



Padraig McManus

## Chief Executive's Review

“ We have positioned ESB to be a high performance company, as an integral part of a competitive electricity market in Ireland, which will generate value for its stockholders and customers...”

### Introduction

I am pleased to report on our results for 2003, which demonstrate significant progress towards achieving our ambitious corporate objectives, to the benefit of customers and stockholders.

2003 was a landmark year for ESB. We achieved a record level of capital investment in the national electricity infrastructure, managed significant improvements in the way in which we carry out our business and maintained continuity of supply to our customers, despite operating under very tight power availability constraints. To facilitate the opening up of the electricity market to competition, we completed two separate power purchase agreements with new external generating companies and also invested

heavily in IT systems required for full market opening. Importantly, we also delivered a creditable financial performance which will allow us to further invest in the business going forward.

### Corporate Strategy

The current corporate strategy, which was launched in 2002, set the direction for group activities and provided the framework for the implementation of transforming plans across ESB. Arising from this strategy, during 2003 there was a focus on improving performance in existing businesses, significant investment in the Irish national infrastructure and targeted development of new business opportunities both at home and abroad.

The corporate strategy sets the strategic direction for ESB, as follows:

- focus is on the core electricity businesses,
- clear financial targets for the coming years,
- best practice leadership is to be achieved in health and safety issues and
- customers will be the focal point for the Group.

In order to realise this strategy, ESB must deliver on certain key business issues:

- renewal of the distribution and transmission networks,
- modernisation of the generation plant,
- development of a fully customer focused Customer Supply business,
- achievement of a successful international business,
- realisation of staff potential and
- empowerment of managers to deliver on this strategy.

In financial terms, these elements are aligned to ensure that all resources are focused on achieving an overall financial target of doubling the profitability of the Group in the period 2002 to 2007, which is imperative if we are to maintain a strong balance sheet, capable of funding the continued investment necessary in the businesses.

Our strategy clearly recognises that we must evolve with the process of liberalisation within the energy sector in Ireland. More importantly, we must actively promote the introduction of competition, while maintaining a core business of significant scale for stockholders. We have positioned ESB to be a high performance company in the competitive electricity market in Ireland, which will generate value for its stockholders and customers as the liberalisation process continues and as there is greater integration of energy markets across Europe.

## Operational Review

In operational terms, ESB performed satisfactorily in 2003. This performance has been achieved through:

- Strong underlying operational performance in all areas, against key performance measures set for senior management under the five year corporate strategy.
- Continued record levels of capital investment (€1.3bn), particularly in the networks, which form a vital part of the national electricity infrastructure.
- Continuity of supply to our customers, despite very tight power availability conditions during the year and continued rising demand growth.
- Improved operating efficiency, combined with improvements in a wide range of business processes which gave rise to €95m in savings during 2003 under the PACT programme. This included a reduction of over 1,000 employees since 2001.
- Closure agreements in respect of five peat stations and the commencement of the construction of two new state of the art peat stations.
- Further development of new generation and supply business opportunities in Northern Ireland, Britain and the rest of Europe in recognition of the need to reduce market share in Ireland, while at the same time being positioned to operate with scale in an integrated European electricity market.
- Continuation of the partnership approach between management and employees within ESB.

It was disappointing that the SeTrans contract to operate a Transmission System in the US did not go ahead due to changes in their regulatory environment.

Additionally we have worked hard to promote competition in the market and delivered significant change in the year through:

- Obtaining approval from the Commission for Energy Regulation (CER), for the business separation arrangements. These will enable ESB Customer Supply and ESB Networks to operate as separate businesses in full compliance with regulatory requirements for confidentiality, non-discrimination and cost transparency.

- Developing major new information technology systems to support full market opening in 2005. These new systems will be required by all competitors in the new market, to enable customers to choose suppliers.
- Entry into purchase contracts equivalent to over 500MW of capacity with two new external entrants in the generation market, having facilitated an open competition for these contracts which was carried out independently by the CER.

The two key elements for competition in any electricity market are Generation and Supply. During 2003, the Generation market became 100% available for third party competition. On an all island basis, allowing for the new generation contracts in place, some 50% of the existing total production is owned by third party competitive generators. In supply, the market is now 56% open to competition and by 2005 when ESB will have completed an investment of over €100m in new systems on behalf of CER, the market will be 100% open. This will be a full two years ahead of the EU target of 2007.

## Annual Price Adjustments

Approximately 80% of ESB's revenue is now regulated by the CER. Appendix 1 provides an overview of this regulatory process.

The requirement for electricity tariffs to be set in advance of the relevant year by the CER, based on a forecast of customer demand and relevant costs, almost invariably means that the actual out-turn for any year will result in either an under or over recovery of revenue by ESB. Any such

under or over recovery of allowed revenue is adjusted by the CER in subsequent years' price determinations.

These year-on-year adjustments can cause material variations in the annual profits earned by the regulated businesses. The current accounting practice in this area does not allow the "smoothing" of such adjustments between years. The year end segmental results of ESB therefore reflect both trading in the current year, as well as adjustments relating to prior years. In particular in 2003, this resulted in the ESB Customer Supply business reporting unusually high profits of €88m, reflecting the impact of €40m of prior year under recovery.

