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## Electricity Supply Board

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### Table Of Contents

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Rationale

Outlook

S&P Global Ratings Base-Case Scenario

Business Risk

Financial Risk

Liquidity

Other Credit Considerations

Group Influence

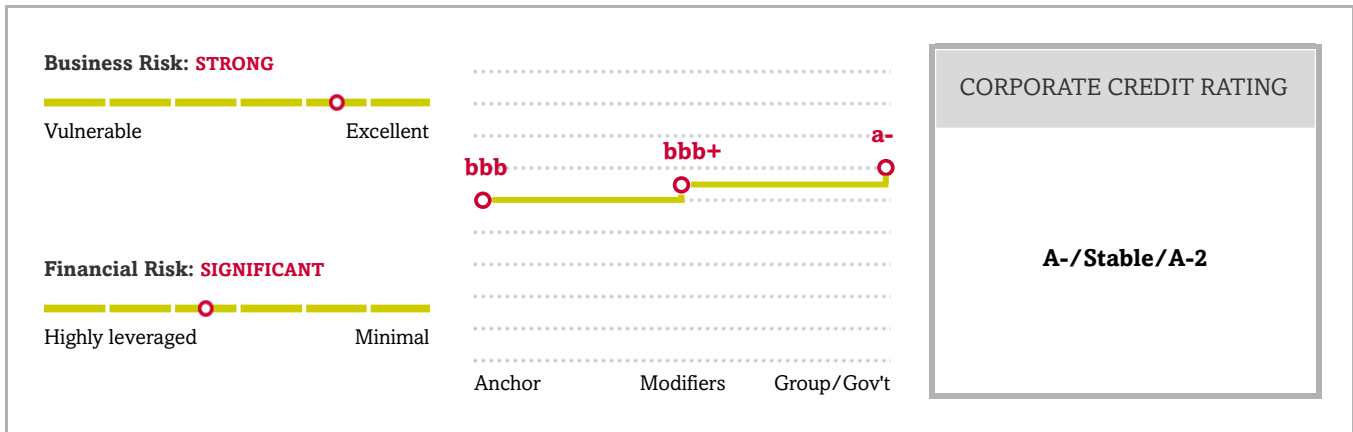
Government Influence

Ratings Score Snapshot

Reconciliation

Related Criteria And Research

# Electricity Supply Board



## Rationale

### Business Risk

- Monopoly market position in regulated service areas and leading position in the Irish electricity market.
- Significant proportion of stable and predictable cash flows from low-risk regulated network operations.
- Supportive features for efficient power generators under the Irish island-wide Single Electricity Market (SEM) framework.
- Vertically integrated power generation and supply operations.
- Good operational performance.
- Regulatory-reset risk at its lowest.
- Exposure of nonregulated activities to competition and merchant risk.

### Financial Risk

- Relatively high financial leverage.
- Stable and predictable operating cash flows within regulatory periods.
- Strong liquidity.
- Sizable capital investment plan.

## Outlook

The stable outlook on Irish 95% state-owned utility Electricity Supply Board (ESB) reflects the stable outlook on Ireland. It also reflects S&P Global Ratings' view that ESB's funds from operations (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 stand-alone credit profile (SACP) of 'bbb+'.

### Downside scenario

We could lower the rating on ESB if we take a similar action on Ireland.

If earnings become more volatile or if the group's profitability weakens, we could revise ESB's SACP downward. 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 weaker power market conditions, 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 increases without a simultaneous increase in FFO generation. This could be caused by an unexpected increase in capital expenditure (capex), debt-financed acquisition due to higher-than-anticipated dividend payout levels. 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 government-related entity (GRE) methodology.

### Upside scenario

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.

ESB's SACP is unlikely to rise over the two-year rating horizon, mainly because of the group's high leverage level due to its sizable and partly debt-financed capex program.

