch's own internal deliberations, where Fitch, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch may update the forecast in future reports but assumes no responsibility to do so

Source: Fitch

Figure 3

Reconciliation of Key Financial Metrics for Electricity Supply Board

(EURm)	31 Dec 15
Total debt with equity credit	5,109
+ (ST leases * ST lease multiple)	0
+ (LT leases * LT lease multiple)	112
+ Other off-balance sheet debt	0
= Total adjusted debt with equity credit (a)	5,221
Readily available cash [Fitch-defined]	101
+ Readily available marketable securities [Fitch-defined]	0
= Readily available cash & equivalents	101
Net lease-adjusted debt (b)	5,119
Cash Flow From Operations [CFFO]	873
- Change in working capital [Fitch-defined]	-43
= Funds From Operations [FFO] (c)	915
Interest received	7
Interest (paid) (d)	-278
= Net finance charge (e)	271
Preferred dividends (paid) (f)	0
Operating lease expense for assets with long economic life (g)	14
FFO adjusted net leverage (x)	
Net lease-adjusted debt/(FFO + net finance charge + LT leases - pref div paid) (b/(c+e+g-f))	4.3
FFO adjusted gross leverage (x)	
lease-adjusted debt/(FFO + net finance charge + LT leases - pref div paid) (a/(c+e+g-f))	4.3
FFO fixed charge cover (x)	
(FFO + net finance charge + LT leases - pref div paid)/(gross interest paid + LT leases - pref div paid) ((c+e+g-f)/(-d+g-f))	4.1
FFO gross interest coverage (x)	
(FFO + net finance charge - pref div paid)/(gross interest paid - pref div paid) ((c+e-f)/(-d-f))	4.3

Source: Fitch based on company reports

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.