

## SCOTTISH AND SOUTHERN ENERGY PRELIMINARY RESULTS FOR THE YEAR TO 31 MARCH 2008

	March 2008	March 2007	Change
<b>Full-Year Dividend</b>	<b>60.5p</b>	55.0p	+10.0%
<b>Adjusted Profit Before Tax*</b>	<b>£1,229.2m</b>	£1,079.3m	+13.9%
<b>Adjusted Earnings Per Share*</b>	<b>105.6p</b>	92.5p	+14.2%
<b>Investment and Capital Expenditure</b>	<b>£810.3m</b>	£663.4m	+22.1%
<b>Power Station Availability (Gas)</b>	<b>95%</b>	95%	-
<b>Power Station Availability (Coal)</b>	<b>91%</b>	92%	-1%
<b>Energy Supply Customer Numbers</b>	<b>8.45m</b>	7.75m	+700,000
<b>Customer Complaints to energywatch</b>	<b>615</b>	840	-27%
<b>Customer Minutes Lost (SHEPD)</b>	<b>72</b>	77	- 5 mins
<b>Customer Minutes Lost (SEPD)</b>	<b>67</b>	72	- 5 mins
<b>Contribution to Government Revenues</b>	<b>£517.1m</b>	£459.5m	+12.5%
<b>Number of Employees</b>	<b>16,892</b>	13,427	+3,465
<b>Lost Time and Reportable Injuries</b>	<b>11</b>	11	-
<b>Reportable Environmental Incidents</b>	<b>1</b>	0	+1

**Sir Robert Smith, Chairman of Scottish and Southern Energy, said:**

“SSE delivered very good operational and financial results in 2007/08, a challenging year for the sector in which many key questions were asked about the sustainability, reliability and affordability of energy. The maintenance of our policy of responsible pricing helped us to gain 700,000 additional electricity and gas customers, making us the UK’s second largest energy supplier. Our power stations performed well, as did our electricity networks, enabling us to contribute significantly to the security and reliability of the UK’s energy supplies.

“Securing future supplies and tackling climate change are the twin goals of energy policy in the UK, Ireland and throughout the European Union, and our expanding programme of investment reflects this. It should enable us to create value for shareholders to complement the value enhancement which flows from continually improving our day-to-day operations.

“We will continue to focus on our energy and infrastructure related businesses in the UK and, following the recent acquisition of Airtricity, in Ireland. That acquisition also provides us with the scope to build on our UK-leading position in renewable energy to develop an international business in this increasingly critical area.

“All of this gives us the means to maintain our track record of dividend growth in the next decade. Delivering that dividend growth, delivering our investment programme and delivering excellent service to customers are our key priorities in 2008/09 and will remain so in the years ahead.”

\*Unless otherwise stated, this preliminary results statement describes **adjusted operating profit** before exceptional items, the impact of IAS 32 and IAS 39 and after the removal of taxation and interest on profits from jointly controlled entities and associates. In addition, it describes **adjusted profit before tax** before exceptional items, the impact of IAS 32 and IAS 39 and after the removal of taxation on profits from jointly-controlled entities

and associates. It also describes **adjusted earnings and earnings per share** before exceptional items, the impact of IAS 32 and IAS 39 and deferred tax.

## KEY BUSINESS DEVELOPMENTS IN SSE FROM 1 APRIL 2007

### GENERATION AND SUPPLY

- Operating profit\* up 12.7% to £724.2m

#### Generation

- Gas-fired power station availability 95%; coal station availability 91%
- Acquisition of Airtricity Holdings Ltd
- Acquisition of Slough Heat and Power Ltd
- Operating/consented onshore wind farm capacity passed 1,000MW mark, with increase of 150MW since January 2008
- Operating renewable energy capacity passed 2,000MW mark
- Operating/consented renewable energy capacity passed 3,000MW mark
- New target for operating renewable energy capacity of 4,000MW by 2013
- Consent granted for extension to Barking Power Ltd
- New target adopted to reduce carbon intensity of power generated by 50% by 2020

#### Supply

- Net gain of 700,000 energy supply customers, to 8.45m following responsible pricing policy
- Grown to become UK's second largest supplier of electricity and gas
- Only supplier to defer electricity and gas price rises to end of winter period
- Further reduction, of 27%, in complaints to energywatch
- Ranked first in uSwitch.com Customer Satisfaction Report
- Top-ranked supplier of electricity and gas in JD Power Customer Satisfaction Study
- 'better plan' energy efficiency reward programme for customers launched
- Sector-leading Customer Charter and new Vulnerable Customers Code of Practice
- Establishment of presence in the Irish all-island market, with 38,000 mainly commercial customers
- Launch of new Energy Performance Certificates business

