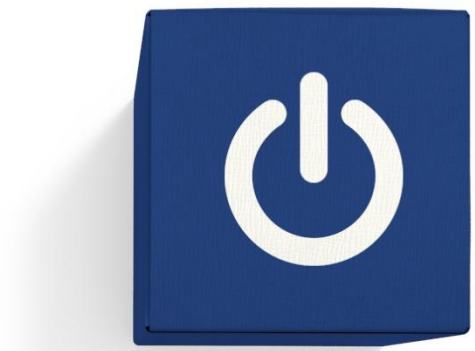
PR6 - Financeability

Commission for Regulation of Utilities

26 June 2025



FINAL REPORT

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Contents

1. INTRODUCTION

One of several factors that the Commission for Regulation of Utilities (CRU) must give regard to when carrying out its statutory functions under the Electricity Regulation Act 1999 (ERA) is to give regard to the need to secure that licence holders, including the electricity network companies in Price Review 6 (PR6), are capable of financing the activities which they are licensed to undertake.

Financeability refers to the ability of a company to raise finance readily, when needed, and on reasonable terms. There are multiple facets to financeability, including that the regulated company can earn a return in line with the risks faced by investors.

A financeability assessment in a price review typically comes after the establishment of the underpinning revenue blocks in the proposed price control, as relevant cashflows are determined by the regulator. The regulatory framework encompasses decisions about the appropriate Weighted Average Cost of Capital (WACC), and depreciation methodology, plus operating expenditure (opex) and capital expenditure (capex) cost allowances, incentives and any adjustments. Once all of the revenue blocks are in place, even if all of these blocks have been appropriately calibrated, the electricity network companies could face a mismatch in the timing of their cash flows, or face other issues, that could preclude their ability to raise finance effectively and efficiently.

As part of CEPA's role as economic advisor to the CRU for PR6, the CRU has asked us to undertake an initial financeability assessment of the proposals for the forthcoming PR6 draft determination. This report summarises our analysis and the conclusions that we have drawn.

1.1. SCOPE AND APPROACH TO THE ASSESSMENT

We have assessed financeability across the four electricity network price controls the CRU will set for PR6, namely the DSO and TAO (ESB Networks) and TSO and 'offshore asset owner (OAO)' (EirGrid) price controls[1]. We have assessed the financeability of the price control proposals both on an independent basis and on a combined TAO and DSO basis, the latter for which we consider may be most appropriate for assessing financeability of the ESB Networks price controls and business.

We consider that a price control financeability assessment is effective as a consistency check and "jumping-off point" to diagnose potential issues in the PR6 price control proposals and investigate what might be causing them – helping answer questions such as:

- Do the licensee's key financial metrics provide sufficient headroom to facilitate the financing of the company's investment programme?
- Are key financial metrics expected to deteriorate in PR6? and
- What policy levers, if any, should the regulator pull to increase headroom or mitigate any such deterioration?"

Addressing these questions will help the CRU meet its statutory "financeability" duties.

Our approach is, therefore, to treat the financeability assessment as a tool to inform the various parameters and decisions in PR6 price controls as opposed to a mechanistic and deterministic framework of analysis where, for example, particular financial metric thresholds must always be met. We consider this holistic approach is consistent with how credit rating agencies (CRAs) and investors in practice approach financeability.

We consider financeability from the perspective of:

[1] The financeability assessment for the OAO is captured separately to this report, but a brief summary is provided in this report.

- Debt finance – how licensees are projected to perform on cash flow and debt capacity metrics.
- Equity finance – how licensees are projected to perform on returns to shareholders and whether the price control package appears "investible" in the round.

From an equity finance perspective, we consider whether the package, viewed in the round, builds a strong investment case for the company and its shareholders, and builds confidence and momentum in the PR6 investment plans. We have considered the following factors in our assessment:

- the level of notional equity requirement and returns;
- the calibration of the PR6 performance incentive framework;
- the approach to the management of revenue variation in period[2]; and
- the expected headroom over and above debt service obligations to manage delivery risk.

From a debt perspective, we have followed standard regulatory practice in Ireland and the UK to assume that the electricity network companies in PR6 will need to maintain an investment grade credit rating and that the PR6 price controls therefore need to be consistent with each of the licensees being able to secure an investment grade credit rating. This assumption is consistent with the electricity network companies being able to access debt markets during periods of disruption and at a low cost of finance.

We adopt the following principles in our debt financeability analysis:

- We test for financeability on the basis that the licensee would, on a standalone basis, be able to maintain a as a minimum a comfortable credit rating of at least Baa2/BBB (under ideally higher) under the price control base case (however, we note the CRU has stated that it does not target a particular credit rating level). We also expect the licensee to remain investment grade (i.e., a minimum of Baa3/BBB-) under credible stress test scenarios.
- We assess financeability for the notional benchmark entity at the assumed level of notional gearing for the notional regulated company.
- We consider qualitative as well as quantitative factors in our analysis, consistent with how CRAs themselves assess the credit risk of energy network utilities.
- Consistent with the approach UK regulators, including Ofgem and Ofwat, have adopted to assess financeability in recent price reviews, as well reviewing key credit metrics and ratios, we provide a 'simulated' credit rating based on Moody's published scorecard methodology[3]. This helps to illustrate how the qualitative factors the CRAs take into consideration in their rating assessment, alongside quantitative factors, can influence a holistic and in the round assessment of financeability. This simulated credit rating should, however, be viewed as indicative rather than definitive.

We use Moody's methodology as it is the most transparent of the CRAs, although we have considered other agencies' guidance in our assessment (e.g., S&Ps and Fitch). We note that the CRAs can apply thresholds for certain quantified credit ratios in their rating assessments. Consistent with the approach that the CRU has taken in prior price reviews, while we have considered and give reference to these thresholds in our analysis, we have not based our assessment on a single metric, or a particular threshold that the CRAs themselves may apply.

As described above, consistent with the CRU's approach to assessing financeability in prior price reviews, our approach is to take an in-the-round assessment of financeability to avoid the risk that variations in individual credit

[2] Under the proposed Agile Investment and Monitoring Framework (AIMF) for PR6.

[3] See Moody's (2022): 'Regulatory Electric and Gas Networks – Rating Methodology', available here.

metrics lead to modelled credit ratings, and conclusions on price control financeability, becoming highly sensitive to small variations in an individual metric.

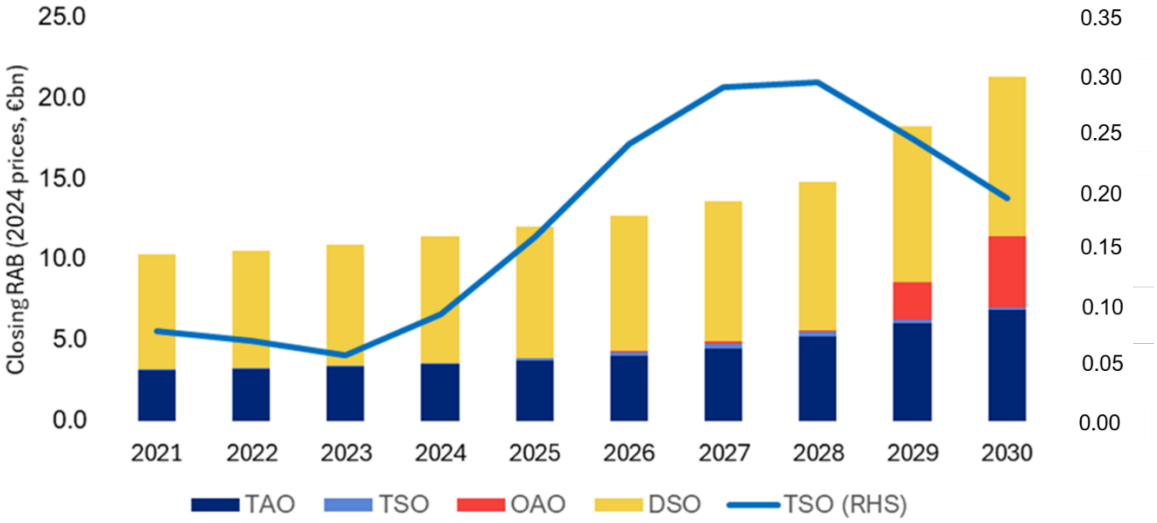
1.2. CONTEXT TO PR6

PR6 is a crucial milestone for the electricity sector in Ireland. The investment plans it will support will play a critical role in helping to facilitate the Government's current policies and plans to transition to a net zero economy and support growth and housing development in Ireland.

To facilitate these objectives, the business plans that each of the electricity network licensees have submitted, and the proposed opex and capex allowances for PR6 in the CRU's draft determinations, involve a substantial step change in investment to transform the electricity system.

The Regulatory Asset Base (RAB) for EirGrid TSO and ESBN is forecast (in 2024 prices) to stand respectively at €160m and €11.9bn at the end of PR5 and based on the company's business plans and CRU's draft proposals for PR6, both companies RAB's are expected to experience significant real growth over PR6. In EirGrid's case, it will also invest in a new offshore RAB related to Phase 1 and Phase 2 of Ireland's offshore wind programme.

Figure 1.1: Forecast real RAB growth from PR5 – PR6



Source: CEPA analysis

To deliver this investment programme, both ESB Networks and EirGrid will need to access significant amounts of new debt and equity capital. This implies that the companies will require substantial equity injections. Our approach for assessing the financeability of PR6 price controls is based on a notional entity and capital structure.

There are also significant execution and performance risks both network companies will need to manage in delivering this step change in investment; including uncertainty regarding the precise scope and the timing of future investment requirements in both onshore and offshore electricity networks. This is one of the reasons why the CRU has proposed an Agile Investment and Monitoring Framework (AIMF) in PR6. In addition to the scale of capital that needs to be raised, the need for this new investment comes at a time when the sector is also under a high degree of external scrutiny.

ESB Networks has highlighted the following pressures on financeability looking into PR6:

- An expanded delivery programme (as illustrated by the expected real RAB growth above) coupled with a more complex regulatory and higher risk economic environment in PR6.
- Step-changes in long lead time ordering with advance procurement obligations, accelerated financial commitments and higher working capital requirements to fund increased stock holdings.

- Uncertainty of size of investment programmes and timing of cashflows related to the flexing of allowed revenues under the PR6 regulatory framework.

EirGrid faces many similar challenges in its role as the TSO including in the establishment and development of its new offshore activities and functions, as discussed in our separate offshore WACC report.[4]

All these factors in the round mean that the financeability assessment of the CRU's price controls at PR6 is more important than ever at the time of the price review.

The issues and challenges, however, are not unique to Ireland. A recent Moody's report on regulated energy networks in Europe[5] states how it has changed its outlook for the sector to negative as large investments for the energy transition weigh on key credit metrics for many energy network utilities. Moody's note how well-established and transparent regulation will continue to support credit quality, but that regulators will also face the challenge of facilitating investment while maintaining affordability with the risk that under existing regulatory frameworks, key credit metrics will deteriorate absent regulatory action or significant equity injections.

