

Financial Review



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	2008 €m	2007 €m	Change €m	Change %
Revenue and other operating income	3,515	3,514	1	-
Operating profit	340	523	(183)	(35%)
Profit after tax	273	432	(159)	(37%)
Capital expenditure	1,094	903	191	21%
Net debt	(2,088)	(1,797)	(291)	16%
EBIT interest cover (times)	3.5	5.0	(1.5)	(30%)
Gearing	42.4%	39.5%	2.9%	7%
Return on Capital Employed (ROCE)	6.6%	10.0%	(3.4%)	(34%)

Overview

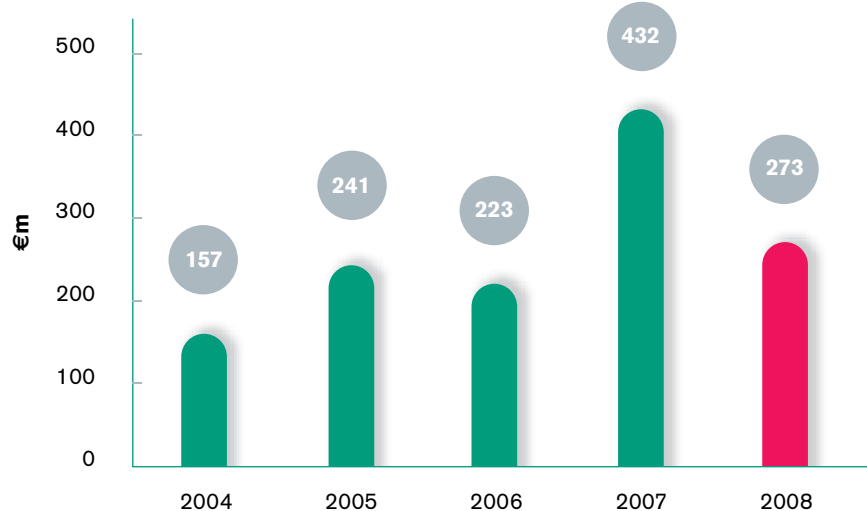
Group results for 2008 are strong with revenue and profit after tax at €3.5 billion and €273 million respectively. The unregulated businesses in particular contributed to the strong outturn, accounting for a substantial proportion of profits. The results for the year are stated after providing a €300 million rebate to mitigate the need for significant tariff increases for all electricity customers. The substantial capital programme continued during the year, with an investment of €1.1 billion of which €630 million was spent in the Networks business. Net debt at €2.1 billion increased by close to €300 million on 2007 with gearing and EBIT interest cover at 42% and 3.5 times respectively. Return on Capital Employed at 6.6% is lower than 2007 but reflects the impact of the €300 million contribution.

Revenue

Year on year comparisons of revenue are distorted by the introduction of the Single Electricity Market (SEM) in late 2007, which has resulted in changes in the way electricity sales and purchases are classified in the financial statements. The effect of the new market on year on year comparatives, reduced both revenue and energy costs by €250 million.

Within the context of the above, revenue including other operating income was €3.5 billion for the year, which was consistent with 2007, with overall market growth in the SEM and higher electricity tariffs being offset by SEM distortions referred to above and lower property disposals.

Profit After Tax



Operating Costs

Operating costs of €3.2 billion increased by €184 million on 2007, of which €143 million related to fuel costs. Fuel costs per GWh increased by 30% on 2007.

Operating Profit

Operating profit for 2008 was €340 million (2007: €523 million) resulting in a decrease of €183 million on 2007, reflecting the impact of the €300 million customer rebate.

Joint Ventures

2008 was another good year for joint venture investments generating profits of €63 million for the Group (2007: €47 million). Increased production from the Synergen plant in particular contributed to the improved outturn.

Taxation

The Group tax charge for 2008 was €31 million (2007: €48 million) and represents an effective tax rate of 12.7% (2007: 11.2%) when the share of joint venture profits is excluded.

Profit after Tax

Profit after tax at €273 million (2007: €432 million) reflects the impact of the €300 million contribution to electricity customers and strong results from the unregulated activities including an increased return from joint venture investments.

Business Unit Performance

Group profit after tax of €273 million arises in Power Generation €199 million, Networks €49 million and the unregulated businesses €99 million, offset by losses of €74 million within the Supply business.

