CREDIT OPINION
20 May 2016

Update

Rate this Research

RATINGS

Electricity Supply Board (ESB)

Domicile	Dublin, Ireland
Long Term Rating	Baa1
Type	LT Issuer Rating
Outlook	Positive

Please see the ratings section at the end of this report for more information.The ratings and outlook shown reflect information as of the publication date.

Analyst Contacts

Augustin Bilodeau 4420-7772-1382
Associate Analyst
augustin.bilodeau@moodys.com

Niel Bisset 44-20-7772-5344
Senior Vice President
niel.bisset@moodys.com

Monica Merli 44-20-7772-5433
MD-Infrastructure Finance
monica.merli@moodys.com

Electricity Supply Board (ESB)

Update Following Change of Outlook to Positive

Summary Rating Rationale

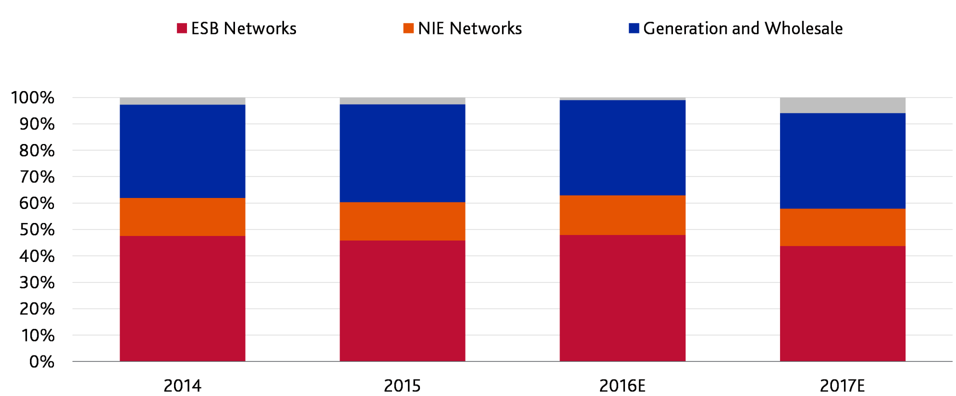
Electricity Supply Board (ESB)'s Baa1 ratings reflect (1) the significant proportion of earnings generated through its regulated transmission and distribution operations in the Republic of Ireland (RoI, A3 positive) and Northern Ireland; (2) the low business risk profile of these businesses; and (3) the company's strong liquidity and access to a diversified range of funding sources.

The ratings also more negatively reflect (1) the relatively higher business risk profile of ESB's generation and supply business, which accounted for 37% of 2015 EBITDA; (2) the challenges associated with a large capital investment programme; and (3) uncertainty in the generation business resulting from the ongoing re-design of the Irish electricity market.

Despite a difficult macroeconomic environment in recent years, net debt to fixed assets has averaged just under 53% over the past three years while funds from operations (FFO) to net debt has averaged just over 18%.

At Baa1 ESB's rating does not incorporate any uplift for government ownership. ESB's positive outlook reflects the positive outlook on the government's bond rating.

Exhibit 1
Regulated Networks will Continue to Generate the Majority of EBITDA



Source: 2015 Annual Report, Moody's estimates

Credit Strengths

- High proportion of earnings from price-regulated networks businesses supported by a consistent and transparent regulatory framework
- Low business risk profile of these networks, and stable returns under well-established and transparent regulatory frameworks
- Solid financial performance against an improving macroeconomic environment
- Prudent financial policy
- Diversified funding sources and sound liquidity position

Credit Challenges

- Relatively higher business risk profile of ESB's generation and supply business
- Uncertainty in the generation business resulting from a potential re-design of the Irish Single Electricity Market (SEM)
- Challenges associated with a large capital investment programme

Rating Outlook

The positive outlook on ESB's ratings reflects (1) the positive outlook on Ireland's long-term government bond ratings and (2) Moody's expectation that ESB will maintain a credit profile consistent with guidance for the Baa1 rating level, which includes FFO interest cover of above 3.5x and FFO to net debt of at least the mid-teens.