Moody's highlight that an important structural factor placing pressure on financeability is that regulatory frameworks allow network companies to recover investment costs over a long period – often 30-50 years – on the basis that the benefits of the investment are spread over the technical / economic asset lives of the asset being in use.

Whilst the expected increase in energy utilities' asset bases from investment will over time increase allowed returns and operating cashflow, Moody's comments that the significant increase in forecast capex – in particular, by electricity transmission companies – will dominate the boost to companies' operating cash flow from these larger asset bases and, in turn, are expected to increase leverage and weaken cashflow based credit metrics. Commenting on the sector in general – as opposed to Ireland specifically – Moody's states:

"*We estimate that, on average, network companies can maintain key credit metrics with annual capex of up to 10% of regulatory asset base (RAB). After that, net equity injections, which may include hybrid issuance, are required to maintain credit quality. Our key credit metrics include leverage, as measured by net to RAB and FFO/net debt, and coverage, as measured by FFO interest cover and adjusted interest coverage.*"[6]

Moody's also states that "[w]*e could change our* [sector] *outlook to stable if we expect key credit metrics to remain broadly flat, absent material equity injections. This is likely to require a scaling back of investment or regulatory decisions that support expected spending, particularly by facilitating equity investment and bolstering key credit metrics through investment peaks.*"[7] Moody's highlights how assumptions of the asset lives that are used by regulators to determine the speed of investment cost recovery from consumers, the basis of cash returns (e.g., nominal vs. real) and the level of allowed equity returns in electricity network companies' price controls, will - over a prolonged period of time – all influence the size of the required net equity injections into energy networks and their financial headroom to manage risk.

Whilst these are only the views of one CRA, they provide useful context of the key inherent challenges and issues that the PR6 financeability assessment would be expected to explore. In particular:

- the credit metrics CRAs and investors are likely to focus on;
- the level of headroom that might be expected to manage the step up in investment and the inherent risks in the delivery of the PR6 programme;

[4] CEPA (2025): 'Offshore Cost of Capital'

[5] Moody's (2025): 'Regulated Electric & Gas Networks – Europe'

[6] Ibid., p.4.

[7] Ibid., p. 1

- the levers within the regulatory framework that are likely to improve headroom and strengthen financeability of the price controls; and
- the trade-offs that exist between decisions the CRU might take as part of PR6 to boost financeability, the level of net equity injections that might be required across the electricity network licensees and level of consumer energy bills.

1.3. REPORT STRUCTURE

The rest of this report is structured as follows:

- Section 2 sets out our preliminary financeability assessment of ESB Networks' price controls in PR6.
- Section 3 sets out our financeability assessment of EirGrid's price controls in PR6.

2. ESB NETWORKS

In this section, we discuss the results from our assessment of financeability for ESBN's DSO and TAO price controls. We first discuss debt financeability, followed by equity finance and investment issues.

Overall, we conclude the proposed PR6 DSO and TAO price controls are financeable. However, there are pressures on financeability, in particular in the TAO price control. With the significant step up in forecast investment, the CRU may wish to consider if levers to improve operating cash flow – such as acceleration of investment cost recovery – might be considered for PR6, particularly as the financial modelling assumes the licensee will have sufficient equity to maintain the notional level of gearing of 55% over PR6.

2.1. DEBT FINANCEABILITY

Our debt financeability assessment considers both qualitative and quantitative factors.

For quantitative metrics on debt, the key question is whether credit ratios for cashflows and debt capacity are expected to be consistent with an investment grade rating (see discussion in section 1.1). To illustrate how qualitative factors that the CRAs consider in their rating assessment might influence debt financeability, we also provide a simulated credit rating score using Moody's published scorecard methodology for Regulated Electric and Gas Networks, which also accommodates key credit ratios.

We present results using the draft determination PR6 baselines in which outturn values are in line with the assumptions proposed by the CRU to set the price control. We use 55% notional gearing, consistent with the CRU's draft determination position. We use other cost of capital estimates and cost allowances from the draft decision.

We also assess an envelope / 'high case' scenario where a further step up in capex and opex is facilitated through the PR6 AIMF aligned with the approach that Ofgem took to assess the financeability of its RIIO-2 electricity transmission and distribution price controls (where both a 'base' and 'high' case were considered prior to any stress testing).[8] We will also run the modelling for the final PR6 decision with updated values following consultation[9]. Given the status of this high case being an envelope of spend that the CRU accepts (and approves) may be required to achieve the objectives of PR6, both baseline and high cases are central to our assessment.

We use the baseline and high case assessments to indicate whether the proposed price control package in the PR6 draft determinations is capable of being financeable. We then assess financeability under 'stress tests' that are designed to indicate the level of "headroom" that may be available to the licensees within the price determination. The stress tests should not be considered to represent 'likely' outcomes for the price control, more so testing the implications of weaker performance in individual parts of the price control.

We have used four stress tests in our analysis, alongside our baseline and high cases:

- 100bps underperformance on the overall cost of debt.
- 10% overspend on opex (borne by the licensee, i.e. 100% sharing rate).
- 10% overspend on capex (borne by the licensee during the price control).
- Underperformance on incentives (modelled as -100bps on Return on Regulated Equity (RoRE) for ESBN and an annual €10m penalty for the TSO – see Section 3).

[8] See Ofgem (2022): 'RIIO-ED2 Final Determinations Finance Annex'

[9] We note that in the factual accuracy check, ESB Networks has flagged an issue with the TAO revenue model (notably that the current model does not capture TSO network spend that flows through to the TAO). We have not updated our papers at this time, but will update all of our analysis ahead of the final PR6 decision. Our indicative analysis indicates that this would not change any overall conclusions on financeability.

The stress tests assume levels of performance that have not been observed in CRU price controls, and so these stress tests should be considered relatively extreme downside scenarios to test financial headroom:

- In contrast to regulated utilities in the UK, the ex-post review and cost recovery framework for electricity network utilities in Ireland means that the electricity licensees in PR6 are arguably less exposed to scenarios where material overspends will ultimately be borne by the regulated company.
- Further, the flexibility of the proposed AIMF in PR6 arguably further mitigates the risk of ESB Networks overspending allowances in the forthcoming price control period, with the expected outcome being full cost recovery because of the flexibility of the regulatory framework.

That does not, however, mean that there could be cost recovery and cashflow timing issues which need to be managed within the regulated company's finances. Of course, we also recognise that the regulatory framework does not guarantee full cost recovery given that recovery of outturn (incurred) costs are subject to an ex-post review by the CRU.

2.1.1. Financeability thresholds

We consider a range of credit ratios and target metrics from Moody's in our assessment, based on its published rating methodology for energy network businesses. We note that ratios from other rating agencies are applicable, for example, ESB Networks refer to the 9-13% FFO / Net Debt assumption used by S&P for a BBB credit rating. We focus on Moody's as the ratios and how it is brought together is most transparent.

Table 2.1: Target credit ratings for thresholds

	Moody's	
Metric	A rated	Baa rated
FFO + Interest / Interest	4.0-5.5	2.8-4.0
FFO / Net Debt	18-26%	11-18%
Adjusted Interest Cover Ratio (AICR)	2.0-3.5	1.4-2.0
Retained Cashflow (RCF) / Net Debt	14-21%	7-14%

Source: CEPA analysis of rating agency guidance

We stress that all individual metrics need not exceed the thresholds in each or every year of PR6 for a licensee to necessarily be deemed financeable from an overall debt perspective – this is generally consistent with the approach taken by the rating agencies and by other regulators.

Our modelling is also based on ESB Networks' current dividend policy – namely paying out 40% of Profits After Tax (PAT) as dividends – and an assumption that notional gearing remains constant at 55% over the price control. We note that adapting the level of dividend payout and gearing of the regulated entity are, in principle, levers that could be used to address financeability pressures if they are identified. In effect, that debt financeability pressures can be addressed by further equity injection or dividend retention.

2.1.2. Results for DSO and TAO separately

The tables below present results on three key credit ratios and the results from our simulated credit rating assessment for the baseline case, high / envelope case and the four stress tests applied to the baseline (see Appendix A for the same stress tests applied to the high case scenario). We also show the forecast Compound Annual Growth Rate (CAGR) of the RAB over the period of PR6 (i.e., 2026- 2030).

Our simulated rating uses a Moody's scorecard - namely the Regulated Electricity and Gas Networks methodology (2022)[10]. We note that this requires assumptions for qualitative factors. We have adopted the scores used for the

[10] For the first quantitative factor, we use the Adjusted Interest Cover Ratio (AICR).

last available ESB credit ratings assessment, noting that this applies to the full ESB business (not just networks) and it could change in future. The rating is for illustrative purposes only.

The table below shows the modelling results for the DSO.

Table 2.2: Debt financeability results for the DSO

	Base	High case	+100bps CoD	+10% opex	+10% capex	-100bps incentives
AICR	1.82	1.82	1.45	1.58	1.38	1.62
FFO/Net Debt	13.6%	13.3%	12.7%	12.7%	12.0%	12.9%
FFO/Interest Cover	4.8	4.8	3.8	4.6	4.4	4.7
Simulated rating	A3	A3	A3	A3	A3	A3
RAB 5-year CAGR	3.7%	6.5%				

Source: CEPA analysis

The DSO's simulated scorecard rating is comfortably investment grade, with AICR and FFO/net debt staying within the Baa thresholds under all stress test scenarios and the high scenario.

The table below shows the modelling results for the TAO.

Table 2.3: Debt financeability results for the TAO

	Baseline	High case	+100bps CoD	+10% opex	+10% capex	-100bps incentives
AICR	1.84	1.84	1.47	1.77	1.75	1.65
FFO/Net Debt	7.7%	7.4%	6.9%	7.4%	7.4%	7.0%
FFO/Interest Cover	3.3	3.2	2.6	3.2	3.2	3.1
Simulated rating	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1
RAB 5-year CAGR	13.0%	17.7%				

Source: CEPA analysis

The TAO's financeability is weaker (relatively) compared to the DSO. This reflects the large capex programme relative to the existing TAO RAB (average TAO capex to RAB of 0.14x over PR6 vs 0.10x for the DSO) and the pressures that this places on the TAO's cashflows. The cost structure of the TAO is materially different to the DSO too (average TAO opex to capex of 0.12x over PR6 vs 0.57x for the DSO) and while FFO/net debt ratio is generally stable compared to prior price reviews, there is some deterioration compared to the baseline level that was reported at PR5 Final Determinations (7.9%). The simulated rating is still two notches above the minimum level for investment grade (Baa3) despite a weaker FFO/net ratio, reflecting the credit strength of the assumption that the regulated company operates under a well-established and transparent regulatory framework.