- ★ Power Generation's profits declined by €33 million over 2007 mainly due to lower energy margins, reduced market share and Power Generation's share of the €300 million customer rebate in 2008.
- ★ Networks' profits declined by €90 million compared to 2007 and reflects Networks' share of the €300 million customer rebate and higher interest costs offset by the net impact of Network tariff increases in 2008.
- ★ Supply's profits fell by €87 million over 2007 and was primarily driven by a regulatory under recovery in 2008 as a result of significant fuel price increases during the year.
- ★ Profits from the unregulated businesses increased by €51 million over 2007 reflecting the improved outturn from the independent generation plants offset by reduced property disposals in 2008.

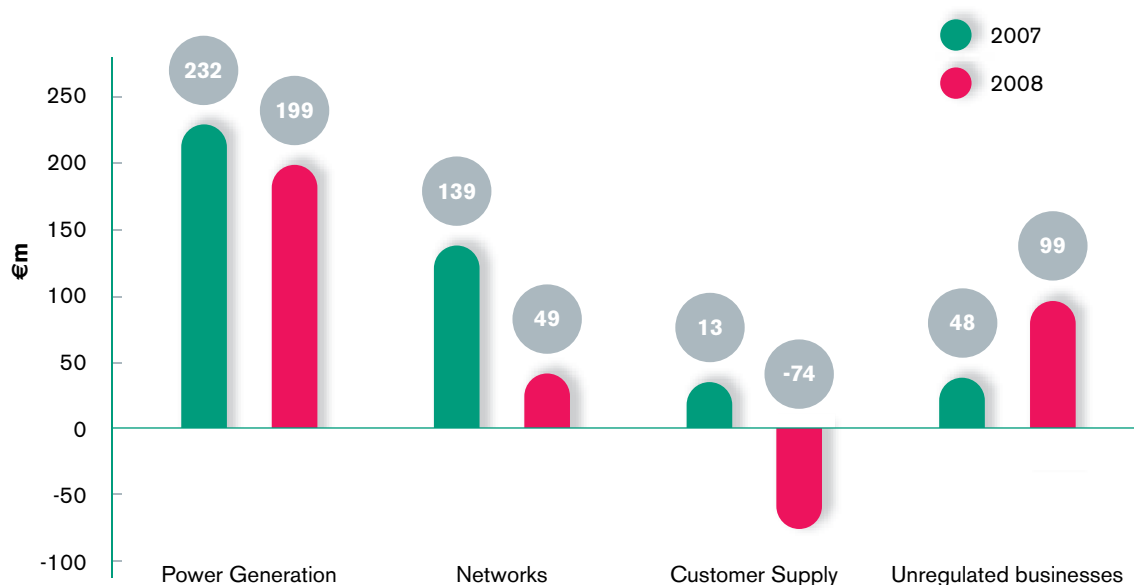
Capital Expenditure

€1.1 billion was invested directly by the Group in capital programmes in 2008. A further €124 million was incurred by the Group's joint venture undertakings. €630 million was spent on the Distribution and Transmission Infrastructure bringing the total investment in this area to over €3 billion over the past five years. €263 million was invested by Power Generation and mainly related to:

