Electricity Supply Board

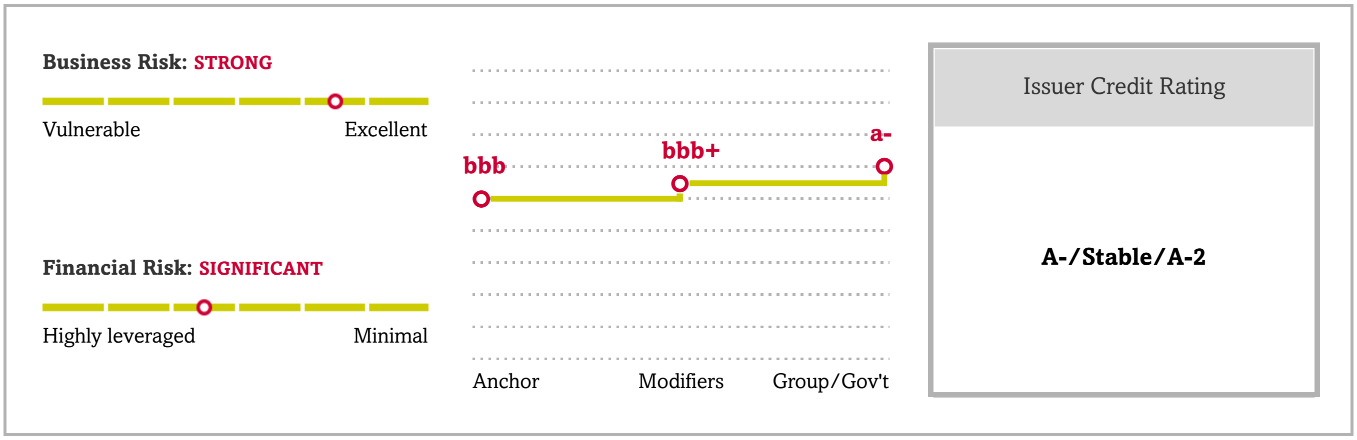
Primary Credit Analyst:
Gonzalo Cantabrana Fernandez, Madrid (34) 91 389 6955; gonzalo.cantabrana@spglobal.com

Secondary Contacts:
Renata Gottliebova, Dublin +353 1 568 0608; renata.gottliebova@spglobal.com
Matan Benjamin, London (44) 20-7176-0106; matan.benjamin@spglobal.com

Table Of Contents

Table Of Contents (cont.)

Electricity Supply Board



Credit Highlights

Overview

Key strengths	Key risks
Strong position in the Irish energy market.	Risk stemming from competition and price volatility.
Stable and predictable regulated networks that generate more than two-thirds of EBITDA, leading to low risk.	Regulatory-reset risk scheduled from January 2021.
Flexible financial policy.	Risks associated with required shift in the energy-generation mix toward renewables.
Moderate support from the Irish government.	

S&P Global Ratings considers that state-owned utility Electricity Supply Board (ESB) is relatively resilient to the effects of the COVID-19 pandemic because it provides an essential service and two-thirds of its activity is regulated. Its exposure to COVID-19 risk is indirect and modest; slowing economic conditions will depress demand. Indeed, we understand that demand was about 10%-15% lower during the lockdown period. The expected impact within the unregulated business is already incorporated into our updated forecast and drives the lower EBITDA in FY2020 compared to FY2019. In line with government measures, ESB is implementing a contingency plan to manage any disruptions and we expect it to maintain credit metrics at a level consistent with the current rating over the next three years. At the same time, we see a risk that the company could suffer from an increase in bad debt. Working capital requirements could also rise. We note the potential working capital impact related to the regulated activities would be recovered in 2021 and 2022. As yet, it is too early to determine the full impact of the pandemic, particularly given the risk of a second wave of infections.

ESB has a strong position in Ireland's energy market. It is a diversified, vertically integrated utility, operating right across the Irish electricity market: from generation, through transmission and distribution, to customer supply. Two-thirds of ESB's EBITDA stems from regulated networks and it has a monopoly position as the electricity-asset owner of the transmission and distribution system for the Republic of Ireland (ROI) and Northern Ireland (NI). It also holds the license as operator of the electricity distribution system in both jurisdictions, through its ring-fenced subsidiaries, ESB Networks DAC (ROI) and NIE Networks (NI).

Low-risk regulated network operations support a significant proportion of stable and predictable cash flows. We forecast that ESB will generate about 70% of its EBITDA from regulated activities and assess the regulatory advantage as strong.

ESB benefits from moderate support from the Irish government, which owns 96% of the company. ESB holds a strong position as an Irish power generator and the monopoly power distributor, and hence benefits from an important role and strong link with the Irish government.