## Investment Programme

ESB invested over €650 million in the development and renewal of the Network infrastructure in Ireland in 2003. As part of the Network Renewal Programme the ESB Networks business completed approximately 17,000km of distribution network in 2003. This was achieved by a mixture of internal and external resources, with a significant volume of work being completed by sub-contractors employed by international construction firms. This achievement exceeded the target for network investment set out in our corporate strategy and highlighted both our project management competence and also our ability to deliver major work programmes.

The renewal of ESB's generation portfolio is a key business objective. Implementation of this progressed during 2003, with agreements being reached on the closure of a number of older peat stations. The construction of two state of the art peat plants as replacements progressed well in 2003 and they are on



target to commence operation in the next twelve months. Full market opening in 2005 poses a significant challenge due to the scale of the process and the IT developments that are necessary to enable a competitive market to operate effectively for all customers. The systems to enable market opening are currently being put in place. Over 300 people (staff and consultants) are currently engaged in this project, which is the largest IT project ever undertaken by ESB.

ESB International successfully reached financial close on a major investment in a 755MW combined cycle power plant in Amorebieta in Spain. The plant will operate under trading arrangements with Shell and demonstrates ESB's ability to operate successfully in the international arena.

## Safety

The safety of our staff, contractors and the public is of primary importance within ESB. Customer safety, as well as the safety of the public, employees and contractors is treated with the utmost seriousness by ESB. We continue to work towards increased public and staff awareness of this issue. The reduction of accidents and near misses is a key focus of management and the objective is to achieve a zero injuries environment.

Unfortunately, it is with deep regret that we report the death of two staff members in a single accident in Tarbert, Mike Healy and Pat McCrohan. The accident was investigated both by ESB and independently by the Health and Safety Authority and all recommendations arising from these investigations will be implemented in full. These accidents, in addition to the death during 2003 of two contractors working for ESB Networks, reinforce the need for continuous vigilance in our commitment to safety.

## Customers

Our strong customer service ethos has served the country well since ESB was founded. Ireland is a small market in electricity terms. It has a small population spread over a wide geographical area. The competing needs of low price, security of supply and quality of service are more difficult to balance for us than many of our much larger European neighbours. The solution is to have a pragmatic mix of competition where possible and sensible regulation where lack of scale does not facilitate this.

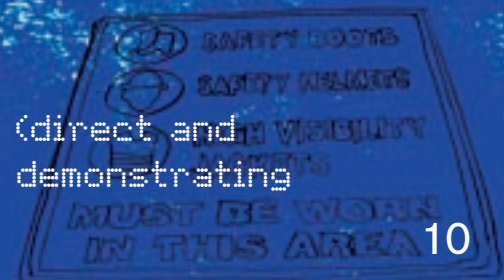
Prior to market opening, we had an effective monopoly on all aspects of the electricity industry. ESB recognised the significance that market opening would have on all our business lines and has reorganised accordingly. We have therefore been concerned to ensure that the changes in the electricity industry will ultimately bring benefits to customers and that customer service standards are maintained throughout the process of transition to full market opening. The individual business lines are discussed later in this report.

## People

Our success to date is unquestionably due to the quality of our people and their dedication and commitment. We have high quality, well motivated and technically gifted staff, with a strong customer focus, who carry out their business to the highest professional and ethical standards. Our business has grown internationally and we have demonstrated time and again our ability to compete successfully abroad. It is encouraging that our expertise is now valued in so many countries overseas and in our home market.

**HELPING TO REALISE THE VISION** During 2003, ESB contributed approximately €2bn to the Irish economy, in the form of payroll, rates, energy purchases, interest charges, dividends and taxation.

» This is significant in terms of both employment (direct and indirect) and expenditure in local communities, demonstrating ESB's commitment to Ireland.



# Our success to date is unquestionably due to the quality of our people and their dedication and commitment

We are now in a rapidly changing business environment and we will need to ensure that our organisational capabilities continue to match the challenges of our business environment. We are committed to continuing to implement an effective partnership model with the Trade Unions and their representatives at all levels, to meet this challenge.

Reflecting this commitment, in 2003 ESB launched a new Human Resources strategy which is focused on ensuring that we support our personnel in meeting the challenge facing us, as we seek to implement our corporate strategy.

## Conclusion

Following a landmark year in 2003, ESB faces further challenges in 2004 as we continue to invest in our asset base.

Our target of 20,000 kms of Network Renewal for 2004 is the most demanding to date. The commissioning of two new peat power stations in Ireland, the significant development of two international stations for completion in 2005 and the completion of the market opening programme, will present substantial challenges for ESB during 2004.

ESB is an Irish company that has served the Irish consumer for over 75 years. We are determined to achieve our strategic objectives, but are alert to the fact that these objectives need to be kept under review, particularly given the pace of change in the industry, to the benefit of our customers, our staff and owners.



**Padraig McManus**

Chief Executive

23 March 2004