Factors that Could Lead to an Upgrade

Upwards pressure could develop on ESB's ratings if (1) Ireland's long-term government bond ratings were to be raised, assuming unchanged support and ESB maintains a credit profile consistent with guidance for the Baa1 rating level; or (2) ESB's underlying credit profile was to strengthen such that FFO interest cover and FFO / net debt were expected to be sustainably above 4.5x and 20%, respectively and no material negative consequences arise from the review of the Irish Single Electricity Market design.

Factors that Could Lead to a Downgrade

Although not currently expected, downward rating pressure could arise from (1) the downward movement in the Government of Ireland's rating by more than two notches; (2) a material debt-funded acquisition or capital investment that eroded ESB's financial flexibility; (3) material unfavourable changes in the regulatory framework in Ireland; (4) an increase in the proportion of non-regulated activities within ESB's business mix; (5) a substantial and persistent deterioration in the group's credit metrics.

Key Indicators

Exhibit 2

	12/31/2015	12/31/2014	12/31/20133	12/31/2012	12/31/2011
FFO Interest Coverage	4.6x	4.4x	4.6x	4.4x	4.4x
Net Debt / Fixed Assets	53.9%	52.4%	51.6%	52.7%	52.3%
FFO / Net Debt	17.8%	16.9%	20.0%	16.3%	15.7%
RCF / Net Debt	13.1%	11.8%	17.2%	15.0%	14.3%

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations
Source: Moody's Financial Metrics

Detailed Rating Considerations

High proportion of earnings from price-regulated networks business supported by a consistent and transparent regulatory framework

Approximately 60% of earnings before depreciation and amortisation (EBITDA) in 2015 was derived from the group's price-regulated transmission and distribution assets. Regulated revenues, cost allowances and operational incentives are subject to five-year-price controls imposed by regulators in RoI (Commission for Energy Regulation, CER) and in Northern Ireland (Utility Regulator, UR).

The current five year regulatory period, PR4, started in January 2016 following the final determinations published by the CER in December 2015 for both the distribution and transmission businesses. The final determinations support our view of a consistent and predictable regulatory framework, with no material changes to the regulatory principles implemented in previous price controls, and limited evolutionary reforms of the kind introduced for recent energy networks price controls in Great Britain.

Overall, we view the settlement as more challenging, but manageable. Positively, all capital expenditure (capex) and operating expenditure (opex) spent by ESB during the previous period, PR3, was allowed on the basis that it was necessary and efficient. With respect to PR4, overall allowed revenues of EUR 5.3 billion (real, 2014) are in line with ESB's submission. As expected, given the current lower interest rate environment, the allowed WACC of 4.95% (pre-tax, real) is lower than PR3's 5.95% (revised to 5.2% for 2014/15). In addition, the CER has set opex and capex allowances for PR4 that will require ESB to cut costs; however these targets are achievable in our view, and there remains some potential upside from incentive mechanisms. CER is still to make a decision on certain outstanding items, although these seem unlikely materially to affect ESB over the next 2-3 years, including: (1) recovery of pension costs associated with a 2010 staff agreement (which are currently not covered by the tariffs, and about which ESB is still discussing with the regulator); (2) a bonus and penalty scheme in relation to certain qualitative targets; and (3) whether a EUR500 million investment programme for the roll-out of smart meters should be implemented.

The capex allowance provides for a significant investment programme, which in part reflects an element of `catch-up' following the underspend in PR3. The final determinations' projections for the regulated asset base (RAB) imply a growth over the five year period of 12% to EUR6.0 billion (real, 2014)_on the distribution side, and of 32% to EUR2.8 billion (real, 2014) on the transmission side. Growth on the transmission side reflects the need to accommodate new wind farms, many of which are to be commissioned by 2017 in order to benefit from the REFIT tariff scheme.