Regulatory reset risk is increasing because the next review in Ireland will occur during 2020. The current regulatory period for the electricity sector (PR4) will end on Dec. 31, 2020. Regulatory periods for the electricity and gas networks sectors have been reviewed every five years in Ireland since 2001 (electricity) and 2002 (gas). At this stage, we expect PR5 will include a moderate reduction on the WACC (pre-tax, real; currently 4.95%) as the cost of funding has fallen since the beginning of the existing period in January 2016 and in line with other European countries.

ESB's strong investment program, which focuses on networks and renewables, should strengthen its long-term position by aligning the company's direction with the energy transition. The company plans to invest €6.5 billion between 2019 and 2024 (72% of total investment in networks, 22% in generation, and 6% in customer solutions).

Outlook: Stable

The stable outlook on ESB mirrors that on Ireland. We expect ESB to be able to maintain funds from operations (FFO) to debt above 17%, based on its regulated network's stable contribution, and despite the sizable capital expenditure (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 weaker performance in the unregulated 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 under our government-related entity (GRE) methodology.

Upside scenario

We cap our ratings on ESB at the sovereign rating because the Irish government owns 96% 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 based on the group's forecasted metrics which are affected by its sizable and partly debt-financed capex program.

Our Base-Case Scenario

Assumptions

Our base-case assumptions for 2020-2021 are:

- Real GDP growth rate for Ireland of (10.5%) in 2020, 6.0% in 2021, and 4.0% in 2022.
- Moderate reduction on the WACC for PR5.
- Continued regulatory visibility and high predictability of earnings from ESB's Ireland-based network operations, as well as its subsidiary, NIE.
- Annual capex of around €800 million-€1,200 million over 2020-2021, with two-thirds invested in regulated networks.
- Dividend payouts of about 30% of net income in 2020 and beyond.

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures over 2020-2021:

- Funds from operations (FFO) to debt of 17%-20% over 2020-2022.
- Debt to EBITDA of 4.6x-4.1x.

Key Metrics

	2019a	2020e	2021e	2022e
EBITDA (bil. €)	1.37	1.22-1.27	1.34-1.39	1.49-1.54
Debt (bil. €)	6.0	5.7-5.8	5.7-5.8	6.1-6.2
Dividends (mil. €)	43	110-130	90-110	110-130
Capex (Bil. €)	0.95	0.87-0.92	1.00-1.05	1.18-1.23
FFO to debt (%)	18.7	16.8-17.3	18.8-19.3	19.2-19.7
Debt to EBITDA (x)	4.4	4.5-4.7	4.1-4.3	4.0-4.2

a--actual. e--estimate.

Company Description

ESB was established in 1927 and is 96% owned by the government of the Republic of Ireland. During 2019, ESB achieved an adjusted EBITDA of roughly €1.37 billion. ESB is an integrated utility predominantly operating in 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.

- ESB is the monopoly owner of the transmission and distribution grids in Ireland and Northern Ireland.
- NIE Networks is a wholly owned subsidiary of ESB. It is the only electricity transmission asset owner and the electricity distribution network owner and operator in Northern Ireland.
- Generation of electricity in Ireland and the U.K. ESB has a 34% share in the electricity generation market across the whole island. Of ESB's total energy production in 2019 (14.7 terawatt hours; TWh), 69% of it was in the I-SEM (Integrate Single Electricity Market), with the remaining 31% in the U.K. In terms of installed capacity, 75% of it sits

in the I-SEM market and the remaining 25% in the U.K.

- Supply of electricity, gas, and energy services to the business and residential markets in Ireland and Northern Ireland. In 2019, ESB had a 34% share of the Irish electricity supply market and supplied 1.25 million customers. Within gas supply, ESB has a market share of 21%.

Business Risk: Strong

The stable and predictable cash flows from its low-risk regulated electricity transmission and distribution network operations underpin ESB's business risk profile. These cash flows contributed almost 70% of consolidated EBITDA in 2019 and 77% in 2018.

We consider that regulatory frameworks for electricity and gas transmission and distribution networks in Ireland exhibit the following supportive characteristics consistent with a strong regulatory advantage:

- Use of system tariffs are set over a five-year period (and reset annually for electricity networks) based on the regulator's allowed operating costs, recovery of allowed capital investment over their asset lifetimes, and an allowed return on the regulatory network asset base.
- The regulator benefits from a solid track record of stability over successive five-year regulatory periods, with well-defined conditions. This provides companies with good visibility on their financial performance.

The regulatory reset risk in ESB's network activities in Ireland is increasing slightly because the new regulatory period is due to start in January 2021. The current electricity price review period (PR4) started in January 2016, and will end in December 2020. ESB has submitted its PR5 to the commission for the regulation of utilities in November. This will set the level of investment, operating expenditure, return, and incentives for the next five years. At this stage, we expect a moderate reduction within the next regulatory period, reflecting the lower cost of funding compared with that in January 2016.

