

CHIEF EXECUTIVE'S REVIEW



Padraig McManus

Progressive large scale investment in the electricity industry, regulatory and market reform, climate change, decreasing our size domestically while expanding abroad, meeting the growing needs of our customers – all are factors that coincided to make 2006 a highly demanding year for ESB. I am pleased to say that the company comprehensively rose to the many challenges it faced and continued successfully to support Ireland's economic and social development.

The electricity industry requires long-term perspectives and investment horizons. It is only through strategic planning that ESB can fulfil its primary and fundamental duty to the public – to deliver power safely to our homes, factories, hospitals, schools, businesses. The company continued to do this through 2006, and for the first time in a single year connected over 100,000 new customers to the electricity networks.

As a company dealing with a potentially lethal product, ESB refrains from making any claims of record results in relation to safety. Instead we concentrate on maximising safety insofar as is humanly possible through the most stringent operational standards. I am, however, heartened to report that last year we reached the kind of objectives that can be the basis of ongoing achievement. 2006 was the first year in over seven decades that passed without a fatality to a member of the public, employee or contractor.

It was all the more remarkable, given that the company connected record numbers of customers to our networks.

We are committed to the relentless pursuit of the kind of safety standards that we know can make zero fatalities achievable.

ESB's ethos is underpinned primarily by a strong commitment to its customers – now numbering two million. Between 2001 and 2006 the company connected almost 500,000 new customers, an unprecedented surge of demand growth in modern times.

Providing our customers and the economy in which they live with a state-of-the-art, safe and reliable service requires large investment in the electricity infrastructure and 2006 saw the conclusion – on time and on budget – of the refurbishment of the medium voltage networks. This was, in effect, the successful implementation of Rural Electrification 2. Yet, despite the sheer scale of work and the multi-billion euro investment involved, the Networks Renewal Project was, in a sense, a silent and unremarked-upon feat.

Against this background Networks profits fell 27% year-on-year due to the negative impact of the five-year Networks Price Review. The Review saw the allowed return on Network assets reduced by over 13% to 5.63% and a 20% reduction in allowed operating costs.

If 2006 marked significant achievement, it was also a year that signalled the many challenges ahead. Climate change now tops the global political, social and economic agenda and ESB is determinedly pro-active in meeting all its obligations in this crucial area. Apart from being the largest "green" generator in Ireland, ESB implements internationally accredited environmental management systems at all its major power plants and the company complies fully with licences issued to it by the Environmental Protection Agency. I am determined that ESB will play an increasingly active role in progressing the renewable energy agenda through the appropriate level and mix of generation. The use of renewables provides benefits in terms of low or no carbon costs but, if this is to work, we must be prepared to debate logically the complex issues involved at generation and networks level. To do otherwise would be to fail to meet the ambitious targets set out by Government.

Meanwhile, in addressing future security of supply issues, ESB progressed plans for the development of a new gas fired power plant at Aghada, Co. Cork. It also reached agreement with the Regulator to close and divest certain other plant in order to attract other investors to the market.

Downsizing ESB's generation and supply businesses in the domestic market is being conducted in parallel to the continuous growth abroad of ESB International. The highly successful international wing is continuing to build a strong portfolio of plant in Spain and Britain.

In Ireland we continue to operate in a market where the rate of regulatory reform evolved through 2006 and ESB addressed and directly met issues of costs, organisation structure and price. Several welcome key decisions were taken by Government, notably in relation to the passage of legislation facilitating the single electricity market – due for implementation in November 2007 – and the promotion of further interconnection. I must, however, express concern that progress on completion of interconnection with the UK remains slow. This development is critical to support the growth of renewables on the system. During 2006 Government produced a Green Paper on Energy Policy which led to the recently published White Paper. This policy poses many challenges for ESB.

ESB views 2006 as another important year when our business objectives had to be reached in an increasingly challenging and difficult environment. But achieve them we did and continued to position ourselves so that we can justifiably look forward with vigour and confidence to the years ahead.