2.1.3. Results for ESBN price controls combined

The table below presents results for three key credit ratios and the results from our simulated credit rating assessment for the baseline case, high case and four stress tests applied to the baseline case when the forecast cashflows are combined for the TAO and DSO.

Overall, we consider the debt financeability of the combined price controls is consistent with investment grade under both baseline and high / envelope cases, with the preliminary simulated scorecard rating several notches above minimum investment grade credit rating on a standalone basis. The FFO / Net Debt ratio remains above 11% in the baseline and high case scenarios but falls below 11% in the stress test scenarios.

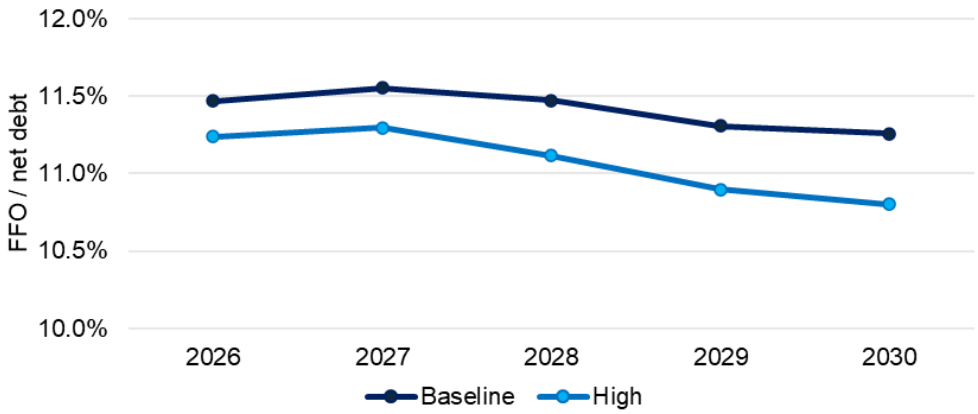
Table 2.4: Debt financeability results for ESBN combined

	Baseline	High case	+100bps CoD	+10% opex	+10% capex	-100bps incentives
AICR	1.83	1.83	1.46	1.64	1.51	1.63
FFO/Net Debt	11.4%	11.1%	10.6%	10.8%	10.3%	10.7%
FFO/Interest Cover	4.3	4.2	3.4	4.1	4.0	4.1
Simulated rating	A3	A3	A3	A3	Baa1	A3
RAB 5-year CAGR	6.9%	10.5%				

Source: CEPA analysis

Figure 2.1 below illustrates the profile of the FFO / net debt ratio (on a combined basis) over the 5-year price control, in both the baseline and high cases.

Figure 2.1: FFO / net debt



Source: CEPA analysis

While there is some decline over time, the ratio remains relatively stable because the financial modelling assumes that the licensee's level of RAB gearing remains constant at 55%. Figure 2.1 shows that in the baseline, the FFO / Net Ratio remains above 11% but in the high case it falls below 11% towards the end of PR6, although on average it is above 11% across PR6.

2.1.4. Conclusions

Our assessment is the notional regulated company is debt financeable at investment grade, despite some relative tightness in specific metrics in the individual price controls (notably FFO/net debt for the TAO).

The more limited headroom for the TAO relative to the DSO reflects inherent differences between the network businesses, with a higher ratio of capex-to-opex and capex-to-RAB reducing financial headroom in the TAO's case. This was also the case in PR5 and is not a new issue for PR6, although the TAO ratios have tightened somewhat relative to PR5. The stress test scenarios also indicate that the regulated business has headroom to manage shocks / stress scenarios which in practice may be mitigated by the regulatory framework. Overall, we do not consider weakness in one metric, and in one price control, to be a substantial cause for concern given the methodologies of the CRAs and factors that would be viewed as supportive to the regulated company. Given the scale of the capital programme, some tightening of the ratios might be expected in the TAO's case.

Nevertheless, we are mindful that the CRU's financial model in effect assumes that a material level of equity injection is available, as the notional licensee's gearing is held constant at 55% for the duration of PR6. This

mitigates against a deterioration of key credit metrics in the modelling. The conclusions on the debt financeability – absent of other mitigating actions – are therefore premised on this equity injection.[11]

Moody's recent commentary and outlook for European energy networks highlights that in order for many European energy networks to maintain credit rating requirements at current rating levels (typically Baa1 or Baa2 on a standalone basis) new equity injections are likely to be required once annual capex exceeds 10% of the RAB. The financial trends observed in our modelling of the notional licensee in PR6 are, therefore, aligned with the trends expected for other regulated electricity network companies in Europe.

Moody's also note in their commentary that decisions by European national regulatory authorities (NRAs) like the CRU on price control allowed returns and regulatory asset lives (which affect the speed of investment cost recovery) may affect the level of the threshold before equity injections are required, as well as the level of headroom that is available to manage risk.[12] The price control package as a whole, and the strength of investment case it creates, may impact willingness for investors to provide this equity.

As a result, the strength of PR6 being an investible package for the regulated company and its shareholders is equally important to whether the price controls can ultimately be viewed as financeable.

In the subsection which follows, we consider a range of issues that are relevant to whether PR6 might be viewed as investible, including the strength of the overall package to support confidence and momentum to manage the financial challenges that ESB Networks face going into the period of PR6. We also explore what might be the levers that the CRU could consider if it wished to strengthen financeability.

2.2. Is the PR6 package investible and supportive of the PR6 objectives?

Equity requirements in PR6

The RAB framework provides comfort that money used to finance investment will be returned to investors over time, with an associated return to compensate for the time value of money and risk of the investment. For a single capex project, the cost of the project is seen as a cashflow out today, with revenue recovered over the useful life of the asset. This creates a negative cashflow impact today, but a positive impact in future years.

The ESB Networks business will be investing in a portfolio of capital projects overtime and across any price control period. There will be new projects where finance is required for investment, and existing finance associated with previous investment and projects to be recovered with a return. Periods with a higher value of new projects (new capex) relative to existing projects (prior investment) will be more cashflow negative (and vice-versa).

PR6 involves a period of high investment for the ESB Networks business. This increases the potential for needing new finance for the business. ESB Networks in their Business Plan submission refer to an 'equity gap' requirement in their analysis as the proportion of new financing that is required after funding of cash outflows from revenues and debt issuance. This can be estimated on a 'gross' or 'net' basis – the higher gross requirement assumes ESB Networks maintains its existing dividend policy[13], the lower net figure deducts expected dividends.

Assessed on this basis, factors that will increase the size of the estimated (gross) equity requirement are the level of capex, interest expense and assumptions of dividend payout.[14] Factors that will reduce the size of the estimated equity requirement are the return on the RAB, return of the RAB (depreciation) and the level of debt issuance,

[11] We note that the CRU's model assumes a dividend payout ratio of 40%, as with previous price reviews. Retention of a greater proportion of earnings would be more supportive of delivering a large investment programme, but we have not modelled this when testing debt financeability.

[12] As they determine the level of free cash flow generated from a given RAB.

[13] As noted above, this is based on paying out 40% of Profits After Tax (PAT) as dividends.

[14] Tax and opex are cash outflows but are expected to have matching cash inflows in the CRU's financial model.

which the CRU's financial model assumes is held constant at 55% of the RAB. In practice it may be that the share of debt and equity used to finance new investment differs from the assumed notional gearing level.

As an indication of the equity that might be required in PR6, we have sought to replicate ESB Networks analysis using the draft determination baseline and high case / envelope cases, as summarised in Table 2.5 below.

This indicates that a c. €1.4bn equity requirement (gross) in the baseline and €2.7bn requirement (gross) in the high case / envelope scenario. This is higher than base requirement indicated when we use ESB Networks input assumptions (€1.1bn gross[15]) in part because ESB Networks assume shorter regulatory asset lives and a higher allowed rate of return in the modelling. The comparisons are also not like for like because of the differences in assumed levels of investment (our modelling assumes a lower DSO baseline, but a higher TAO baseline).

Table 2.5: Modelling of equity requirement (gap) under various scenarios

€bn, nominal	ESBN BP inputs (base)	Baseline case	High case
Cash inflows	**14.8**	**13.0**	**15.6**
Revenues	11.1	9.5	10.3
Debt issuance	3.7	3.5	5.3
Cash outflows	**15.4**	**13.9**	**17.8**
Capex	9.9	9.1	12.5
Interest	1.6	1.5	1.6
Tax	0.2	0.2	0.2
Opex	3.7	3.1	3.5
Net gap	(0.6)	(0.9)	(2.2)
Dividends	(0.5)	(0.5)	(0.5)
Gross gap	(1.1)	(1.4)	(2.7)

Source: CEPA analysis of CRU model

This analysis indicates that substantial equity investment is being assumed in the debt financeability analysis when based on a constant 55% level of notional gearing. As a result, the strength of the investment case for this financing is crucial to the overall financeability of the PR6 package.

In the subsections which follow we explore the following questions that, in our view, are particularly relevant to the strength of this investment case in PR6:

- Does the PR6 proposal give strong regulatory commitment and foresight of the allowed revenue to build confidence and momentum in investment plans? Are equity financing assumptions reasonable?
- Is the base level of return (the Allowed Cost of Equity) reasonable?
- Is the calibration of the regime reasonable and based on stretching but achievable targets?
- Is the risk exposure reasonable? Is there sufficient "headroom" to manage risk?

We also discuss:

- Levers within the regulatory framework that would increase allowed revenues in the period – either via bringing forward revenues or increasing current revenues with no impact on the future – and would reduce the size of the equity requirement (gap) in PR6.

[15] ESB indicate a gross gap of €1.0bn in their November 2024 submission, noting a slight difference in model construction.

- These levers would increase consumer bills in PR6, which highlights how the CRU has to balance considerations of affordability, financeability and deliverability in ultimately calibrating the PR6 price controls.

We discuss each of these issues in turn.

Commitment and foresight of the allowed revenue and the reasonableness of equity financing assumptions

As we understand will be discussed in the CRU's regulatory framework and supporting draft determination papers, the regulatory framework in PR6 is underpinned by the following key principles:

- Significant ex-ante baseline allowances (a c. 79% increase compared to PR5 on a combined TAO and DSO basis[16]) in tandem with flexible access to additional funding as requested through the AIMF.
- Proposal that ex-ante allowances are divided into two high level categories: baseline allowances and envelope/high case allowances.
- As well as the baseline allowances, CRU will approve envelope/high case allowances – funding that may be needed to deliver on network need and accessible via variations to revenues under the AIMF.

Aspects of this regulatory framework are to be developed with ESB Networks prior to PR6's Final Determinations, and representations to the findings of the CRU's draft determination may result in further expenditure allowances being added into the baselines by the CRU's Final Determination. However, overall, we consider this proposal gives strong regulatory commitment and foresight of the allowed revenue that ESB Networks will have available to build its investment, supply chain and financing plans around.