For further information on the Irish regulatory framework, see "Why We See The Republic of Ireland's Electricity And Gas Regulatory Framework As Supportive," published May 8, 2018.

On the other hand, the regulatory period in Northern Ireland runs from Oct. 1, 2017, to March 31, 2024. The current six-and-a-half-year price control period (RP6) in Northern Ireland follows the key principles of the regulatory frameworks applicable to U.K.-regulated utility businesses, which we assess as credit-supportive. These strengths are partially offset by the most recent regulatory determination, which we see as tough and as having one of the lowest WACCs we have seen (3.18% vanilla). However, the price control includes an adjustment mechanism to WACC for new debt raised during RP6 to reference the market rate prevailing at the time of issue.

ESB also benefits from its leading market position in the Irish electricity generation market. ESB's well-balanced power generation and supply operations offset, to some extent, the risk stemming from competition and price volatility. We consider ESB well-positioned, and a significant proportion of its energy margin is expected to continue benefiting from capacity payments and quasi-regulated regulatory supports.

Financial Risk: Significant

ESB's financial risk profile reflects our view that the group will still generate gradually increasing FFO over the medium term, mainly because of growth in its regulated assets base as it has made sizable investments to reinforce the networks and increase renewables. Our forecast suggests that FFO will remain above 17%.

We expect ESB to increase capex over the next few years, mostly to extend and upgrade its networks, and shift the energy generation mix toward renewables and away from fossil fuels such as coal. Capex includes €3.0 billion-€3.6 billion over the next three years, compared with our expected EBITDA generation of about €4.0 billion in the same period. Even though the large capex program will strain the balance sheet, we consider it credit-positive over the medium term. The company benefits from a supportive dividend policy through a pay-out ratio of about 30% of net income under our forecast.

Liquidity: Adequate

We assess ESB's liquidity position as adequate, 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. 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, further support our assessment.

Principal Liquidity Sources	Principal Liquidity Uses
Principal liquidity sources for the 12 months from March 31, 2020 include: • Available cash balance of about €230 million; • An undrawn committed credit facility of about €1.30 billion maturing in February 2025; • Annual FFO of about €1.15 billion; and • Working capital inflows of around €96 million and proceeds from asset sales of about €65 million.	Principal liquidity uses for the same period include: • Capex of about €0.9 billion; • Debt maturities of about €85 million in the next 12 months; and • Dividend payments of about €115 million in the next 12 months.

Environmental, Social, And Governance

Of the energy produced by ESB in 2019, 83% was produced through fossil fuels--almost exclusively gas--leading to a carbon intensity of 406 grams of carbon dioxide per megawatt-hour. This is above the average carbon intensity at the EU in 2017--295 grams per megawatt--partially because of the lack of hydro and nuclear, but also because of the current low level of renewables. We expect ESB's carbon intensity to decline gradually over the next decade as the company transitions its thermal-based generation to clean energy sources; particularly after the expected end of coal generation at Moneypoint in 2025.

ESB has a relevant position in Ireland due to its role as distribution system operator. The company has a long track record of successfully managing the network operations. Although ESB owns the transmission grid, its operations are conducted by Eirgrid.

Group Influence

We assess ESB's group credit profile at 'bbb+', based on the consolidated cash flows and debt at the level of ESB. We view 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 consider ESB as a GRE. Our long-term issuer credit rating of 'A-' on ESB incorporates one notch of uplift above the SACP, reflecting our view that there is moderately high likelihood that Ireland would provide timely and sufficient extraordinary support to ESB in the event of financial distress.

We base our view of a moderately high likelihood of extraordinary government support 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 96% 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.

Issue Ratings - Subordination Risk Analysis

Capital structure

ESB's group capital structure consisted of €5.2 billion as of Dec. 31, 2019, the vast majority unsecured. The majority of ESB's debt is raised via ESB Finance DAC (financing vehicle), apart from NIE debt (currently €820 million bonds), which is raised by NIE Finance. As a result, structural subordination is fairly limited, at 15% under our calculations.

Analytical conclusions

ESB's debt is rated 'A-', the same level as the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

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

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

- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- 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, 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

Related Research

- Ireland 'AA-/A-1+' Ratings Affirmed; Outlook Stable, May 29 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	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 June 15, 2020)*	
Electricity Supply Board	
Issuer Credit Rating	A-/Stable/A-2
Issuer Credit Ratings History	
09-Jun-2015	A-/Stable/A-2
13-Feb-2013	BBB+/Stable/A-2
17-Jan-2012	BBB+/Negative/A-2
Related Entities	
Northern Ireland Electricity Networks Ltd.	
Issuer Credit Rating	BBB+/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and

Ratings Detail (As Of June 15, 2020)*(cont.)

debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:

Infrastructure Finance Ratings Europe; InfrastructureEurope@spglobal.com