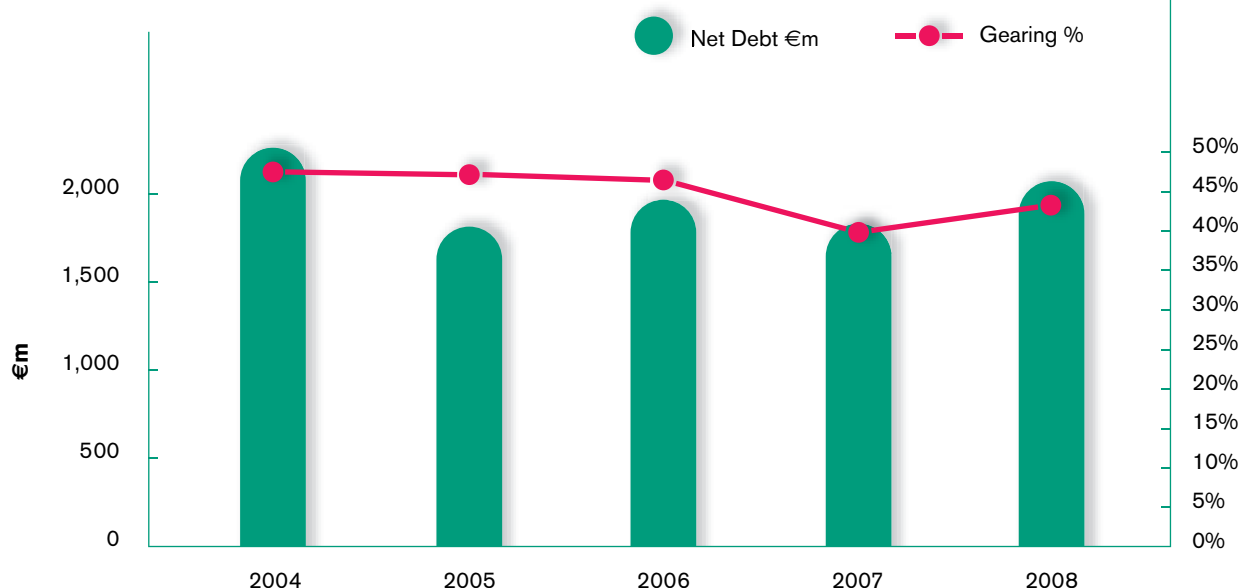
- ★ the progression of the construction of the new 430 MW Combined Cycle Gas Turbine (CCGT) plant in Aghada, Co. Cork; and
- ★ the Environmental Retrofit Project in Moneypoint, Co. Clare which will significantly reduce the sulphur dioxide (SO_x) and nitrogen oxide (NO_x) emissions from the station over the next ten years.

€180 million was invested by ESB International during 2008 including €102 million on renewable investments and €62 million on the 860 MW Carrington, Greater Manchester, CCGT project.

Business Unit Performance (Profit after tax)



Net Debt and Gearing



Net Debt and Gearing

Net debt (borrowings of €2.2 billion less cash of €83 million) was €2.1 billion at the year end (2007: €1.8 billion). Funds generated from operations during the year were €872 million while funding requirements for the 2008 capital programme, interest, dividend payments and other funding requirements were €1.1 billion. The revaluation of debt at year end foreign exchange rates as required under IAS 21, further increased the debt balance by €33 million. Gearing was 42% at year end and 61% of the debt portfolio was at fixed interest rates. The average coupon rate was 5%.

Employee Benefits

For financial reporting under EU IFRS, the full liability and pension costs have been considered in determining the appropriate liabilities to be recorded in the financial statements, notwithstanding that the scheme is not a typical balance of cost defined benefit scheme wherein the employer is liable to pay the balance of contributions required to fund the benefits.

In compliance with EU IFRS, a portion of the net assets and liabilities of ESB's defined pension scheme, computed in accordance with IAS 19 have been included in the Balance Sheet under employee related liabilities. In accounting for the pension deficit ESB has availed of the option to defer the unrecognised portion of the pension deficit over the future service lives of employees. At the end of 2008 the pension deficit calculated in accordance with IAS 19 was €2.6 billion, an increase of €1.2 billion on 2007. This primarily reflects the impact of the economic downturn on the fund's asset valuation.

Regulation

Since the introduction of the SEM in November 2007, the wholesale price of electricity is market driven, with virtually all electricity generated sold into a market pool overseen jointly by the Commission for Energy Regulation (CER) and the Northern Ireland Utility Regulator. ESB Power Generation participates in the electricity market on a basis similar to all other generators. In support of the development of the SEM ESB Power Generation sold 13 TWh of Contracts for Differences, eight of which were directed by the CER. This offered fixed price power to other market participants.

Annual electricity tariffs are set in advance of the relevant year by the CER, based on a forecast of both customer demand and relevant costs. As with any forecast, there is almost invariably a difference with the actual outturn for the year which results 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 setting the price determinations for subsequent years. In addition, specific costs reflected in the Income Statement may be recovered in the tariff in different or over a number of accounting periods. Such timing differences can cause material variations in the annual profits earned by the individual regulated businesses and cause distortions in reviewing the year on year performance of ESB's regulated businesses. Timing differences have resulted in a reduction in the year on year outturn of the Supply business of €85 million. This is driven by an insufficient tariff rate in 2008 to recover significant increases in fuel costs that arose in the earlier part of the year.