### NETWORKS

- Energy Networks operating profit\* of £544.4m, compared with £471.1m in previous year

#### Electricity Networks

- Power Systems operating profit\* of £382.9m, up from £368.0m in the previous year
- Investment in electricity networks up 29% to £264.4m
- Additional revenue of £16m earned under Ofgem's Quality of Service and other incentive schemes
- Beaulieu-Denny Public Inquiry completed in February 2008

#### Gas Networks

- Share of SGN's adjusted operating profit up from £103.1m to £161.5m
- SGN capital expenditure up 49% to £179.8m and replacement expenditure up 14% to £199.2m
- Improved efficiency ranking
- Agreement on Gas Distribution Price Control 2008-13

#### Telecoms Networks

- Telecoms Networks operating profit\* up 2.9% to £14.3m (on continuing businesses up 28.4% to £13.1m)
- Sale of sites assets for £79m total consideration

- Acquisition of additional fibre optic and telecom duct network

## **ENERGY-RELATED SERVICES**

### **Contracting, Connections and Metering**

- Operating profit\* up 7.8% to £55.6m
- Coverage of Contracting business extended, now with 64 branches nationwide
- Acquisition of three additional streetlighting PFI contracts
- Further expansion of out-of-area electricity networks, with 45 in operation or under construction
- Premises connected to SSE gas pipelines now above 50,000
- First new water and sewerage company since privatisation
- Completion of in-sourcing of Metering work in three areas of the UK
- Installation of Smart Meters under way via Energy Demand Reduction Trial

### **Energy and Home Services**

- 115,000 new gas boiler and telecoms customers, taking total to 235,000
- Product portfolio enhanced with electrical wiring service

### **Gas Storage**

- Operating profit\* of £50.9m, compared with £55.9m in previous year
- First caverns at Aldbrough set for commercial operation in autumn
- Planning permission secured to double the size of Aldbrough development to over 800mcm

## **BALANCE SHEET AND FINANCIAL MANAGEMENT**

- Net debt up £1.433bn to £3.666 bn
- Average debt maturity 8.6 years
- Underlying interest cover of 11.7 times
- Purchase of 16.66m shares (1.9% of called-up share capital) for £238.2m
- 24.5m new shares issued under 3.75% Convertible Bond
- 870.1m shares in issue on 31 March 2008

## **STRATEGIC OVERVIEW**

### **Purpose and Strategy**

SSE's core purpose is to provide the energy people need in a reliable and sustainable way. In line with this, its strategy has been and will continue to be the delivery of sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of regulated and non-regulated energy and utility businesses.

Within this strategic framework, SSE will continue to focus on enhancing and creating value for shareholders from its energy and infrastructure-related activities in the UK and Ireland and from the development of an international renewable energy business.

Implementation of the strategy will continue to be founded on SSE's well-established financial principles. These principles are: delivery of sustained real dividend growth; effective management of core businesses; rigorous analysis to ensure investments are well-founded and, where appropriate, innovative; maintenance of a strong balance sheet; deployment of a selective and disciplined approach to acquisitions; and use of purchase in the market of the company's own shares as the benchmark against which financial decisions are taken.

### **Future Environment**

This strategy and these principles have been shown to be robust in a wide variety of financial and operational conditions and have led to SSE becoming the UK's broadest-based energy company. SSE will continue to adhere to them in the future.

That future will be different. Over the next decade, key questions will be asked of companies in the energy sector. How are they responding to climate change? How are they responding to rising global demand for energy as supplies of oil and gas deplete? How are they helping to secure energy supplies and make them more reliable? How are they helping customers to use less energy? SSE believes these are the right questions and that its strategy and priorities are delivering the right answers.

The days of meeting an unchecked demand for energy through monolithic carbon-intensive power stations are coming to an end. Increasingly, the emphasis will be on energy efficiency, renewables, cleaned-up fossil fuel plant and micro generation. SSE is active in all of these areas and preparing for this profound change.

SSE's primary focus for shareholders will be on delivering sustained real growth in the dividend, and the changing nature of energy production is why the acquisition of Airtricity should help to maintain its track record of growth during the second decade of this century. So, too, should the scale of the investment opportunities which that acquisition and SSE's established businesses and new ventures have created.