The financial modelling also does not weaken the assumptions that ESB Networks has itself proposed in its plan regarding equity financing, specifically the assumption of 55% notional gearing and dividend yield targets consistent with its group policy. This is despite the substantial investment growth period that will be experienced in PR6 which might have led these assumptions to at least be revisited.

Level of return

The key determinant of the company's ability to access equity finance is the allowed return on equity.

As discussed in our cost of capital report, we have built our proposed allowance for equity returns by considering the level of returns that investors are likely to be able to achieve from other equity investments and by positioning the return offered by ESB Network logically against these alternative investments. We have benchmarked the returns against listed comparators and other regulatory determinations in our cost of capital report. The proposed point estimate for the draft determination 'aims up' in the range being based on the 67th percentile.

Accordingly, we are satisfied that ESB Networks should be capable of securing equity finance on an ongoing basis throughout the next five years.

We note that there are two elements of the allowed rate of return (allowed WACC) where there remains differences between our conclusions or approach and ESB Networks; namely, (i) the size of the inflation differential adjustment (Ireland vs. Eurozone/Germany) required within the allowed rate of return, and (ii) the approach to reflecting the weight of embedded and new debt when calculating an 'all in' cost of debt for the notional licensee. These factors might be viewed as indicating that the allowed return in aggregate is too low.

As we discuss in our cost of capital report, we have increased the bottom-end of our range for the inflation adjustment to reflect feedback from ESB Networks and its advisors, but consider the evidence on the appropriate size of adjustment is more mixed than ESB Networks indicates in their submissions, given ESB predominantly relies on historical evidence as a proxy for the *expected* differential in PR6. We will review the evidence base again ahead

[16] On a controllable opex and gross capex basis, including Frontier Shift.

of finalising our WACC recommendation to the CRU at Final Determinations, but note that our proposal for the adjustment (a 30bps uplift to the WACC) is aligned with the original proposal that EirGrid and its advisors made on the appropriate size of adjustment, which is based on historic and forecast evidence.

Our estimate of the cost of debt assumes a range for the weight of new debt (25%-40%) while ESB Networks proposes a 'RAB weighted' methodology for calculating the proportions of embedded and new debt. We are comfortable with our proposal and methodology for draft determinations[17], and that it gives appropriate weight to the mix of embedded and new debt costs that could be faced by the notional licensee. We will review this assumption again for Final Determinations once the balance of baseline and envelope/high case capex requirements are finalised, alongside an update to the data cut of date which informs the cost of debt estimate.

Overall, we are satisfied that the proposed level of return is sufficient to attract and reflect the cost of debt and equity finance, and is a fair reflection of the expected opportunity cost of capital in PR6 based on current known information and financial market data.

Calibration of the regulatory framework and risk exposure

Return on Regulatory Equity (RoRE) analysis is one way to consider potential returns during a price control and the risks that the licensee faces. It is a standard tool of analysis used in UK network utility regulation.

RoRE measures the returns that regulated companies have/will earn by reference to notional regulatory equity (so in ESB Networks case, 45% of the RAB at 55% notional gearing). A RoRE forecast can be built up ex ante based on the expected returns facilitated by the regulatory framework. This brings together cost risk, incentives/outcomes risk, and interest cost risk, with the aim of identifying factors such asymmetry or imbalance in the framework.

The extant ex post cost recovery framework in PR5 which is proposed to be retained in PR6 (alongside the proposed AIMF) should in principle provide mitigations against escalating costs and the risk that these are not recovered by the licensee. This contrasts with regulatory frameworks in some other contexts where allowances are generally fixed ex ante and incentive / cost sharing mechanisms require the regulated company to bear (or retain) a proportion of any variation in outturn cost compared to the ex-ante allowances (e.g., 50%).[18]

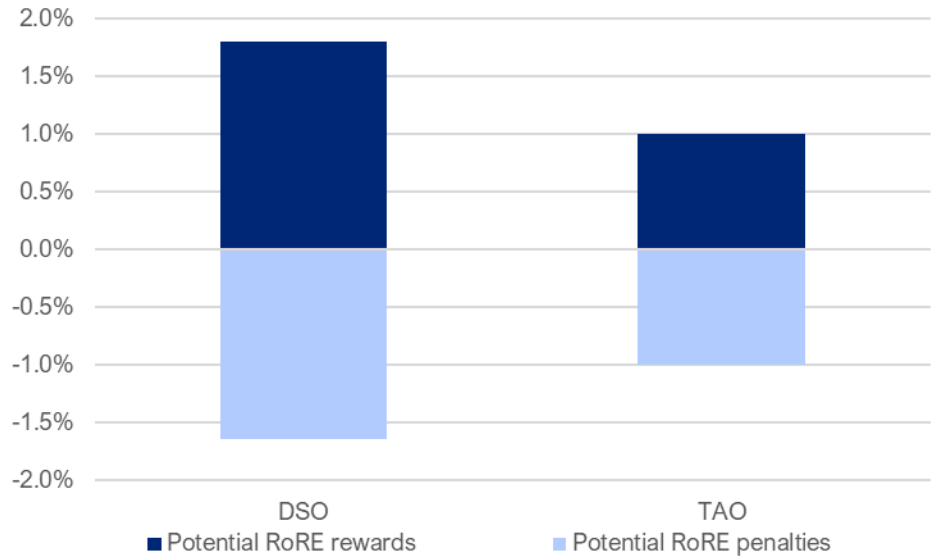
Overall, while there is still work required to "codify" the PR6 regulatory framework, we consider the framework supportive and a mitigation against cost recovery risk from an equity investor perspective.

The performance incentive framework has evolved from PR5 with a similar level of RoRE risk proposed for PR6, as illustrated for the DSO and TAO price controls below.

[17] Although we see some attractions to the 'RAB weighted' approach that ESB Networks has proposed, we also consider it has several inherent limitations, as discussed in our cost of capital report.

[18] The approach to cost recovery / economic regulation for the electricity licensees in PR6 is, as a result, closer to rate of return regulation.

Figure 2.2: PR6 RoRE range projected – DSO and TAO



Source: CEPA analysis

The proposed RoRE at risk over PR6 is less than +/-2% for the DSO and TAO networks in PR6 and the regime has been calibrated to be broadly symmetric. We note that whether in practice the expected outcome is symmetric will depend on the approach to incentive design and how stretching the CRU's targets are.

We understand that key components of the performance incentive package – in particular, the unplanned outages incentive in the DSO price control – remain open for discussion and debate. The package of incentives will need to be carefully calibrated to ensure that in the round the performance regime is considering stretching for a well performing company[19], but also balanced in the expected outcomes in the round.[20]

As this stage, we have no reason to conclude that the PR6 package will not ultimately achieve these objectives; the proposed targets for the unplanned outage incentive are likely to be critical to this, and will need to be carefully considered by the CRU alongside its final decisions on the allowed expenditure in PR6 to ensure that the regime is seeking stretching but achievable performance improvement.

Finally, an unmitigated equity risk for the licensee relates to interest rate variation compared to the fixed cost of debt allowance in the CRU's allowed rate of return. The previous subsection showed how a reasonable level of headroom is maintained even in a relatively unlikely scenario where *all* of the notional licensee's debt costs are assumed to exceed the allowance by 100 basis points.[21] Nevertheless, we consider the assumptions that are made around the allowed cost of debt, and the scope for interest rates to increase during PR6, is an issue that will need to be considered carefully as part of the PR6 Final Determination. However, this should be done alongside an update to the market data that underpins the cost of debt allowance given the size of ESB Networks investment programme and the volatility in European debt markets in the last 6-months.

Overall, we consider that the level of risk associated with the PR6 package in its current form should be acceptable to investors. But there are elements of the package, in calibrating the final PR6 determination, that will need to be carefully reviewed, particularly as regards performance incentive targets and cost of debt allowance.

[19] Taking into account the unique circumstances of the business and network in Ireland.

[20] This is sometimes referred to as the 'fair bet' test in economic regulation.

[21] Albeit FFO / Net Debt falls below 11% in the combined licensee case although is still above 10%.

Is headroom sufficient to accommodate and manage risk?

As we discussed in the previous subsection, we consider there is adequate headroom within the modelled cashflows for us to conclude that the package is debt financeable at investment grade level.

Nevertheless, as discussed in the introduction, ESB Networks faces several challenges in managing an expanded and complex investment and delivery programme in PR6, with various external risks that may impact the scope and the cost of the programme. There is also some inherent tightening of headroom, in particular in the TAO price control, as a result of the size of the capital programme that is expected to be required in PR6.

We do not consider the level of headroom ultimately prohibitive to achieving the objectives of PR6. However, these factors in the round might suggest there is a case for the CRU to consider if there are levers that could help support the licensee's operating cashflow further given the scale of equity requirement, the inherent execution and performance risks associated with delivery of the PR6 programme, and some of the other 'headwinds' which ESB Networks has highlighted in its submissions on financeability issues.

We discuss potential levers below.

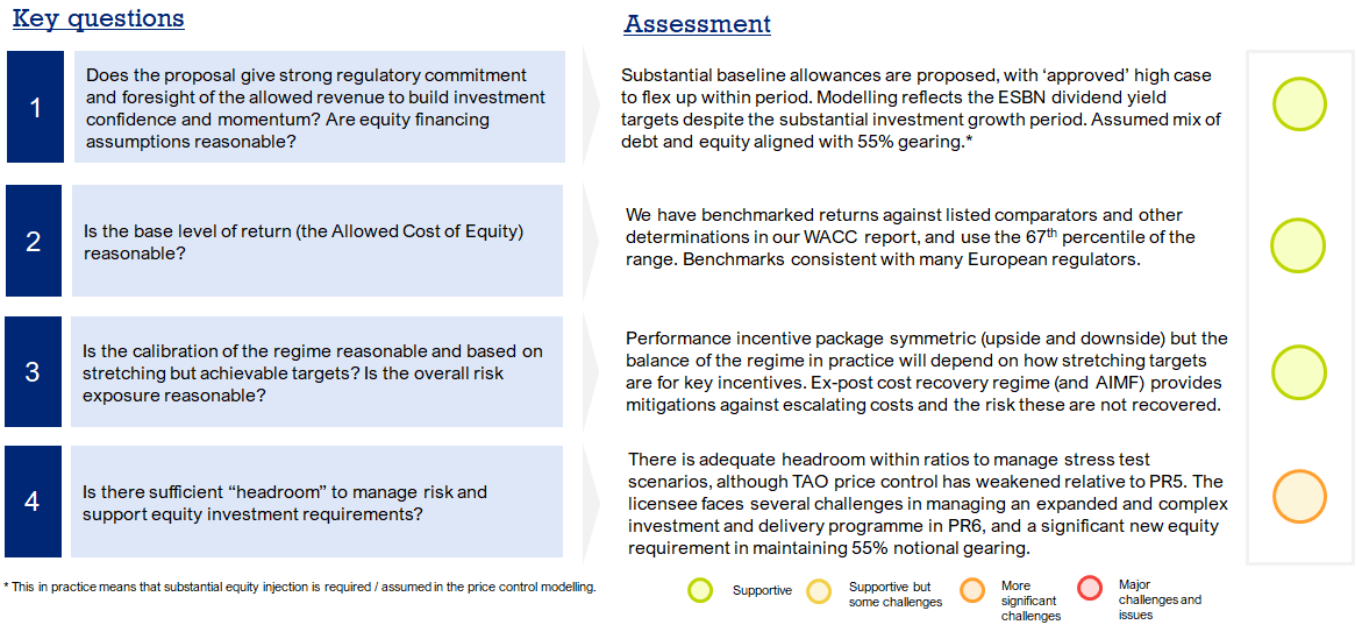
Conclusions

Our assessment is summarised in the figure below.