## S&P Global Ratings Base-Case Scenario

### Assumptions

- Foreign direct inflows, including into the labor-intensive services sector, will bolster Ireland's real GDP growth, which we forecast to average 3.6% over 2015-2018.
- Continued regulatory visibility and high predictability of earnings from ESB's Ireland-based network operations.
- Our projections are based on the final revenue determination for the ESB Networks business in the Republic Of Ireland covering the period 2016 to 2020, which was published in December 2015.
- Unchanged assumptions on capacity payments because the proposal to reduce these is under consultation.
- Dividend payouts will increase gradually to 40% of net income from 2017 onward from 35% in 2015.
- 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 the Commercial Operation entry of ESB's new 880 megawatt combined cycle gas-fired plant at Carrington near Manchester, which is coming online around the third-quarter of 2016.
- Investment into smart metering if approved by the regulator of about €500 million between 2018-2020.

### Key Metrics

	2015A	2016F	2017F	2018F
FFO/debt (%)	16.4	16-17	17-18	19-20
DCF/debt (%)	(1.5)	0-2	0-2	2-4
FFO cash interest (x)	5.2	5-6	5-6	6-7

A--Actual. F--Forecast. FFO--Funds from operations. DCF--Discretionary cash flows. All figures fully adjusted by S&P Global Ratings.

## Business Risk

Our assessment of ESB's business risk profile as strong is underpinned by ESB'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. These operations contributed almost 61% of consolidated EBITDA in 2015, excluding exceptional items. ESB also has well-balanced power generation and supply operations. Power generation is operated under the SEM 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 are fairly certain 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 view the unregulated power and gas business as having moderately high risk due to competition and price volatility. Despite continuing challenging conditions in the Irish and U.K. generation and supply markets, as well as depressed power prices, we see ESB as having a strong competitive advantage.

The company is further supported by the vertical integration of its supply and generation portfolio, which balances the retail customers and a diverse generation fleet. Even though about 33% of EBITDA in 2015 came from the generation business, ESB benefits from income supports. These include SEM capacity payments, support for the wind margin under the renewable energy feed-in tariff (REFIT) or renewable obligation certificate (ROC) regimes, and support for the peat plant margin, which has a fixed return under a public service obligation contract.

The regulatory reset risk in its network activities in the Republic of Ireland is currently at its lowest. The regulator published the final revenue determination in December 2015 and will run until 2020. We see the framework somewhat challenging particularly in terms of operating costs efficiencies, but it is not credit negative. Furthermore, we see a risk that the capacity payments ESB earns--about 40% of the capacity pot in Ireland--could be reduced by a further 10%, based on recently announced consultations by the regulator. This would be on top of another recent 10% reduction, which had a negative impact on EBITDA.

### S&P Base-Case Operating Scenario

- Regulatory-reset risk at its lowest.
- Exposure of nonregulated activities to competition and merchant risk.

### Peer comparison

Table 1

Electricity Supply Board -- Peer Comparison					
Industry Sector: Multi Utility Company					
	Electricity Supply Board	SSE PLC	Scottish Power Ltd.	EnBW Energie Baden-Wuerttemberg AG	Energie AG Oberoesterreich
Rating as of May 23, 2016	A-/Stable/A-2	A-/Stable/A-2	BBB/Positive/A-2	A-/Stable/A-2	A-/Stable/--

