Research Update:

Ireland-Based Electricity Supply Board Affirmed At 'A-' Despite 2018 Results Being Below Expectations; Outlook Stable

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Rating Action Overview

- The 2018 results of Ireland-based 95% state-owned utility Electricity Supply Board (ESB) were below our expectations primarily because of operational issues that affected its generation activity, which led its credit ratios to weaken slightly.
- We expect its credit ratios to recover this year amid growth coming from the network operation and an improvement in its generation activity.
- We are affirming our 'A-/A-2' ratings on ESB.
- The stable outlook reflects that, despite sizable capital expenditure (capex) required for the transformation of its generation portfolio, ESB should be able to maintain funds from operations (FFO) to debt above 17% on average, based on its regulated network stable contribution and an improvement in the generation profitability.

Rating Action Rationale

The affirmation reflects our expectation for a recovery in credit metrics in 2019 stemming from growth in the network operation and normal profitability returning to generation activity, despite the dip in credit ratios in 2018.

Although we have reassessed ESB's liquidity profile to adequate from strong, our assessment is neutral for the rating.

ESB's 2018 results were below our expectations. A combination of factors affected its generation activity and led to about €150 million reduction in adjusted EBITDA, to €1.2 billion. Results were weakened by:

- The reduced running of I-SEM plants that lead to lower volumes and spreads on average. Most of ESB's power stations secured contracts in the first I-SEM capacity auction but some small and old thermal units did not.

- Unplanned outages at Moneypoint. All three main coal-fired turbines at the ESB's Moneypoint power station have been out of action for a number of months in Q4 2018 and into early 2019. We understand that by April 2019 all three were already back online. Moneypoint is one of Ireland's largest generating stations with a total generation capacity of 915 megawatts (MW)--more than 20% of the installed capacity in Ireland.
- Lower spreads in Carrington offset by higher winds.

Although we recognize that dividend distribution was reduced substantially in 2018 (€35 million compared to €116 million in 2017), this has not been enough to compensate for the reduction in EBITDA, leading FFO to debt to decline to 15.6%. This is below the 17% we defined as threshold for ESB to maintain its current rating.

Of the three factors described above, we understand that only the reduced running of the I-SEM plants will permanently affect our forecasts. We expect the effects of Moneypoint and Carrington to be temporary and we therefore forecast the contribution from generation activity to rebound in 2019. We also expect to see growth in the contribution from the network operation, reflecting the gradual growth in regulated asset base (RAB).

We expect ESB to increase capex over the next few years, mostly for extending and upgrading the networks and shifting the energy generation mix toward renewables and away from fossil fuels such as coal. Capex includes €3.0 billion-€3.2 billion over the next three years--notable when compared with our expected EBITDA generation of about €4.0 billion in the same period. Despite the large capex program putting a strain on the balance sheet, we consider it credit-positive over the medium term.

Overall, our base case is for FFO to debt in 2019-2021 to be between 18%-19%.

Outlook

The stable outlook on ESB reflects the stable outlook on Ireland. It also reflects our expectation that ESB will be able to maintain FFO to debt above 17%, based its regulated network's stable contribution and despite sizable capex required for the transformation of its generation portfolio.

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 stem from lower returns from the regulated network businesses--reflecting underperformance against regulatory allowances--or lack of recovery in the generation business.

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 capex, a debt-financed acquisition, or higher-than-anticipated dividend payouts. 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 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.

We are unlikely to revise ESB's SACP upward over our three-year rating horizon, mainly because of the group's high leverage due to its sizable and partly debt-financed capex program.

Company Description

ESB is an integrated utility predominantly operating in the Republic of Ireland and Northern Ireland. 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.

Our Base-Case Scenario

Our base-case assumptions for 2019-2021 are:

- Real GDP growth rate for Ireland of 3.8% in 2019, 3.0% in 2020, and 3.0% in 2021.
- Continued regulatory visibility and high predictability of earnings from ESB's Ireland-based network operations as well as its subsidiary NIE.
- Moneypoint fully operational as of April 2019.
- EBITDA margin of about 35%-37%.
- Annual capex around €1 billion-€1.1 billion over 2019-2021.
- We expect dividend payouts of 40% of net income in 2019 and beyond.
- Exposure of non-regulated activities to competition and merchant risk albeit ESB has been able to retain its market share.

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures over 2019-2021:

- EBITDA increasing to €1.3 billion-€1.4 billion over 2019-2021 from €1.2 billion in 2018.
- Debt increasing to more than €6.0 billion in 2021 from €5.7 billion in 2018.
- FFO to debt of 18%-19% over 2019-2021 from 15.6% in 2018.
- Debt to EBITDA gradually declining to 4.3x in 2021 from 4.7x in 2018.

Liquidity

We now assess ESB's liquidity position as adequate (previously strong), reflecting our view that ESB's liquidity resources will exceed its funding needs by 1.4x 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 for the 12 months from Dec. 31, 2018:

- Available cash balance of about €230 million.
- An undrawn committed credit facility of about €1.37 billion maturing in January 2022.
- Annual FFO of about €1.16 billion.

Principal liquidity uses for the same period are:

- Capex of about €1.1 billion.
- Debt maturities of about €500 million in the next 12 months.
- Dividend payments of about €60 million in the next 12 months.
- Some working capital outflows of about €300 million in the next 12 months.

Ratings Score Snapshot

Issuer 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 (Medial Volatility)

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (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)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | 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: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - 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
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

Ratings List

Ratings Affirmed	
Electricity Supply Board	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
ESB Finance DAC	
Senior Unsecured	A-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.