We consider the level of return and risk exposure support the conclusion that the equity package is investible in the round. The allowed return has been benchmarked against other determinations and risk exposure through incentives remains constrained and calibrated in principle to be symmetric and balanced in outcomes.

ESB Networks faces several challenges in managing an expanded and complex investment programme. The largest challenge to financeability is likely to be the quantum of new equity finance required to support the notional licensee's PR6 investment programme at 55% gearing. Under the 'high case' / envelope case, the estimated equity gap is three times higher than the baseline i.e. needing an additional €1,600m from the notional company's shareholder relative to the business plan. In a context where such significant new investment is required – and a set of wider execution and delivery risks for the regulated company to manage – there may be a case for the CRU at least considering levers that might help to strengthen cashflow and the package in the round.

Figure 2.3: Assessment of the strength of investment case of the PR6 regulatory package



Source: CEPA analysis

One option would be to increase the allowed equity rate of return.

However, as discussed above we have benchmarked the returns against listed comparators and other regulatory determinations in our cost of capital report. The proposed point estimate for the draft determination 'aims up' in the range being based on the 67th percentile.

Another option – which would help in practice to reduce the scale of equity inflows required to finance the scale of investment programme and would provide greater headroom within key credit ratios such as FFO / Net Debt – would be to review the asset lives that underpin the CRU's depreciation policy in PR6. ESB Networks has made this request in its business plan submission, and has proposed that asset lives for network capex for the DSO be reduced from 45yrs to 42yrs, and for the TAO from 50yrs to 45yrs from the start of PR6.

In the table below, we present the key ratios under ESB Networks' proposal ('ESBN Proposed Asset Lives') compared to the baseline modelling above, which retains the same assumptions from PR5 ('Existing Asset Lives').

Table 2.6: Credit metrics with changing asset lives [22]

	DSO		TAO	
	Existing Asset Lives	ESBN proposed asset lives	Existing Asset Lives	ESBN proposed asset lives
AICR	1.82	1.82	1.84	1.84
FFO/Net Debt	13.6%	14.5%	7.7%	8.6%
FFO/Interest Cover	4.8	5.1	3.3	3.5
Simulated rating	A3	A3	Baa1	Baa1
RAB 5-year CAGR	3.7%	3.3%	13.0%	12.6%

Source: CEPA analysis

The ratios improve for FFO / Net Debt and the FFO / Interest Cover ratio as more cashflows are provided through depreciation. Of course, this comes at an additional cost for the consumer in the next few years, as the shift in the asset lives accelerates (brings forward) cost recovery relative to the current regulatory policy.[23]

We consider regulatory depreciation policy should be primarily underpinned by asset live assumptions that are justified from an economic and technical point of view rather than by financial issues and requirements. [24] However, we note that some other regulators as well as basing their regulatory depreciation policies on technical assessments of asset lives, also consider other criterion in their decision making, including financeability, intertemporal fairness[25] and affordability.[26]

From this perspective, there is a judgement at PR6 of the appropriate balance to strike between affordability and intertemporal fairness considerations on the one hand, and creating as supportive a financial package as possible on the other hand, to enable ESB Networks to build confidence and momentum in delivering its investment plan and managing the execution and financing challenges of its investment programme.

A reduction in asset lives at PR6 would provide a means to strengthen ESB Networks cashflow but (all else equal) will increase bills in the short term for Irish consumers.

[22] Modelling is based on the PR6 draft determination baseline scenarios.

[23] Greater depreciation reduces the size of the RAB compared to the counterfactual, hence the lower RAB CAGR observed.

[24] Given that there are in principle other levers to manage financeability.

[25] Intertemporal fairness relates to whether the cost of investment is being fairly spread across each generation of customers in a way that reflects how investment is expected to provide services to customers.

[26] See for example, Ofwat (2025): 'PR24 Final Methodology – Appendix 10: Aligning risk and return'

2.3. Conclusion

Overall, our preliminary assessment is that the proposed PR6 package is capable of being financeable at investment grade level for the DSO and TAO and on a combined basis.

The largest challenge to financeability is likely to be the quantum of new equity finance required to support the PR6 investment programme and there being sufficient headroom and flexibility to manage the inherent risk and uncertainty in the delivery and execution of the scale of programme required in PR6.

We consider the overall investment case for PR6 supportive, but there may be levers, such as changes to depreciation policy (asset lives) that could be used by the CRU to strengthen the investment case and the management of the financing and delivery challenges PR6 poses for the licensee.

3. EIRGRID

In this section, we discuss the results from our assessment of financeability for EirGrid's TSO price controls. Our approach has similarities to the ESB Network financeability, but reflects the different characteristics of the onshore TSO business and EirGrid's expanding offshore role as offshore asset owner (OAO).

Overall, we conclude the proposed PR6 TSO price control is financeable. The level of returns being proposed are likely lower than during PR5 (relative to the cost base), but we consider that the overall returns are sufficient to compensate for the risks faced by the EirGrid business.

When looking at the financeability of the TSO, for PR5 we used the financeability assessment more as a tool to inform CRU's decisions on parameters in the framework as opposed to setting absolute thresholds of remuneration levels that the company must meet. The debt metrics are met comfortably under the PR5 decision and PR6 proposals, although the reasonableness of returns to equity are more subjective.

We provide a brief summary of the expected trends in key financial metrics for EirGrid's offshore price control in forming an early perspective on whether the EirGrid TSO licensee's price controls – in the round – should be viewed as financeable.[27] Overall, the medium term trend of key credit ratios for the offshore business seem consistent with investment grade and as a result, we consider the TSO licensee is financeable overall.

3.1. CHANGE TO TSO FINANCIAL FRAMEWORK

For PR6, the CRU also commissioned CEPA to undertake a review of the financial framework applying to the TSO[28]. We have taken a two-pronged approach to this review.

First, we reviewed the appropriateness of the current financial regulatory framework that drives the overall level of remuneration (return) for the TSO in PR5, and whether this approach should be retained by the CRU in PR6. Second, we have explored what alternative approaches might be considered for PR6. As part of this review, we have explored three different financial framework structures, and reviewed the appropriateness from a theoretical and incentives point of view, as well as assessing the impact on profitability and financeability of each option. This review has resulted in a proposed option for PR6 draft determinations.

Under the PR5 approach, a large portion of the TSO's returns were driven from "pass-through" activities i.e. from the margin applied on revenues that the TSO collects on behalf of others in the industry. CEPA's proposed framework for PR6 reduces the size of the margin applying to external pass-through items, and instead introduces a new margin – a return on internal opex, to drive returns from more of the TSO's core internal activities.

This proposal – and the resulting level of remuneration that it produces – has formed the basis of the financeability assessment that is set out in the subsections below.

3.2. DEBT FINANCEABILITY

Moody's applied a different scorecard methodology (Regulated Electric and Gas Utilities[29]) for rating the Electricity System Operator (ESO) in Great Britain than the European regulated energy network scorecard methodology that we have used to assess ESB Networks price controls. As a result, we have used this energy utilities scorecard methodology as the basis for our analysis of the TSO in PR6.

[27] Noting that a more detailed assessment of offshore financeability is set out separately to this report as part of the CRU's offshore price control draft determination paper.

[28] CEPA (2025): 'Review of the financial regulatory framework of the TSO for PR6'

[29] Note that this is a different rating guidance to ESB Networks.

How more qualitative factors of the business operating environment would be treated in the rating assessment is less clear for the TSO given the unique characteristics of the TSO. As a result, we do not seek to assume how issues such as the regulatory framework would be treated in the rating assessment, and we do not provide a simulated rating assessment. Instead, we focus on quantitative factors.

For the quantitative metrics on debt, the key question is whether the key metrics for cashflows and debt capacity used in the rating assessment are expected to be consistent with an investment grade rating and the credit rating levels the CRU assumes to estimate the cost of debt (A/BBB).

Consistent with ESB Networks, we present results for the TSO using a baseline case in which outturn values are in line with the assumptions proposed by the CRU to set the price control. This baseline case assessment would indicate whether the proposed price control package set by the CRU is capable of being financed. We use 55% notional gearing in our modelling for the TSO price control, consistent with the CRU's draft determination position. We use other cost of capital estimates and cost allowances from the draft decision.

We then assess financeability under 'stress tests' that are designed to indicate the level of "headroom" that may be available to the licensee within the price determination. The stress tests should not be considered to represent 'likely' outcomes of the price control, more so testing the implications of weaker performance in individual parts of the price control.

We consider that the most relevant credit ratios are those used at PR5 for the TSO, namely:

- (CFO pre-Working Capital (WC) + Interest) / Interest.
- CFO pre-WC / Debt.
- (CFO pre-WC - Dividends) / Debt (3-year average).

Finally, a debt financeability assessment concerns a company's expected performance on cash flow and debt capacity metrics. In considering a credit rating assessment for an asset light company, while the standard quantitative factors considered in credit rating assessments are important, weight must be placed on the availability of capital to provide sufficient liquidity for the company to operate given the activities it is responsible for. As a result, we also consider the adequacy of the liquidity available to the company to manage the various operating and 'cash collection agent' activities that the TSO performs as licensee.

The results of our analysis are presented in the subsections which follow.

3.2.1. Financeability thresholds

We consider a range of credit ratios and target metrics from Moody's in our assessment, based on their rating methodology for energy utilities, which is consistent with the rating methodology that Moody's itself has applied in rating assessments of the ESO in Great Britain.

Table 3.1: Target credit ratings for thresholds

	Moody's	
Metric	A rated	Baa rated
(CFO pre-WC + Interest) / Interest.	4.5-6.0	3.0-4.5
CFO pre-WC / Debt.	19-27%	11-19%
(CFO pre-WC - Dividends) / Debt (3-year average).	15-23%	7-15%

Source: CEPA analysis of rating agency guidance

As we discussed in the previous section, we stress that the all metrics need not exceed the individual thresholds in each or every year of PR6 for a licensee to necessarily be deemed financeable from an overall debt perspective – this is generally consistent with the approach taken by the rating agencies and by other regulators.

