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Research Update:

Vertically Integrated Utility Electricity Supply Board Ratings Affirmed; Outlook Triggers Updated; Outlook Stable

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Overview

- We are affirming our 'A-/A-2' long- and short-term ratings on Ireland-based vertically integrated utility Electricity Supply Board (ESB).
- We continue to see Ireland-based, 95% state-owned vertically integrated energy utility ESB as a government-related entity (GRE) with a moderately high likelihood of extraordinary government support in the event of financial distress.
- The stable outlook reflects the stable outlook on Ireland. It also reflects our view that the ESB group will maintain headroom under its cash flow coverage ratios, namely funds from operations to debt of 17%, on average.

Rating Action

On May 26, 2017, S&P Global Ratings affirmed its 'A-/A-2' long and short-term corporate credit ratings on Ireland-based vertically integrated energy utility Electricity Supply Board (ESB). The outlook is stable.

We also affirmed our 'A-' issue credit rating on ESB's senior unsecured debt.

Rationale

Our affirmation reflects ESB's consistent and predictable revenue and cash flow streams from its monopoly low-risk, regulated multi-utility business in Ireland and Northern Ireland. In 2016, regulated network activities reflected roughly 63% of earnings. The remainder was composed of earnings from ESB's Generation and Wholesale Markets business (33% of 2016 group EBITDA), which benefits from capacity payments and regulatory supports including for wind; and its retail supply business Electric Ireland.

We base our ratings on ESB on its stand-alone credit profile (SACP), which we continue to assess at 'bbb+', reflecting its strong business risk profile and significant financial risk profile. ESB benefits from one notch of uplift as we view ESB as having a moderately high likelihood of extraordinary government support based on its:

- 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, with the remainder 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.

ESB's strong 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 63% of consolidated EBITDA in 2016. This contribution is typically higher than peers' contribution from stable and predictable regulated network activities at the same business risk levels. 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 is operated under the single electricity market (SEM) framework, which covers the Republic of Ireland (ROI) and Northern Ireland. ESB's portfolio--which includes coal, gas, peat, wind, and hydropower--is composed of relatively modern plants enabling the group to withstand difficult market conditions. Given that ESB's power plants rank well across the merit order, we believe that the company would benefit from capacity payments, which are generally awarded to the most flexible plants in the SEM market. Despite continuing challenging conditions in the Irish and U.K. generation and supply markets, as well as depressed power prices, we see ESB as able to maintain relatively stable cash flow generation.

ESB's financial risk profile reflects our view that the ESB group will still generate gradually increasing funds from operations (FFO) over the medium term mainly because of sizable investments in networks driven by network reinforcement for increased renewables. We expect FFO to debt to remain at 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 for its network activities (50% of EBITDA in 2016) is somewhat challenging, particularly in terms of operating cost efficiencies, we believe the company should be able to achieve its regulatory targets. That said, the draft determination for Northern Ireland Electricity Networks Ltd. (NIE NETWORKS), covering the period from October 2017 to March 2024, is challenging, and if the final determination--to be published on 28 June 2017--is unchanged from the draft determination, then NIE NETWORKS' credit metrics could deteriorate (13% of group EBITDA in 2016) (please refer to " Northern Ireland Electricity Ratings Affirmed Despite A Tough Draft Determination; Outlook Stable," published on May 26, 2017 on RatingsDirect).

Lastly, we see a risk to the level of capacity payments ESB earns--about 40% of the capacity pot in Ireland. The level of potential remuneration under the SEM capacity mechanism is likely to fall as part of the re-design of the Irish electricity market to more closely align energy trading with the EU (the I-SEM reforms), being jointly led by the Irish Regulatory Authorities (Commission for Energy Regulation in ROI and the Utility Regulator in Northern Ireland). However, 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 May 2018. We will have more clarity of potential changes at the end of 2017. 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 efficient asset base, the effect should not be too material at group level.

Assumptions

- Ireland's real GDP growth will average 3.0% over 2017-2019.
- Average SEM demand growth of 2.0% over 2017-2019.
- Euro to pound sterling exchange rate of 0.84 and euro/dollar rate of 1.11.
- We assume continued regulatory visibility and high predictability of earnings from ESB's Ireland-based network operations as well as subsidiary NIE NETWORKS.
- We expect dividend payouts to increase gradually from 38% of net income in 2016 to 40% from 2017 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 ROI and the commencement of commercial operation entry of the Carrington power plant from September 2016 (885 megawatt combined cycle gas turbines near Manchester in the U.K.).
- NIE NETWORKS' EBITDA based on draft determination received on March 24, 2017.

Based on these assumptions, we arrive at the following credit measures:

	2016A	**2017E**	**2018E**
EBITDA margin	42.2	39-41	40-42
FFO/debt	18.6	17-18	17-18
DCF/debt	5.4	(1)-1	1-3

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

Liquidity

The short-term rating on ESB is 'A-2'. We assess ESB's liquidity position as strong, reflecting our view that its 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 for the 12 months from Dec. 31, 2016:
- Available cash balance of about €364 million.
- An undrawn committed credit facility of about €1.44 billion maturing in January 2022.
- Access to €68 million (as of Dec. 31, 2016) available through an undrawn bank loan from the European Investment Bank maturing in December 2025, which ESB can use to fund investments.
- Annual FFO of about €1 billion.

Principal liquidity uses for the same time period:
- Capital expenditure (capex) of almost €1 billion.
- Debt maturities of about €500 million.
- Dividend payment of about €110 million.
- Working capital outflows of about €100 million.

Outlook

The stable outlook on Irish 95% state-owned utility ESB reflects the stable outlook on Ireland. It also reflects our view that ESB's FFO to debt will remain at 17%, on average, over the medium term, which is in line with our guidance for the current SACP of 'bbb+' underpinned by a supportive financial policy.

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 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 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 increased without a simultaneous increase in FFO generation. This could be caused by an unexpected increase in capex, debt-financed acquisition, or higher-than-anticipated dividend payout levels. At the current sovereign rating level, if we lowered the SACP by one notch, the rating on ESB would also be one notch lower according to our 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 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.

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)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (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)

Related Criteria

- 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
- 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Electricity Supply Board	
Corporate Credit Rating	A-/Stable/A-2
Electricity Supply Board	
ESB FINANCE Ltd.	
Senior Unsecured	A-

Additional Contact:
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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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the 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.