ESB's Northern Ireland business (NIE), has good visibility about future cash flows until 2017 following the publication in April 2014 by the UK Competition and Markets Authority of its Final Determination in relation to the 2012-2017 period. A decision by the UR to adopt in future a methodology more similar to that used by the Office of Electricity and Gas Markets (Ofgem) in Great Britain would reduce regulatory risk and hence would be a credit positive.The regulator's consultation published in September 2015 suggests that it is likely to adopt a balanced approach.

Material earnings contribution from higher-risk generation and supply businesses but ESB is well-placed to cope with low power price environment and changing market dynamics

The majority of group earnings not derived from regulated network businesses are from ESB's power generation business (ESB Generation and Wholesale Markets), which accounted for 33% of EBITDA in 2015 and which we consider to be well diversified in respect of the SEM.

In the SEM, ESB has a power generation portfolio with a diverse fuel mix, which protects its earnings against shifts in commodity price dynamics which have in recent years resulted in higher running hours for coal-fired generation at the expense of plant fired by natural gas. The strong earnings contribution from its hydro, coal and peat assets have helped the portfolio to generate a stable source of earnings.

Power prices in SEM have declined by nearly 30% since mid-2015, reflecting a decline in commodity prices, including gas and CO_2 prices which dropped about 30% and 25% respectively year-on-year. Current prices below EUR40/MWh are well below our estimates published in June 2015 of EUR53-58/MWh. However, we estimate that ESB's hedging policy, and its diversified portfolio will help limit the negative impact on profitability.

The capacity payment mechanism also helps stabilise the group's generation earnings even as load factors for some of ESB's older gas-fired power plants decline as they have been pushed out of merit. However, the level of potential remuneration under this mechanism is likely to fall from the end of 2017 as part of the re-design of the Irish electricity market (the I-SEM reforms), which is currently being designed in order for Ireland to achieve “market coupling” with Great Britain, part of EU Target Model, which envisages ever greater interconnection of national energy markets within the EU.

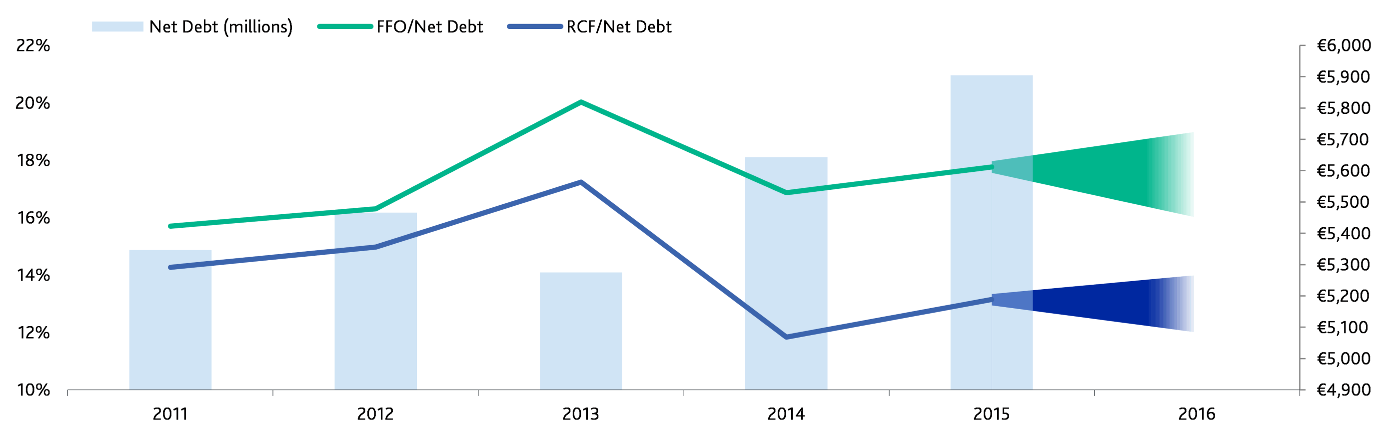
Based on the high-level design announced in September 2014, the aim of the I-SEM reforms will be to put in place new market frameworks which reduce overall system costs and reallocate those costs (principally between standby “capacity” and more active “flexibility”) to reflect the changing shape of the market. As the former incumbent and with by far the largest market share, ESB could be vulnerable in the face of any attempts to increase competition. However, we expect that the very complexity of the reforms could benefit larger players. These will include, inter alia, the creation of new physical power markets; a self-balancing requirement and new forms of financial hedging.