Our modelling is also based on the same dividend policy as applied for ESB Networks – namely paying out 40% of Profits After Tax (PAT) as dividends – and an assumption that notional gearing remains constant at 55% over the price control[30]. We note that adapting the level of dividend payout and gearing of the regulated entity are, in principle, levers that could be used to address financeability pressures if they are identified.

3.2.2. Credit ratios for the TSO

The table below shows the results from the PR6 financial model for the baseline, high case and the stress test scenarios applied to the baseline. The quantitative metrics overall are aligned with the TSO's rating being comfortably investment grade with the pre-working capital ratios materially above A thresholds, leaving material headroom in all of these ratios. This remains the case under all stress tests and our high case scenario.

Table 3.2: Debt financeability ratios for the TSO

Average PR6 pre-WC financing ratios	Baseline	High case	+100bps CoD	+10% opex	+10% capex	€10m incentive penalty
(CFO pre-WC + Interest) / Interest.	20.2	19.7	15.8	17.4	18.6	18.5
CFO pre-WC / Debt.	63.8%	62.0%	63.0%	54.8%	59.0%	58.4%
(CFO pre-WC - Dividends) / Debt	61.3%	59.9%	60.5%	52.3%	56.5%	55.9%
RAB 5-year CAGR	3.7%	10.1%				

Source: CEPA analysis

3.2.3. Liquidity

As we discuss in our separate report on the financial regulatory framework for the TSO[31], the large quantum of pass-through costs and revenues the TSO handles as purchaser of (e.g., system) services and collection agent for TUoS charges create a need for significant liquidity. The levels of charges and recoveries associated with external activities are both non-controllable by EirGrid and large in relation to EirGrid's own internal costs. While EirGrid may bear limited or no underlying risk on these cashflows,[32] liquidity is required to manage large and moving balances arising from when payments are made, and revenues are received. The internal and external costs associated with transmission planning / development activities that EirGrid undertakes, also need to be financed.[33]

[30] In practice, EirGrid's dividend payout is based on a fixed annual payout, rather than the variable approach set out here.

[31] CEPA (2025): 'Review of the financial regulatory framework of the TSO for PR6'

[32] As we discuss in our report, EirGrid and its advisors have tended to describe EirGrid's collection agent activities and the remuneration it receives for these activities as revenue collection 'risk' as opposed to primarily a liquidity challenge that have to be managed by sufficient credit lines to manage the company's (potentially large) swings in liquidity requirements.

For example, KPMG in its PR6 cost of capital report for EirGrid note that as a result of performing TSO's collection agent activities, EirGrid "*bears the following risks: (1) Reputational / fiduciary responsibility risk: The expectation of zero errors may be comprised by operational failures or cyber-attacks, potentially leading to reputational damage and financial loss if legislation is breached. (2) Income variation risk and cost variation risk: The receipts and payments may vary from forecasts in scale and timing. Any shortfalls must be financed by the onshore TSO, with the frequency, scale, and duration of shortfall being unpredictable and uncapped."* KPMG (2024): 'Cost of Capital estimation for EirGrid's onshore activities at PR6'

The distinction between what is ultimately a working capital requirement (a timing 'risk'), and a true underlying risk of cost recovery is important to the level of remuneration that EirGrid might ultimately expect to receive from these roles.

[33] In many ways these can be seen to be equivalent to a company investing in stock – once these projects are transferred to the TAO, revenues are received.

When EirGrid is owed by different parts of the industry, that is, where its debtor balances are greater than its creditor balances, it is essentially tying up its working capital (which has an opportunity cost, even if it is ultimately not at risk). Although, not fixed assets, these still comprise investments that the business is making. To fund these activities, the TSO has the option of either increasing the level of capital employed in the business – that is equity and long term debt - to provide the required liquidity, or it can instead make varying degrees of use of a shorter term working capital facilities, which are agreements to access debt facilities, which can be drawn down and used by EirGrid to make payments, which are then paid back once revenues have been recovered.

At both the regulated entity and group levels, EirGrid has in practice large retained earnings, reflected in high cash balances. It also has access to large externally provided Working Capital Facilities (WCFs). It is not clear the extent to which EirGrid uses its own cash balances, as opposed to the WCFs, to manage the activities reflected in its Regulatory Accounts (RAs). As we discussed in our report on the TSO financial framework, cash balances in the businesses covered by the RAs do, however, appear to be higher than those for the group as a whole.

We consider from a debt financeability perspective, EirGrid's access to sufficient liquidity, and the regulatory framework being sufficiently supportive of the recovery of the costs of this liquidity, to be a critical element to whether external lenders and CRAs would view the TSO as financeable.

Based on the current regulatory framework and the proposals we have put forward for PR6 – see our separate TSO financial framework report – we consider these conditions are met under the PR6 proposals:

- EirGrid has access to large WCFs the costs of which are fully underwritten (on a pass-through basis) by the consumer under the extant regulatory framework and in our proposals for PR6.
- While we understand that the size and volatility in EirGrid's liquidity requirements are increasing in PR6 (e.g., as a result of FASS) the regulatory framework can underwrite larger WCFs if needed.[34]
- The proposed regulatory framework for PR6 provides additional margins, on the basis of a management fee to remunerate additional working capital requirements the TSO might have in place.
- Whilst considerable financial flows are associated with EirGrid's external 'cash collection agent' activities, EirGrid's P&L bears extremely limited risk as, as far as can be seen, all costs are ultimately recovered through the K-factor.[35]

These factors lead us to conclude that the proposed financial regulatory framework for the TSO, and the various sources of liquidity that are underwritten by this regulatory framework, mean that the TSO should be considered capable of being financed under the proposed PR6 price controls.

3.3. Is the PR6 package investible and supportive of the PR6 objectives?

Similar to our assessment for ESB Networks, we have considered whether the PR6 package in the round should be viewed as investible from an equity finance perspective.

For this, we have considered:

- The level of expected return – by reference to a range of profit metrics.
- Calibration of the regulatory framework and risk exposure.
- Headroom to manage risk within the price control.

[34] Indeed, we understand that EirGrid has recently proposed that its WCFs should be extended.

[35] Although full recovery can take several years.

Level of return

As with credit metrics, we consider that assessment of equity metrics should not be used in a deterministic way. As discussed in our report on the financial framework for the TSO, the CRU's current regulatory framework provides different forms of remuneration for the TSO related to:

- fixed assets (captured in the RAB);
- cost of working capital employed in the notional business; and
- higher operational gearing relative to the DSO and TAO.

This framework does not target a specific overall profit margin for the TSO. Instead, it targets specific allowed returns as appropriate for the capital considered employed within the business.

Three key equity metrics we have considered for the TSO include:

- EBITDA margin.
- EBIT margin.
- RAB/EBITDA.

The table below summarises each of these three metrics, including and excluding the external revenues and imperfection costs that pass through the TSO's price control in the denominator of the calculation.

We place most weight on the first EBIT margin presented, which is EBIT over the net revenue (within EirGrid's control), and similarly place most weight on the EBITDA over net revenues. When exploring our proposed approach for the PR6 TSO financial framework, we considered how the EBIT margin varied under the options considered, as well as what activities were driving returns in each case. We place limited weight on the latter metrics which include in the denominator various pass-through costs and revenues.

We present each of the metrics for the baseline, high case and each of the stress test scenarios applied to the baseline. Rather than a percentage of RoRE stress test, for the TSO we test a scenario where 50% of the maximum annual penalty[36] under the performance incentive framework in PR6 applies to the TSO. This provides for a more challenging stress test in EirGrid's case than a 100bps of RORE.

Table 3.3: Equity metrics for the TSO

Average PR6 profit margins		Base	High case	+10% opex	€10m incentive penalty
EBITDA margin	Internal (net) revenues	39.0%	40.2%	33.0%	35.3%
	Incl. external revenues and imperfections	5.5%	6.3%	4.7%	5.0%
EBIT margin	Internal (net) revenues	7.8%	7.8%	1.8%	4.1%
	Incl. external revenues and imperfections	1.1%	1.2%	0.2%	0.6%
RAB/EBITDA		2.8	2.9	3.4	3.2

Source: CEPA analysis

[36] As discussed below, the maximum annual downside under the TSO's performance incentives is c. €17m p.a.

As we discuss in our TSO financial framework report, benchmarking EBIT or EBITDA margins for a business activity like the TSO is challenging. CEPA has previously expressed a view of 3-10% as being an appropriate EBIT benchmark for these activities.[37] Oxera has suggested 8-12%.[38]

The overall EBIT margin on net revenue is close to those modelled at PR5, but slightly lower following the change in the proposed financial framework for the TSO. Overall, we consider that the level of proposed returns is sufficient given we consider an EBIT margin ranging from 3% to 10% is likely to be appropriate for the TSO, given the mix of activities being undertaken and the low-risk environment in which the regulated business operates.

While the EBIT margin is particularly sensitive to an opex overspend[39], we note that the TSO has a supportive regulatory framework which facilitates cost recovery through both the AIMF and the ex-post review process, thereby limiting the financial exposure of the regulated company. This is a stress test which assumes no pass through of additional costs and so we consider the scenario unlikely to occur in practice.

Calibration of regime and risk exposure

Similar to ESB Networks, we have considered the high-level calibration of the PR6 draft decision from the perspective of the strength of the cost recovery framework and the proposed calibration and strength of the performance incentive framework.

As discussed above, the extant ex post cost recovery framework in PR5, which is proposed to be retained in PR6, alongside the proposed AIMF, should in principle provide mitigations against escalating costs and the risk these are not recovered by TSO (particularly given the proposed opex reopener mechanism). This contrasts with regulatory frameworks in some other contexts where allowances are fixed ex ante and incentive / cost sharing mechanisms require the regulated company to bear (or retain) a proportion of any variation in outturn cost.

Overall, as with ESB Networks, while there is still work required to "codify" the PR6 regulatory framework, we consider the framework supportive and a mitigation against cost recovery risk for the TSO.

As with ESB Networks, the performance incentive framework proposed for PR6 has evolved from PR5. The regime has been calibrated to deliver a similar overall level of RoRE risk for PR6, but with the forecast growth in the RAB, this implies a far more powerful regime in € terms, as illustrated below.

As was the case in PR5, the performance framework is upside weighted in its calibration. Provided that the TSO was expected to beat some of the performance incentive targets, and potentially underperform others, setting the incentive framework in this way can be considered to provide a means, in expectation, for EirGrid to earn additional returns under its price control over and above the base EBIT provided under the price control.

However, the strengthening of the incentives in monetary terms would imply that if EirGrid were to receive the maximum penalty under the performance incentives – which we consider to be a relatively unlikely scenario – this would result in a material reduction in the TSO's EBIT. While we consider the power of performance regime to not be unreasonable[40], it does suggest that the CRU will need to consider carefully how stretching the targets that underlie the performance incentives in PR6 can ultimately be, given the value it proposes to place at risk.