Financial Risk Management

Framework for Treasury and Trading Operations

The main financial risks faced by the Group relate to foreign exchange, interest rates, commodity (electricity and fuel) price movements, counterparty credit and operational risk.

Group Treasury is responsible for the day to day treasury activities of the Group. The Board Finance Committee is updated on an ongoing basis on key treasury matters and an annual report covering the treasury activity is also submitted to the Committee for review.

Commodity price and counterparty credit risks are managed by the relevant business unit (Power Generation, Customer Supply and ESB) in the context of an overall Group trading risk management framework. These efforts are co-ordinated by Group Trading Risk Management, which works to ensure that the Group's market, credit and operational risks are managed in a way to protect the company from loss, while respecting the ring-fencing obligations in place between the business units. Treasury and trading risk management activities are reviewed regularly by Group Internal Audit.

Derivative instruments are used to mitigate financial risks and are executed in compliance with the Specification of the Minister for Finance issued under the aegis of the "Financial Transactions of Certain Companies and Other Bodies Act 1992". During 2008, the Group did not hold or trade derivative instruments for speculative purposes. Hedge accounting pursuant to IAS 39 is used primarily for hedges of foreign currency liabilities and interest rate risks from non-current liabilities. It also covers commodity and foreign exchange hedges arising from the SEM.

Foreign Exchange and Interest Rate Risk Management

The majority of the Group's business is transacted in Ireland or within Europe. Operating and investing cash flows are mainly denominated in euro. Foreign currency exposures arise from purchasing fuel and other materials or services, foreign currency denominated debt and from business that is carried on outside the eurozone.

The majority of fuel related currency exposures are managed using currency derivatives such as forward purchase contracts. Other material foreign currency exposures are hedged as appropriate. The Group's policy is to borrow directly in euro or to convert any foreign currency borrowing to euro through the use of derivative instruments. There are specific instances where foreign currency denominated debt is matched by a foreign currency denominated asset or net revenue flow. At the end of 2008, 95% of ESB's debt was effectively denominated in euro. It is also the Group's policy to have a minimum of 50% of the debt portfolio at fixed rates of interest, subject to cost and market outlook.

Funding and Liquidity Management

The Group's debt management strategy targets a debt portfolio profile with a diverse mix of counterparties, funding sources and maturities. Structured non-recourse and limited recourse financing is used where appropriate, taking into account the compatibility between funding costs and risk mitigation. All borrowing facilities are in compliance with the Electricity Acts and relevant regulatory requirements and Group Treasury maintains diversity in ESB's lender base in order to achieve a strategic spread of risk.

ESB has adequate undrawn committed borrowing facilities in place to ensure that liquidity demands can be met as required. At year end, the Group had over €600 million of undrawn committed facilities, the first of which does not mature until 2012. In addition, the Group holds cash balances in the form of short-term bank deposits, sufficient to meet any immediate cash requirements.

The Group continues to monitor markets where opportunities exist to access longer term funding facilities which complement the Group's investment strategy and resultant borrowing requirements.

Counterparty Credit Risk

The Group is exposed to credit risk from the counterparties with whom it holds its bank accounts and transacts within financial and commodity markets. The Group's policy is to limit exposure to counterparties based on assessments of credit risk. Exposures and related limits are subject to ongoing review and monitoring. Dealing activities are controlled by putting in place dealing mandates with counterparties.

Summary and Future Outlook

The Group delivered a strong financial performance during 2008 with all key financial indicators within acceptable parameters. Looking forward, key financial priorities for the Group will include:

- ★ Continuing to successfully deliver the significant capital expenditure programmes while funding this growth, both internally and externally, maintaining strong financial indicators and a healthy balance sheet;
- ★ Continuing with performance improvement programmes to deliver sustained growth in Shareholder Value;
- ★ Management of the trading risk arising from the SEM and related markets while continuing with effective fuel procurement strategies to mitigate the volatility in market prices;
- ★ Successfully operating the regulated businesses within the agreed regulatory framework; and
- ★ Continued focus on credit risk management.