Table 1

Electricity Supply Board -- Peer Comparison (cont.)						
	--Fiscal year ended Dec. 31, 2015--	--Fiscal year ended March 31, 2015--	--Fiscal year ended Dec. 31, 2014--	--Fiscal year ended Dec. 31, 2014--	--Fiscal year ended Sep. 30, 2014--	
(Mil. Mix curr.)	€	£	£	€	€	€
Revenues	3,335.4	32,204.4	7,107.4	21,760.1	1,885.2	
EBITDA	1,370.6	2,618.9	1,254.8	1,959.9	261.7	
Funds from operations (FFO)	981.4	2,011.9	954.5	1,294.8	204.9	
Net income from cont. oper.	289.5	543.1	472.9	(450.7)	50.0	
Cash flow from operations	954.4	2,106.0	1,117.4	1,745.4	229.1	
Capital expenditures	773.0	1,630.0	1,156.1	1,586.5	155.3	
Free operating cash flow	181.4	476.0	(38.7)	158.9	73.8	
Discretionary cash flow	(91.3)	(61.9)	(938.7)	(157.9)	9.8	
Cash and short-term investments	133.9	1,674.9	50.7	3,179.2	304.5	
Debt	5,980.7	9,552.8	4,481.1	6,752.8	666.4	
Equity	3,858.6	3,814.3	4,575.9	5,545.6	1,458.5	
<b>Adjusted ratios</b>						
EBITDA margin (%)	41.1	8.1	17.7	9.0	13.9	
Return on capital (%)	5.1	13.2	8.1	12.7	5.7	
EBITDA interest coverage (x)	4.1	5.1	6.9	2.3	5.9	
FFO cash int. cov. (x)	5.2	7.3	8.2	6.7	7.4	
Debt/EBITDA (x)	4.4	3.6	3.6	3.4	2.5	
FFO/debt (%)	16.4	21.1	21.3	19.2	30.8	
Cash flow from operations/debt (%)	16.0	22.0	24.9	25.8	34.4	
Free operating cash flow/debt (%)	3.0	5.0	(0.9)	2.4	11.1	
Discretionary cash flow/debt (%)	(1.5)	(0.6)	(20.9)	(2.3)	1.5	

## Financial Risk

ESB's significant financial risk profile reflects our view that the ESB group will generate gradually increasing FFO over the medium term. This is based on the implementation of the revenue determination in the regulated 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 DCF 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.

### S&P Base-Case Cash Flow And Capital Structure Scenario

- Adjusted FFO to debt to remain between 16%-18% over the next two years.
- DCF to debt of about -2%, turning slightly positive in 2017 due to the completion of a special dividend.

### Financial summary

Table 2

Electricity Supply Board -- Financial Summary					
Industry Sector: Multi Utility Company					
	--Fiscal year ended Dec. 31--				
	2015	2014	2013	2012	2011
Rating history	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Negative/A-2	BBB+/Watch Neg/A-2
<b>(Mil. €)</b>					
Revenues	3,335.4	3,258.0	3,422.5	3,260.1	2,916.2
EBITDA	1,370.6	1,319.7	1,382.3	1,131.7	1,162.8
Funds from operations (FFO)	981.4	951.8	1,038.7	831.1	930.4
Net income from continuing operations	289.5	215.3	510.2	194.1	100.0
Cash flow from operations	954.4	1,022.8	1,000.9	794.1	784.9
Capital expenditures	773.0	896.7	727.7	703.9	771.9
Free operating cash flow	181.4	126.1	273.1	90.2	13.0
Dividends paid	272.7	283.8	146.8	72.5	77.0
Discretionary cash flow	(91.3)	(157.7)	126.3	17.7	(64.0)
Debt	5,980.7	5,701.3	5,442.3	5,552.1	5,503.1
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	3,858.6	3,889.0	4,122.5	3,779.5	3,794.8
Debt and equity	9,839.3	9,590.3	9,564.8	9,331.6	9,297.9
<b>Adjusted ratios</b>					
EBITDA margin (%)	41.1	40.5	40.4	34.7	39.9
EBITDA interest coverage (x)	4.1	4.1	4.2	4.0	4.9
FFO cash int. cov. (x)	5.2	5.4	5.2	5.1	7.3
Debt/EBITDA (x)	4.4	4.3	3.9	4.9	4.7
FFO/debt (%)	16.4	16.7	19.1	15.0	16.9
Cash flow from operations/debt (%)	16.0	17.9	18.4	14.3	14.3
Free operating cash flow/debt (%)	3.0	2.2	5.0	1.6	0.2
Discretionary cash flow/debt (%)	(1.5)	(2.8)	2.3	0.3	(1.2)
Net Cash Flow / Capex (%)	91.7	74.5	122.6	107.8	110.6
Return on capital (%)	5.1	5.4	7.0	4.5	5.1
Return on common equity (%)	7.5	5.4	12.9	5.1	2.6
Common dividend payout ratio (un-adj.) (%)	94.1	131.8	13.4	40.4	72.5

## Liquidity

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 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, proven access to capital markets, even under dire market conditions.