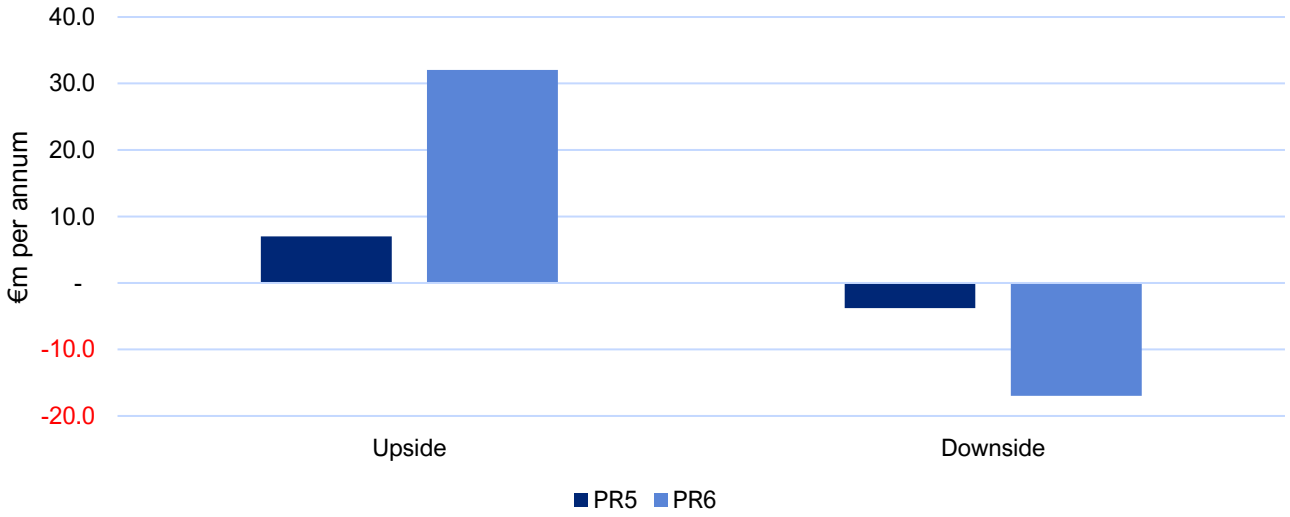
[37] CEPA (2011) Financeability of the universal service – report for Ofcom.

[38] Oxera (2019) NGESO financial price control parameters for RIIO-2 – Prepared for National Grid Electricity System Operator, p. 33. Available online.

[39] That is not recoverable through an adjustment to allowed revenue.

[40] It is consistent with the scale of RoRE % at risk that was adopted for PR5.

Figure 3.1: PR6 incentive range relative to PR5 – annual averages



Source: CEPA analysis

Is headroom sufficient to accommodate and manage risk?

The credit ratios that Moody's have used for the ESO's credit rating show considerable headroom. The equity metrics above also show that the proposed remuneration framework provides headroom to accommodate opex shocks and to absorb penalties under the performance incentive framework. The EBITDA margin – which we consider the more appropriate metric in considering operational headroom for the management of business risk – maintains considerable headroom even in the stress test scenarios which, for the reasons set out above, we also consider to be relatively unlikely scenarios in practice.

As noted above, the stress tests do illustrate that the achieved EBIT margin is sensitive to an unrecoverable opex overspend and/or a large penalty under the performance framework.

Conclusions

Overall, substantial returns are provided for renumerating capital employed under the proposed TSO financial framework, as demonstrated by modelled profit margins for the PR6 period. That said, changes in key equity return metrics underline the sensitivity of the TSO to cash flow variations, particularly to downside scenarios such as unfunded opex overspend or maximum performance incentive penalties.

3.4. Offshore financeability

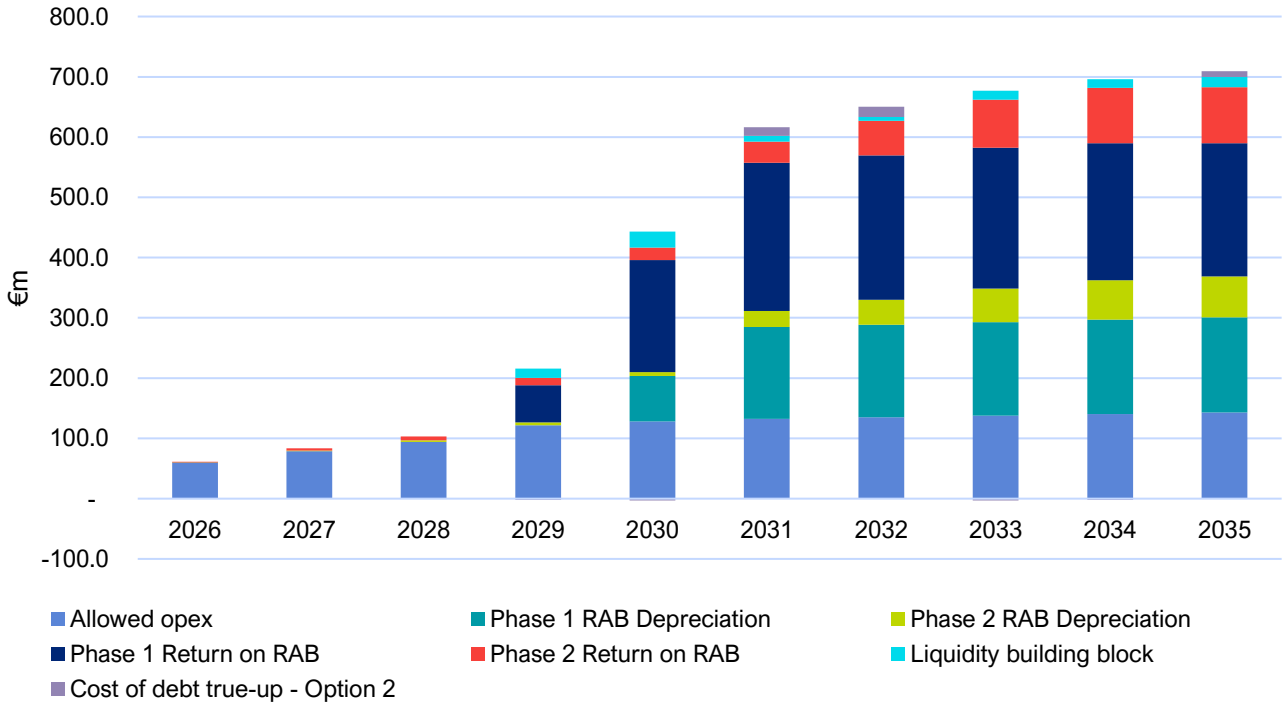
Given that we consider the TSO's onshore price control financeable, we have also reviewed the key findings of the offshore financeability assessment in the CRU's draft decision to provide a preliminary view on whether the TSO licensee overall, can be considered financeable under the PR6 proposals.

Assessing the financeability of the TSO licensee on a combined basis is considerably more challenging than for ESB Networks. There are fundamental differences in the activities of the TSO and EirGrid's new offshore asset ownership function, as well as differences in regulatory framework – offshore for example, includes a cost of debt true-up mechanism and allowed returns on a hybrid real/nominal basis. The offshore programme is also expected to have a different capital structure and be financed solely from new debt rather than new and embedded debt.

As a result, we have assessment financeability of EirGrid's offshore and onshore TSO price controls separately. Our assumption is that if the offshore and onshore price controls are financeable on an independent (standalone) basis, we would expect the TSO licensee overall to be financeable.

We have focused on a scenario and the build-up of allowed revenues over PR6 and PR7 where EirGrid is required to make six ATV payments to Phase 1 developers and construction of the Tonn Nua project will be completed by the end of PR7. The allowed revenues in this scenario are illustrated below.

Figure 3.2: Offshore Allowed Revenues, €m nominal, 6 ATV payments and Tonn Nua completion



Source: CEPA analysis

Consistent with the approach that CRU stated it would take in CRU202499, we have reviewed the financeability of the offshore revenue control under the proposed notional company capital structure (60%) and the 'actual' capital structure that EirGrid has stated it is targeting for financing its offshore grid programme ('actual capital structure'). We understand EirGrid's current proposal is to target a RAB gearing level of c. 70%.

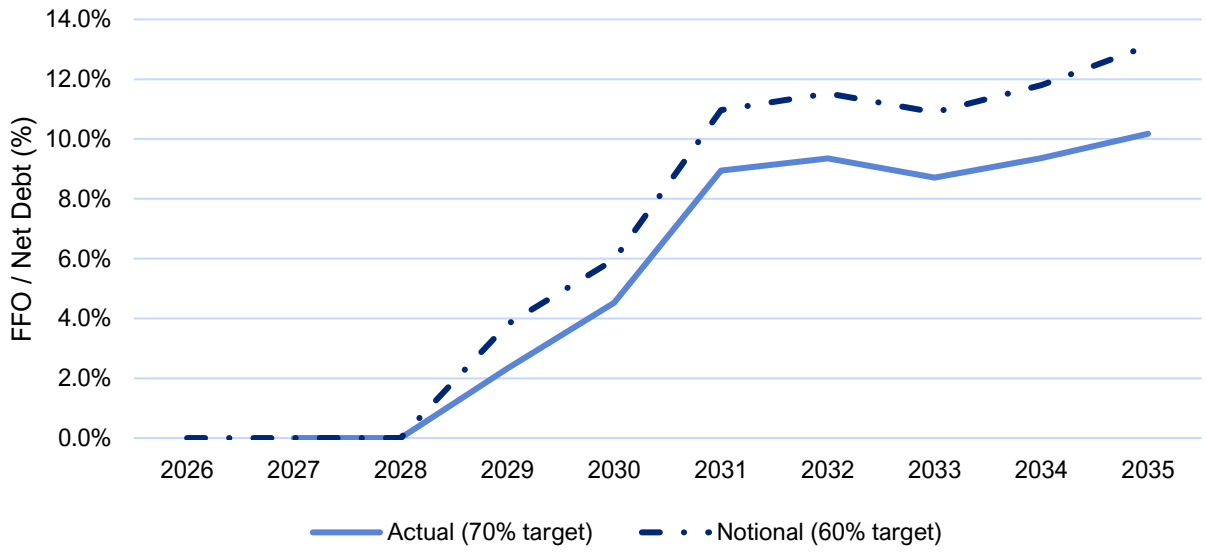
The assumed 'actual' capital structure reflects an assumption by EirGrid that it will receive a significant new equity injection in PR6, although we understand the quantum and the terms of this new equity injection are still under discussion with the Shareholder. We assume that this new equity injection will be forthcoming for similar reasons as we conclude that ESB Networks price controls are investible.

