

CHAIRMAN'S REVIEW



Tadhg O'Donoghue

In accordance with the provisions of the Electricity (Supply) Act 1927 (as amended) the Board presents the Annual Report and Accounts for the year ended 31 December 2006.

FINANCIAL PERFORMANCE

I am pleased to report that ESB put in a strong financial performance in 2006, notwithstanding significant business challenges. Profit after tax in 2006 was €223 million. This result, while down €18 million on 2005 was, I think, satisfactory bearing in mind the impact of the regulatory review and the 40% increase in the Group's energy costs in 2006. The key financial indicators show that ESB remains financially strong, notably as regards debt levels, interest cover and gearing. The Board is determined to maintain this policy of prudent financial management.

OPERATIONAL PERFORMANCE

ESB power stations' availability in 2006 was 78% against a target of 82% due in particular to problems with outdated plant. Of the total ESB Power Generation portfolio of 4,651 megawatts some 1,300 megawatts is accounted for by old and inefficient power stations which ESB would close if free to operate on an exclusively commercial basis. However ESB

is required to continue to operate these stations on grounds of security of supply. The longer this requirement is imposed the greater the resulting financial and operational cost to ESB.

After year end ESB Power Generation received the final approvals to build a new 430 megawatt gas fired generating station at Aghada, in Co. Cork. This was a very welcome outcome which now allows ESB to plan for the replacement of old plant. However the restrictive conditions attached to those approvals mean that this investment, considered on a stand alone basis, will be of marginal economic benefit to the Company.

In the year under review ESB Networks completed 105,127 new connections – another record year. Also in 2006 the six year programme to refurbish and upgrade 63,000 kilometres of the medium voltage distribution network was completed on time and on budget at a total cost of €870 million. I want to acknowledge this major achievement. ESB Networks has now launched a new programme to refurbish the low voltage distribution network – that part of the system which delivers electricity directly to the customer.

Throughout the year ESB Customer Supply continued to improve its service to its almost two million customers and the Board has established a Market and Customer Committee to oversee these efforts. The full opening of the market has seen

many business and large customers move to other suppliers. However, ESB Customer Supply continues to be the main supplier for most of the domestic customers in the State.

GROWTH AND EXPANSION

Every company must pursue growth if it is to reward its owners, serve its customers and attract high calibre staff. It is for this reason that the Board has approved a strategy of addressing the obligatory decline in its home market by investing outside our traditional market, notably in power stations in Northern Ireland, Britain and Spain. In Northern Ireland the new power station owned by ESB International at Coolkeeragh experienced significant operational difficulties. Good progress has been made in resolving these but long term issues also need to be addressed in cooperation with the equipment manufacturer. The ESBI/Osaka Gas joint venture power plant at Amorebieta in Spain continues to operate extremely well. ESBI has also entered into a joint venture agreement with Scottish & Southern Energy plc to develop an 840 megawatt combined cycle facility at Marchwood near Southampton. These exciting investments should generate an increasing share in revenues and profits over the coming years.

BUSINESS CHALLENGES

In line with policy objectives, ESB's market share continued to decline in 2006 with ESB Power Generation and ESB Customer Supply having about 50% of their respective markets. This reduction in market share will continue with the commencement of the Single Electricity Market scheduled for November 2007 when ESB Power Generation's market share will fall to some 33%.

This major down-sizing brings with it significant risks and challenges for ESB which are compounded by the fact that, as part of the new regulatory model, ESB entered into long term electricity purchase contracts with independent generators. Without the benefit of these off-take contracts with ESB the independent new stations would not have got off the ground. These contracts have a combined value of 2.5 billion euro in today's money and represent a significant exposure for ESB for years to come.

As regards price increases, ESB has the task of communicating to electricity users that it is only one of a number of market players. It needs to be clearly understood that price increases are no longer exclusively or even mainly

driven by ESB. Prices are determined by the independent Regulator and are designed to attract and reward new entrants to the market. In fact, ESB is currently not permitted to sell electricity to its customers at a price below that fixed by the Regulator. The sooner this restriction is lifted the sooner the efficiencies and savings achieved in recent years by ESB as well as any reduction in fuel costs can be passed on to our customers.

The Single Electricity Market (SEM) will in 2007 create a single wholesale electricity market north and south. If properly structured the SEM should lead to a reduction in prices for the consumer.

At the time of writing, the Minister has launched the long awaited White Paper on Energy Policy which contains a range of exciting and welcome proposals for the energy sector. However certain proposals specific to ESB will present significant challenges, notably the proposal to reduce the Company's asset base by more than one billion euro through the transfer of the transmission network to the state company Eirgrid and the proposal radically to alter the business model for our Network's business by moving to lower rates of return and lower dividends for stockholders.

BOARD, STOCKHOLDERS AND STAFF

The terms of three worker board members – John McGinley (a board member since 1995), Pat Smith (a board member since 1999) and Eamonn Connolly (a board member since 2003) expired at the end of 2006. Each of these board members made his own individual and valued contribution. I welcome the four new worker board members John Nugent, Bobby Yeates, Tony Merriman and John Coleman. I would like to thank all my Board colleagues for their contribution during the year.

I would also like to thank the Minister for Finance and the Minister for Communications, Marine and Natural Resources and their respective officials, for their continued support and assistance during the year. My congratulations to the management and staff. They have achieved a great deal, delivering on very ambitious targets.



Tadhg O'Donoghue
Chairman

19 April 2007