### Principal Liquidity Sources

- Available cash balance of about €101.5 million as of Dec 31, 2015.
- An undrawn committed credit facility of about €1.19 billion maturing in January 2020.
- Access to €250 million available through a bank loan from the European Investment Bank, which ESB can use to fund investments.
- Close to £100 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, 2015.

### Principal Liquidity Uses

- Capex of almost €1 billion.
- Debt maturities of about €170 million in the next 12 months.
- Dividend payment of about €110 million.

### Debt maturities at March 31, 2015

- 2016: €170 million
- 2017: €474 million
- 2018: €436 million
- 2019: €827 million
- 2020: €506 million
- After 2020: €2,451 million

## Other Credit Considerations

We use our positive comparable rating analysis modifier to reflect ESB's contributions from stable and predictable regulated network activities, which are higher than the peer average.

## Group Influence

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

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



## Reconciliation

Table 3

### Reconciliation Of Electricity Supply Board Reported Amounts With Adjusted Amounts (Mil. €)

--Fiscal year ended Dec. 31, 2014--

#### Electricity Supply Board reported amounts

	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations
Reported	5,109.1	3,860.5	1,380.0	531.1	207.0	1,380.0	857.0
<b>S&amp;P Global Ratings adjustments</b>							
Interest expense (reported)	--	--	--	--	--	(207.0)	--
Interest income (reported)	--	--	--	--	--	1.3	--
Current tax expense (reported)	--	--	--	--	--	(43.4)	--
Operating leases	108.4	--	13.6	6.7	6.7	6.9	6.9
Postretirement benefit obligations/ deferred compensation	677.4	--	0.1	0.1	36.4	(48.6)	86.1
Surplus cash	(133.9)	--	--	--	--	--	--
Capitalized interest	--	--	--	--	52.6	(52.6)	--
Asset retirement obligations	115.2	--	--	--	1.6	(2.0)	3.1
Nonoperating income (expense)	--	--	--	(7.9)	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	1.3
Non-controlling Interest/Minority interest	--	(1.9)	--	--	--	--	--
Debt - Accrued interest not included in reported debt	83.3	--	--	--	--	--	--
Debt - Other	21.0	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	(0.6)	(0.6)	--	(0.6)	--
EBITDA - Other	--	--	(22.6)	(22.6)	--	(22.6)	--
D&A - Other	--	--	--	32.2	--	--	--
Interest expense - Other	--	--	--	--	30.0	(30.0)	--
Total adjustments	871.5	(1.9)	(9.4)	8.0	127.4	(398.7)	97.4

#### S&P Global Ratings adjusted amounts

	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations
Adjusted	5,980.7	3,858.6	1,370.6	539.1	334.3	981.4	954.4

## 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

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+/a	a-/bbb+	<b>bbb</b>	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-

### Ratings Detail (As Of May 24, 2016)

#### Electricity Supply Board

Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Senior Unsecured	A-2

#### Corporate Credit Ratings History

09-Jun-2015	A-/Stable/A-2
13-Feb-2013	BBB+/Stable/A-2
17-Jan-2012	BBB+/Negative/A-2
08-Dec-2011	BBB+/Watch Neg/A-2

#### Related Entities

##### ESB FINANCE Ltd.

Senior Unsecured	A-
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**Ratings Detail (As Of May 24, 2016) (cont.)**

**Northern Ireland Electricity Ltd.**

Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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