First, we have benchmarked the proposed allowed return for the offshore price control against comparable investments and consider the allowed return a fair reflection of the opportunity cost of capital. Indeed, it reflects a time limited uplift relative to the allowed equity rate of return proposed for onshore networks in PR6. The performance incentives for the offshore business will also be constrained and calibrated to be largely symmetric and balanced in outcomes during PR6. The regulatory framework has various features in place to facilitate investment cost recovery and mitigate the financing risk the company is exposed to.[41] Overall, while there are still elements of the regime to be finalised, at this stage we view the proposal to be investible. As a result, we have focused our assessment on key credit metrics that will be the focus area of the CRAs.

The figures below compare the FFO / Net Debt and AICR vary over PR6 and PR7 under EirGrid's target capital structure compared to the notional company at 60% notional gearing.

[41] See below for a discussion of the impact of the cost of debt true-up mechanism.

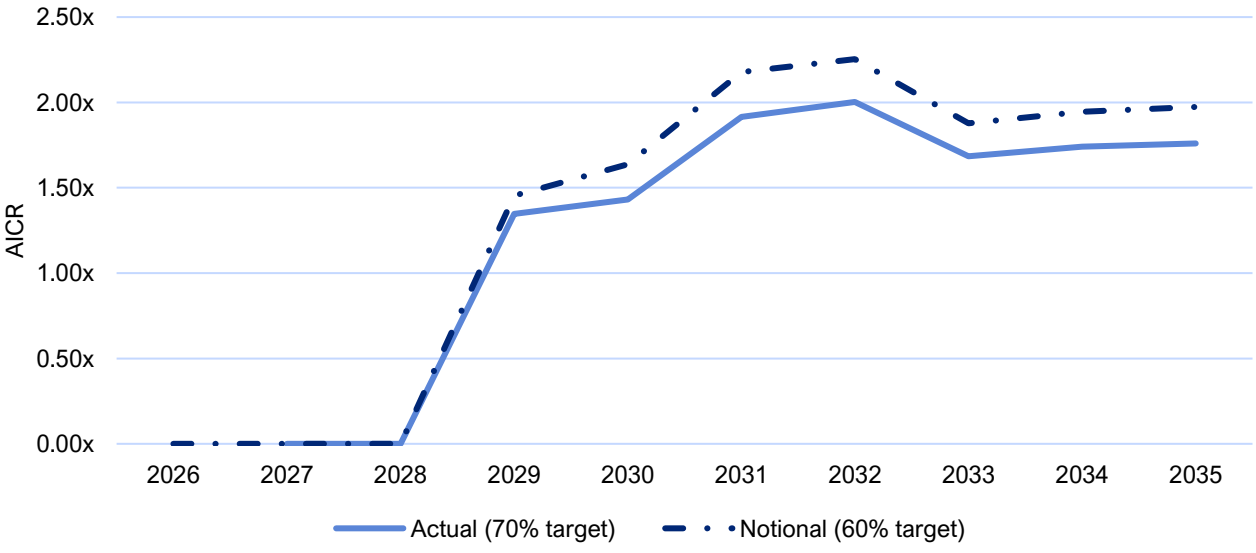
Figure 3.3: Expected evolution of the FFO / Net Debt ratio under target / actual and notional capital structure



Source: CEPA analysis

Figure 3.3 shows that the FFO / Net Debt ratio starts from a relatively weak position as the offshore business is established in PR6, and then under the proposed financial package, there is an upward trend in the ratio over time as Phase 1 ATV payments are reflected in Allowed Revenue and there is a greater degree of operating cashflow and headroom in the offshore business. Going into PR7, the FFO / Net Debt ratio rises above 10% supported by the profile of allowed debt returns and the start of depreciation of Tonn Nua construction costs.

Figure 3.4: Expected evolution of the AICR ratio under target / actual and notional capital structure



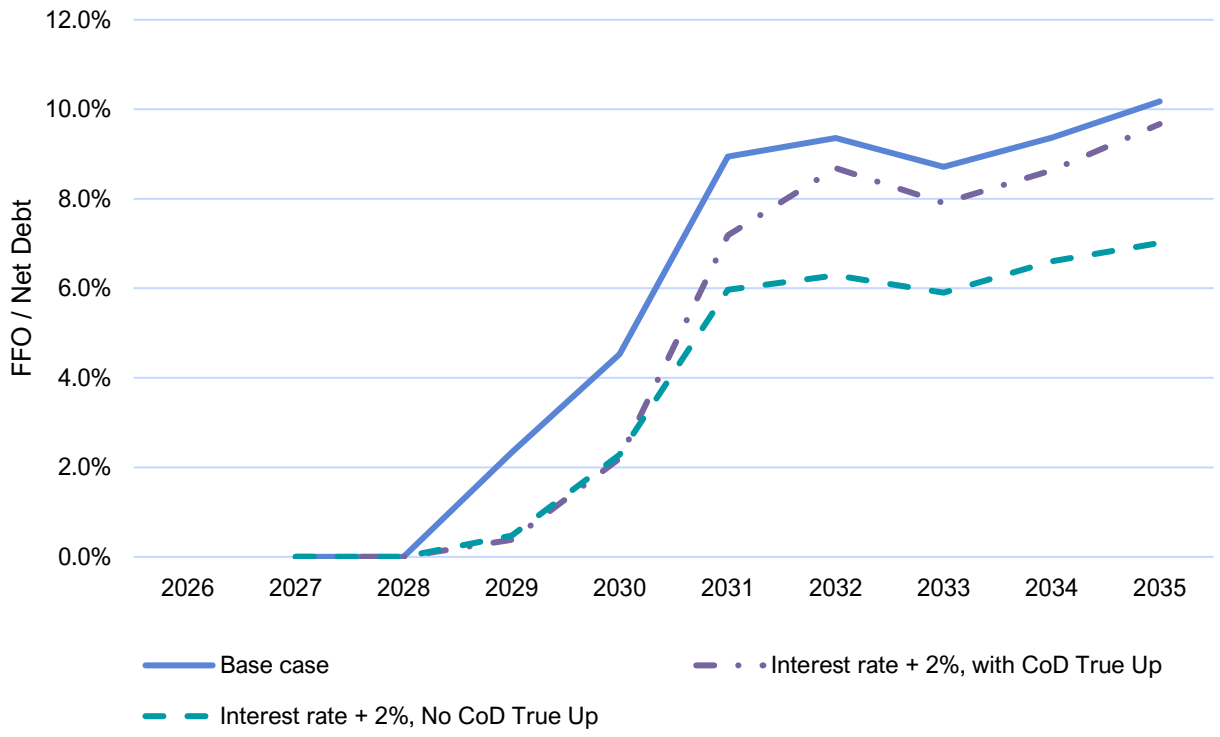
Source: CEPA analysis

As with the FFO / Net Debt ratio, the AICR also starts from a relatively weak position in PR6 but shows a strong upward trend going into PR7. Given it would be expected that the AICR would show some weakness as the offshore business is established and goes through a period of high-upfront investment, the long-term trend indicates that the financial package proposed generates sufficient headroom for the company to be financeable at investment grade.

While there is less headroom under the target actual capital structure compared to the notional capital structure because there are higher debt servicing costs at a higher level of gearing, the ratios looking forward to PR7 are at a level we understand to be consistent with investment grade. This also appears to be the case in the stress scenarios that are reported in the CRU's draft decision paper.

Of particular importance, is the scenario that assumes a 200bps increase in the company's cost of debt above the Allowed Debt Rate of Return. Differences in the gearing level of the notional company and the actual company may result in mismatches between allowed debt returns and EirGrid's actual debt costs despite the Cost of Debt True-up Building Block that is proposed for the offshore revenue control. The figure below shows the FFO / Net Debt over PR6 and PR7 under EirGrid's target capital structure under this scenario.

Figure 3.5: Expected evolution of the FFO / Net Debt ratio under +200bps increase in interest costs



Source: CEPA analysis

This analysis shows that under a relatively extreme scenario in which all EirGrid's debt costs are at 200bps above the interest rate assumed in the Allowed Debt Rate of Return, the FFO / Net Debt ratio[42] retains significant headroom, albeit reduced relative to the assumptions in the base modelling. This helps to illustrate the significant benefit and support for financeability that the proposed offshore price control Cost of Debt True-up mechanism provides the licensee. Overall, we consider that the risk of mismatch, until allowed rates of returns are reset by the CRU at the next price review, is sufficiently constrained that it does not cut across the financeability of the offshore programme. The proposed Cost of Debt True-up mechanism provides significant protection against the risk of interest rate volatility which is perhaps the most material risk for EirGrid during PR6 and PR7 given the proposed regulatory treatment of performance incentives and the approach to investment cost recovery.

Overall, we conclude that based on the financial modelling that has been undertaken of the offshore price control in PR6 and PR7 to date, the CRU's proposals seem financeable.

[42] Similar trends are also observed in the AICR.

3.5. Conclusion

Overall, our preliminary assessment is that the proposed PR6 package is financeable at investment grade level for the TSO licensee in PR6. The largest challenge to financeability is likely to be the quantum of new equity finance required to support the offshore PR6 investment programme and the calibration of remuneration framework for the TSO in light of the changes we have proposed to the current framework in a separate report.

Appendix A ESB NETWORKS STRESS TEST UNDER HIGH CASE

Table A1: Debt financeability results for the DSO

	High case	+100bps CoD	+10% opex	+10% capex	-100bps incentives
AICR	1.82	1.45	1.57	1.27	1.62
FFO/Net Debt	13.3%	12.4%	12.4%	11.3%	12.6%
FFO/Interest Cover	4.8	3.8	4.6	4.3	4.6
Simulated rating	A3	A3	A3	Baa1	A3
RAB 5-year CAGR	6.5%				

Source: CEPA analysis. Stress tests are layered on top of the high scenario.

Table A2: Debt financeability results for the TAO

	High case	+100bps CoD	+10% opex	+10% capex	-100bps incentives
AICR	1.84	1.47	1.77	1.70	1.64
FFO/Net Debt	7.4%	6.6%	7.2%	6.9%	6.8%
FFO/Interest Cover	3.2	2.6	3.2	3.1	3.0
Simulated rating	Baa1	Baa1	Baa1	Baa1	Baa1
RAB 5-year CAGR	17.7%				

Source: CEPA analysis. Stress tests are layered on top of the high scenario

Table A3: Debt financeability results for ESBN combined

	High case	+100bps CoD	+10% opex	+10% capex	-100bps incentives
AICR	1.83	1.46	1.64	1.43	1.63
FFO/Net Debt	11.1%	10.2%	10.4%	9.7%	10.4%
FFO/Interest Cover	4.2	3.3	4.1	3.8	4.0
Simulated rating	A3	Baa1	Baa1	Baa1	Baa1
RAB 5-year CAGR	10.5%				

Source: CEPA analysis. Stress tests are layered on top of the high scenario.

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