



➤ Padraig McManus

Chief Executive's Review

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Introduction

2004 was a year of real progress for ESB with many corporate objectives progressed during the period. Utility companies typically experience slow or gradual change given the capital intensive nature of the business. For ESB, the pace of change has been relentless, driven by market deregulation, new competition, a dynamic expanding domestic economy, significant environmental legislation, comprehensive regulation and escalating fuel prices.

Against this backdrop our corporate strategy is designed to position ESB as a high performance electricity company, delivering value for stockholders and customers, while maintaining a strong balance sheet to competitively fund the continued investment in the business. Five key principles underpin the strategy:

- Continued improvements to service standards for customers, building on the strong customer service ethos which has been an integral part of the business since the foundation of the company over seventy five years ago,

- Achieve best practice leadership in health and safety issues,
- A focus on the core electricity businesses,
- Delivery of clear financial targets and
- Compliance with all EU Directives and National legislation.

Operational Performance

Key challenges for 2004 included the significant investment programme required within Networks, the commissioning of two new Peat Stations in Lanesboro and West Offaly, the development of two international power plants in Coolkeeragh (Northern Ireland) and Amorebieta (Spain) and the completion of the necessary investment in systems to facilitate market opening. I am pleased to report that significant progress has been made in successfully delivering on these challenges and in progressing the corporate strategy, during 2004.

It is worth highlighting that over 90,000 new customers were connected to the electricity system. This remarkable level of connection activity means that since 2000 over 346,400 new connections have been made. The sheer number and location of the connections are placing huge demands on the system and are key drivers of our massive capital programme. Specifically during the past year:

- This programme has seen over €700 million invested in the distribution and transmission networks, bringing the spend since 2000 in this area to €2.6 billion. This included replacement of 15,600km in 2004 of medium voltage networks to improve the reliability of the national infrastructure.
- Prioritisation within the IT area was given to ensuring all necessary IT systems were developed and operational to facilitate full market opening by 19 February, 2005.
- Power Generation business completed the largest planned maintenance programme in its history, with over thirty projects delivered, including a large number of major overhauls on key plant.
- The modernisation of our domestic generation portfolio continued with the construction of two new state of the art peat plants, operated and staffed to best international practice. The 100MW Lough Ree Power Plant entered commercial operation during the year and the 150MW West Offaly Power Plant entered commercial operation in early 2005. A closure agreement was also concluded for Bellacorick peat station, finalising our closure programme for all six old peat station locations.
- A significant investment project commenced to address environmental emissions in the coal fired Moneypoint station in Clare, to secure its long-term operation. This investment will facilitate the implementation and the ongoing operation of the plant to best international practice, in compliance with all relevant environmental obligations. This investment is underpinned by a best practice agreement, which represents a step change and a key milestone in the evolution of our business as a competitive generator.
- Continued progress in the international generation market occurred with the development of a 755MW combined cycle power plant, Amorebieta, in Spain and

a 400MW plant in Coolkeeragh in Derry. These investments are in recognition of the need to reduce market share in the Republic while at the same time positioning ourselves to operate with scale in an integrated European electricity market.

- Operational efficiencies continued to be delivered through the PACT change programme, which generated savings of €130 million during 2004.
- Staff numbers in the core businesses have decreased by nearly 1,500 since 2001.

Safety

ESB is committed to the promotion of the highest possible standards to ensure the safety of staff, contractors and the public. Safety is a core value for the company and our target is uncompromising, we aim for zero injuries. Unfortunately there were five fatalities during the year when members of the public came into contact with overhead lines. In 2004 we continued in our efforts to reinforce the need for continuous vigilance by all when dealing with electricity.

All recommendations from the ESB internal review and the independent review conducted by the Health and Safety Authority into the tragic accident in Tarbert Power Station in 2003 are being implemented in full.

Reducing the number of accidents and near misses is a key focus and priority of management. In this context, Power Generation received the Health and Safety Authority Minister's Award for Safety. The award recognised the safety awareness training programme which is mandatory for all of Power Generation staff. We will continue our efforts in 2005 to again improve our safety performance.

Market Opening and Regulatory Developments

ESB very much welcomed the full opening of the electricity market on 19 February, 2005 a full two years in advance of the timescale required by the EU Directive. ESB has recognised the need for additional entrants into the generation market for a successful deregulated market and

in this regard the company has been to the forefront in facilitating and supporting the introduction of competition, specifically in the following areas:

- Making available 400MW of ESB's energy at a discounted price to independent suppliers to enable market participants to develop their businesses and manage risk in the evolving Irish electricity market. A further 190MW of electricity has also been made available to independent suppliers from Synergen, a joint venture power plant between ESB and Statoil.
- Making available additional power (Top Up) and buying excess power (Spill) generated by independent generators to support their development in the market place and insulate them from market and technical risks.
- Implementing appropriate ringfencing arrangements to the satisfaction of the Regulator between Networks and remaining businesses within the ESB Group, fully recognising the requirement for confidentiality, non-discrimination and cost transparency in a Networks business which services all participants in the market impartially.
- Investing over €120 million in information technology systems to accommodate full market opening requirements from February 2005. These new IT systems will facilitate competition in the market, by enabling customers to choose electricity suppliers and to change between suppliers without difficulty.
- Entering into off-take arrangements with the independent generators at Aughinish and Tynagh and alternative energy generators to facilitate their entry into the market. These agreements protect these companies from market risk and allow them to successfully finance new independent generation.