Solid financial performance against an improving macroeconomic environment

ESB's financial profile improved in 2015, with FFO to net debt increasing to 17.8% from 16.9%, consistent with Moody's guidance for a Baa1 rating, notwithstanding that net debt rose by EUR336 million to EUR4,975 million.

Exhibit 3

Despite a challenging macroeconomic environment and increasing net debt, ESB has effectively managed the challenges associated with maintaining cash flow and key financial metrics



Source: Moody's Financial Metrics, Moody's assumptions

EBITDA rose by 3.6% on a like-for-like basis to EUR1,348 million in 2015, thanks mainly to improved availability across the generation fleet, the non-recurrence of 2014's storm related costs, and an improving macroeconomic environment which Moody’s estimates will be reflected in GDP growth of 5% and 3.5% in 2016 and 2017 respectively. These positive elements more than counteracted the negative effect on Networks' earnings of the lower PR3 interim WACC review.

A new 880 megawatt combined cycle gas-fired plant at Carrington, near Manchester is due to be fully commissioned around Q3 2016 at which point the impact of the project on group credit metrics should turn positive as it starts to generate earnings (we estimate around EUR50-60 million EBITDA per annum) and repay associated debt.

Prudent financial policy means leverage will remain moderate despite significant capital expenditure programme

In January 2015, ESB completed the payment of EUR421 million of special dividends to its shareholders, which it agreed in 2013 to fund through the sale of non-core assets. The final tranche was partially funded by a drawdown of ESB's credit facilities rather than, as originally envisaged, through the sale of the peat-fired generation assets at West Offaly and Lough Ree.

We expect the Irish government to act in a flexible manner and to support ESB in its explicit aim to sustain a minimum Baa1 rating. To this end, we expect the company to remain moderately levered (with net debt to fixed assets below 60%) for the foreseeable future despite what we consider to be a material capital investment programme agreed with the CER as part of the RoI networks price control. The company will need regular access to capital markets to fund what we expect to be around EUR1 billion capital outlay per annum.

Government-Related Issuer methodology considerations

ESB is 95%-owned by the Irish government, and as such Moody's considers the company's rating according to its methodology for Government-Related Issuers (GRIs), published in October 2014. In view of this and the critical importance of ESB's assets to the Irish state, we consider there to be a clear linkage between the credit profile of the company and that of the A3-rated Irish government.

At Baa1 ESB's rating is based upon Moody's evaluation of the company's standalone credit strength and does not incorporate any uplift for ownership by the government. The positive outlook on ESB's Baa1 ratings mirrors the positive outlook on the government's bond rating, and reflects the fact that a notch of support could be incorporated into the rating in accordance with the GRI methodology, if Ireland's government bond rating were to strengthen further from its current positioning at A3.

Liquidity Analysis

We consider ESB to have a sound liquidity position. As at 31 December 2015, the company reported approximately EUR134 million of cash and cash equivalents and EUR1.39 billion of undrawn committed facilities, including a EUR1.44 billion revolving credit facility extended to 2020 in January 2015, with an option for a further two year extension to 2022.