OPERATIONAL REVIEW

Capital expenditure from 2001 to 2005 was approximately €1,000 million per annum and a further €831 million was incurred in 2006. Of this, over €600 million was spent on maintaining and upgrading the Networks and €121 million was invested in Power Generation, primarily on the major environmental project at Moneypoint, Co Clare – a development that will reduce harmful emissions from the station by over 80%. A record number of new customers – 105,127 in total – were connected to ESB Networks compared to 496,000 for all of Britain.

The refurbishment and upgrading of 63,000 kilometres of medium voltage networks was successfully completed in 2006. The value of this investment was demonstrated in the resilience of the Networks during the winter storms. It will greatly enhance the reliability and robustness of our networks for decades to come and improve service to all electricity customers.

Power station availability was 78% against our target of 82%. While most of ESB's plant performed to best international standards, problems were experienced with older plant that would be retired, but for security of supply reasons. It was for this reason that during 2006 ESB sought and obtained approval for the construction of a new 430 MW combined cycle facility at Aghada, Co. Cork. Construction is due to begin later this year. This new plant, coupled with a programme of divesting/closing of older mid-merit plant, is an important step towards achieving our objective of becoming a smaller, more efficient and well diversified power generator. This will position ESB Power Generation to compete on equal terms with other generators who, by 2008, will account for more than 50% of the market.

ESB International's strategy of seeking growth opportunities abroad to compensate for reduced market share at home continued throughout 2006. To-date, generation plant has been commissioned in Northern Ireland (400 MW at Coolkeeragh) and Spain (800 MW at Amorebieta). During 2006 ESB International obtained all necessary consents and approvals for the construction of an 840 MW combined cycle facility at Marchwood near Southampton. This project will be developed on a joint venture basis by ESB International with Scottish & Southern Energy plc and construction is due to begin during 2007.

PRICE REVIEWS

The price of electricity to be paid by customers is determined by the Regulator. The end-user price is made up of generation, supply, Public Service Obligation (PSO) and networks (transmission/distribution) components. The generation and supply components are applicable to all generators and suppliers whereas the networks' and PSO components accrue primarily to ESB. In 2006 the average price of electricity increased by 4.1%. The increase was limited to this level by the fact that the underlying Networks charges payable to ESB actually fell by 11%.

Fuel prices eased on international markets in the second half of 2006. This had a positive impact on electricity prices as from 1 January 2007.

SINGLE ELECTRICITY MARKET

In December 2006 a Memorandum-of-Understanding was signed between the British and Irish governments for the establishment and operation of a Single Electricity Market ("SEM") north and south. The SEM provides for a single wholesale market for the sale of electricity by generators to suppliers on an all-island basis.

During 2006 ESB undertook a major investment in new business processes and systems in preparation for the SEM which is due to come into operation in November 2007. Statutory responsibility for security of supply rests with CER while the SEM will facilitate competition between all generators on equal terms.

EIRGRID PLC

As of 1 July 2006 Eirgrid plc, a separate State-owned company, took responsibility from ESB National Grid for the operation and maintenance of the electricity transmission system. Prior to that, these functions were performed on a ring-fenced basis by ESB National Grid. I want to acknowledge the contribution of all who brought the establishment of Eirgrid to a successful conclusion.

INTERCONNECTION

Following a 2006 Government decision, the Regulator initiated the design of a competition for the construction of an undersea electricity interconnector between Ireland and Britain. The interconnector will be owned by Eirgrid and is scheduled to become operational by 2012. A new north-south interconnector is also scheduled for completion by 2011-2012.

ESB welcomes these major and challenging interconnection projects as they will enhance competition and improve system stability to the benefit of all customers, including ESB customers.

SAFETY

ESB is unremittingly committed to safety. In 2006, for the first year since 1934 there was no fatal injury to a member of staff, to contractors or the public. Significant progress was also made in reducing to 55 the number of injuries to staff resulting in an absence from work of over one day (lost time). This represents a reduction of over 80% in the past 9 years.

An extensive safety leadership programme, fully supported by the Board and management, is in place throughout ESB to address key strategic safety issues. All senior managers undertake safety audits and reviews. These assist in demonstrating our commitment to safety to staff and contractors.