The effect of these initiatives is dramatic. Power Generation's market share at the end of December 2004 was 65%. It is expected that when the two new independent power generators at Aughinish and Tynagh enter the market in 2005 and early 2006, Power Generation's market share will reduce significantly below 60%.

One of the key issues facing the evolving electricity market is the lack of scale in the Republic and ESB supports the establishment of an all-island electricity market in the short term while also promoting the development of a UK/Ireland regional market in the longer term.

In June 2004 the Minister for Communications, Marine and Natural Resources and the Minister for Enterprise Trade and Industry in Northern Ireland announced the initiative to develop an all-island Electricity Market under which they have committed to a challenging work programme which will see an all-island market established in 2007. In November 2004 the Ministers jointly published the document entitled "All-Island Energy Market – A Development Framework" which gives responsibility for the management and development of the market to the two regulatory authorities.

By 2007 Power Generation's market share will drop to 43%, provided current plans, including the all-island electricity market develop to schedule. While concerns have been expressed on the dominant position of ESB generation, it is clear that expected developments within the market over the next 2 to 3 years will result in ESB having well under half the Irish generation market. This is a dramatic change in a relatively short space of time.

Price

In relation to price, we suffer from several unhelpful traits when it comes to generating and distributing electricity. Firstly, we have high exposure to fossil fuel prices but have little or no indigenous fuel sources of any scale. Thus we suffer from the cost of importing fuel to an island economy, (adds 10% to our fuel bill for shipping coal, gas and oil). Secondly, we lack any economies of scale due to the small size of the Irish market. Thirdly, we have a low level of population density which means that on average we have three times more network per customer than the European average.

Electricity prices have increased by 36% since 2001. Recent rises have been driven by the large increases in world fuel prices, particularly the price for gas. ESB, through its fuel contracting and purchasing strategy has mitigated the impact of these increases on customers.

ESB recognises that recent price increases are placing a strain on industry and consumers and we are striving to minimise the need for future increases. Of key importance in determining future prices will be the success of the development of the all-island market and ultimately the UK/Ireland market.

People

The past number of years has seen significant changes in the Irish electricity market. ESB staff have adapted well to these changes. The partnership model with the Trade Unions has served ESB and its customers well, enabling management and Unions to work together to achieve common goals in a positive and cooperative manner. With continuing trade union support the partnership model will effectively address the new challenges facing ESB. With full market opening in 2005 and the further development of the deregulated electricity market, the business environment within which ESB operates will continue to change and additional challenges for the company will emerge. We are committed to the continuation of the partnership model to ensure ESB manages these challenges effectively.

I would like to acknowledge the dedication and loyalty of ESB staff in embracing change over the last number of years and for their continuing efforts in delivering on our corporate objectives.

Looking Forward

While significant progress has been achieved during 2004, 2005 will be another challenging year. Looking forward, key priorities during the coming year will include:

- Delivering on the significant capital investment programme, to meet growth and reliability standards and deliver a quality service to customers.
- Continuing to drive safety performance as an integral part of the business.

- Driving performance improvement to ensure continuing value for money and a competitive cost base to the benefit of stockholders and customers.
- Managing increasing debt levels associated with capital investment programme.
- Implementing the Infrastructure Agreement with EirGrid, the independent company created to operate the transmission system.
- Operating the new IT systems to enable customers choose electricity suppliers and switch between suppliers without difficulty, in the context of full opening of the electricity market.
- Achieving an acceptable outcome to the Regulatory price reviews covering (i) the next 5 years for Networks and Supply and (ii) for Power Generation covering the period up to the introduction of the new all-island market arrangements, scheduled for 2007.
- Completing the disposal of our Retail business to Bank of Scotland as recently announced.
- Successfully commissioning the 1,155 MW generation plants in Coolkeeragh and Amorebieta.

I have no doubt that the above challenges will be successfully met by ESB and I look forward to further delivering on our corporate objectives during 2005.

We were deeply saddened by the untimely death of Anne Taylor on 25 April 2005. During her time on the Board she was a challenging and supportive colleague who always had the best interests of ESB at heart. She will be sadly missed by her many friends in ESB.



Padraig McManus

Chief Executive

28 June 2005