We estimate that ESB would have sufficient liquidity through cash, committed facilities and approximately EUR1.6 billion of retained cash flow to fund approximately EUR1.5 billion of capital expenditure and EUR500 million of debt amortisations and maturities over the next 18 months if it did not have access to capital markets or other sources of funding not already committed.

Following the issuance of a EUR500 million bond in June 2015 and the refinancing of bonds maturing in 2017, the next maturity concentration is in 2019.

Corporate Profile

ESB is the former incumbent vertically integrated electric utility in the RoI, which holds leading market positions in power generation and electricity supply, as well as being the monopoly owner of electricity distribution and transmission networks across RoI and Northern Ireland.

The group's regulated businesses contribute the majority of the group's earnings. Across RoI and Northern Ireland, ESB's network assets (which include over 180,000 km of power lines in RoI and over 47,000 km in Northern Ireland) had a combined regulatory asset base (RAB) of approximately EUR9.3 billion as at the end of December 2015.

In addition, the group had a market share of 49% across the Irish Single Electricity Market (SEM) during 2015 and served 1.5 million electricity and gas customer accounts across Ireland, which equated to a 38% electricity market share.

ESB is majority owned (95%) by the Government of Ireland through the Minister for Public Expenditure Reform (85%) and the Minister for Communications, Climate Change and Natural Resources (10%). The remaining 5% stake is held by an employee share ownership trust.

Rating Methodology and Scorecard Factors

Whilst the methodology grid maps ESB to an A2 based on three years of historic metrics and an A3 based on our forward view of financial metrics, the assigned rating of Baa1 is lower. This is because the grid does not specifically take into account the additional risk compared to peers rated under the methodology posed by the material contribution to group earnings from unregulated businesses, such as power generation and electricity supply.

Exhibit 4

Regulated Electric and Gas Networks Industry Grid [1],[2]	Current FY 31/12/2015		Moody's 12-18 Month Forward View As of 20/5/2016 [3]	
Factor 1 : Regulatory Environment and Asset Ownership Model (40%)	Measure	Score	Measure	Score
a) Stability and Predictability of Regulatory Regime		Aa		Aa
b) Asset Ownership Model		Aa		Aa
c) Cost and Investment Recovery (Ability and Timeliness)		A		A
d) Revenue Risk		Aa		Aa
Factor 2 : Scale and Complexity of Capital Program (10%)				
a) Scale and Complexity of Capital Program		Baa		Baa
Factor 3 : Financial Policy (10%)				
a) Financial Policy		Baa		Baa
Factor 4 : Leverage and Coverage (40%)				
a) FFO Interest Coverage (3 Year Avg)	4.5x	A	4.8x - 4.2x	A
b) Net Debt / Fixed Assets (3 Year Avg)	52.6%	A	56% - 58%	A
c) FFO / Net Debt (3 Year Avg)	18.2%	A	16% - 19%	Baa
d) RCF / Net Debt (3 Year Avg)	14.0%	Baa	12% - 14%	Baa
Rating:				
Indicated Rating from Grid Factors 1-4		A2		A3
Rating Lift		0		0
a) Indicated Rating from Grid		A2		A3
b) Actual Rating Assigned		baa1		baa1

Government-Related Issuer	Factor
a) Baseline Credit Assessment	baa1
b) Government Local Currency Rating	A3
c) Default Dependence	High
d) Support	Mod
e) Final Rating Outcome	Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations
[2] As of 31/12/2015; Source: Moody's Financial Metrics
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures
Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
ELECTRICITY SUPPLY BOARD (ESB)	
Outlook	Positive
Issuer Rating	Baa1
Senior Unsecured MTN -Dom Curr	(P)Baa1
ST Issuer Rating -Dom Curr	P-2
ESB FINANCE LIMITED (ESB FINANCE)	
Outlook	Positive
Bkd Senior Unsecured	Baa1

Source: Moody's Investors Service

REPORT NUMBER 1027952

MOODY'S
INVESTORS SERVICE