The Strategic Partnership with the Health and Safety Authority to improve electrical safety in the construction and agricultural sectors continues to make good progress.

ENVIRONMENT

Climate change presents one of the most significant challenges for the world today. In this context, a further 60 MW of renewable wind generation was commissioned in Ireland by ESB in 2006 bringing to 296 MW the total amount of renewable generation owned or contracted by ESB. This represents 29% of all renewable electricity generation in the State making ESB the largest generator of green electricity. We will continue to develop our renewable portfolio, including through international investments.



ESB is the National sponsor of Girls' and Women's hockey

ESB's emissions of carbon dioxide in Ireland reduced to 10.6 million tonnes (Mt) in 2006, down from 12.3 Mt in 2005. The reduction has resulted in ESB achieving its objective of limiting emissions to 11 Mt. ESB's specific emissions will fall further with the development of the new gas-fired plant at Aghada.

With the exception of two small emergency generation units, all ESB's thermal and hydro generating stations are now accredited to the ISO 14001 environmental management system standard. ESB has fully complied with the requirements of its Integrated Pollution Prevention and Control licenses issued by the Environmental Protection Agency. The €380 million environmental retrofit project at Moneypoint coal station will reduce its sulphur dioxide and oxides of nitrogen emissions by over 80%. The project is on schedule for completion in 2008.

ESB is reducing fuel consumption in our transport fleet through a policy of purchasing fuel-efficient vehicles, provision of video-conferencing facilities and encouraging staff to make use of public transport.

CORPORATE RESPONSIBILITY

Corporate responsibility permeates our organisation culture, our planning and operational controls and our response to our legal and regulatory obligations. It sustains us as a prime energy provider and underpins our relationship with our customers, our staff and government. It is demonstrated at a practical level by our safety and environmental programmes and through community based projects dealing with suicide prevention and care for the homeless.

ESB engages in an extensive sponsorship programme including sponsorship of the GAA Minor Hurling and Minor Football Championships, National sponsor of Girls' and Women's hockey, ESB BEO Celtic music festival, the U20 Rugby Six Nations home International series as well as supporting Irish International athletes through the Athletics Ireland development programme.

PEOPLE

I commend our staff who continue to meet the challenge of radical change in the industry. Just over 20 years ago, ESB had 13,500 staff in its core activities in Ireland. Today we have 6,700 in the core business and 1,100 in ESB International – notwithstanding the massive increase in activity levels brought about by our investment programme and dynamic growth in the economy. Few companies, whatever their ownership model, could change so much while delivering such performance improvements and infrastructure construction.

We owe this success to partnership and a shared understanding of the need for change. Through this joint approach with staff and unions we addressed our pension deficit in January 2006. We will continue to keep this situation under review in the knowledge that we can address the very real challenges that lie ahead.

In 2006, our esteemed colleague and friend, Tony Donnelly, retired as Deputy Chief Executive after a career of over 40 years of outstanding service to ESB. Another highly valued Director, Sean Wyse, was appointed Director of Elcom, the electricity complaints arbitrator.

Aidan O'Regan was appointed as the new Deputy Chief Executive and Brid Horan became Executive Director, Customer Supply and Group Services.

LOOKING TO THE FUTURE

ESB celebrates its 80th birthday in 2007. Since its foundation ESB has been a fundamental pillar in the development of the Irish economy and ESB staff and management remain committed to this goal, regardless of the scale of the business challenges.

ESB continues to be a strong and viable company and we look forward to competing in the new all-island electricity market. We anticipate further changes with the arrival of new players and the construction of new interconnection and closer integration of the markets in Ireland, the UK and France.

ESB International will continue to grow strongly, making up for the inevitable loss in domestic market share.

The challenge for ESB is to continue to provide a world class service for all its customers while adapting to the new market realities and meeting its environmental and corporate responsibilities.

Our embedded knowledge, our experience, our heritage of interaction with our public and our commitment to public service will make all of the above a reality.



Padraig McManus

Chief Executive

19 April 2007