#### **Priorities for 2008/09 and beyond**

For this reason, SSE's continuing focus during 2008/09 will be on the efficient and timely delivery of investments in renewable energy, other electricity generation, electricity and gas networks and gas storage. The value created from these investments will be complemented by the identification and delivery of enhanced operational performance in the management of power stations and the operation of electricity and gas networks and in SSE's other energy-related services.

As SSE's investment programme, expected to be around £1.3bn in 2008/09, gathers pace, the growth in its modern and diverse asset base should continue, reinforcing its position as the UK's broadest-based energy company. This, in turn, should enable SSE to maintain its track record of dividend growth in the second decade of this century, as should continuing profit growth based on continuous improvements in operations from which customers will benefit. Through ongoing responsible pricing and sector-leading service delivery, SSE expects its number of customers to continue to grow.

In uncertain financial times, there is one question being posed by many investors: which companies provide an unambiguous commitment to, and focus on, sustained real dividend growth, backed up by a track record of having delivered it in the past and the means to deliver it in the future? SSE believes that is the right question, and that, with its commitment to sustained real dividend growth, it is one of those companies. In line with that, its priority for 2008/09 is to deliver its target of at least 4% real growth in the dividend payable to shareholders.

## **FINANCIAL OVERVIEW**

#### **Preliminary Financial Results for 2007/08**

These preliminary results for the year to 31 March 2008 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus is on profit before tax before exceptional items, the impact of International Accounting Standard (IAS) 32 and IAS 39 and after the removal of taxation on profits from jointly-controlled entities and associates (adjusted profit before tax). The following table reconciles SSE's reported profit before tax and its adjusted profit before tax.

	<b>March 08</b>	<b>March 07</b>
	<b>£m</b>	<b>£m</b>
<b>Reported Profit before Tax</b>	<b>1,083.8</b>	<b>1,132.0</b>
Movement on derivatives (IAS39)	164.1	(56.2)
Exceptional items	(65.2)	(31.9)
Tax on JVs and Associates	41.9	31.8

Interest on convertible debt	4.6	3.6
<b>Adjusted Profit before Tax*</b>	<b>1,229.2</b>	<b>1,079.3</b>
Adjusted current tax charge	(317.2)	(282.6)
<b>Adjusted Profit after Tax*</b>	<b>912.0</b>	<b>796.7</b>
<b>Reported Profit after Tax</b>	<b>873.2</b>	<b>830.5</b>
Number of shares for basic and adjusted EPS (million)	<b>863.2</b>	<b>860.9</b>
<b>Adjusted EPS*</b>	<b>105.6</b>	<b>92.5</b>
<b>Basic EPS</b>	<b>101.1</b>	<b>96.5</b>

### Adjusted Profit Before Tax\*

Adjusted profit before tax\* grew by 13.9%, from £1,079.3m to £1,229.2m. While there was increased profitability in all parts of SSE, the most significant growth continues to be achieved in Generation and Supply. This reflects the successful development and deployment of SSE's diverse and flexible electricity generation portfolio, which now comprises around 10,500MW of capacity, and the sustained increase in the number of energy supply customers, which totalled 8.45 million on 31 March 2008. Significant growth was also achieved in Scotia Gas Networks, thereby helping SSE to maintain the balance in profitability between its regulated and non-regulated activities.

As previously stated, SSE's emphasis is on adjusted profit before tax\* on a full-year, as opposed to six-monthly, basis and its interim results in any financial year should always be viewed in light of that. This is because interim results are more likely to fluctuate, with unusual variations or exceptional circumstances. The majority of SSE's adjusted profit before tax in 2007/08 was delivered in the first six months; in 2008/09, SSE expects the reverse to be the case.

### Exceptional Items

There were three exceptional items. First, in Budget 2007, the UK government announced a reduction in the main Corporation Tax rate, from 30% to 28%, and accordingly SSE has re-stated its deferred tax provisions. A £32.4m credit has been recognised in relation to SSE's share of joint ventures and associates and is therefore reported in profit before tax, which is adjusted accordingly. A further £55.4m has been released by SSE, which is included in the headline tax charge. The second exceptional item was a foreign exchange loss of £22.2m on the unhedged proportion of Euro debt raised for the acquisition of Airtricity. The third exceptional item was a £55m gain before tax on the disposal of SSE's telecoms sites assets in August 2007.

### Adjusted Earnings Per Share\*

To monitor financial performance over the medium-term, SSE continues to focus on adjusted earnings per share\*, which increased by 14.2%, from 92.5p to 105.6p.

### Final Dividend

SSE's first responsibility to shareholders is to deliver sustained real growth in the dividend. The Board is recommending a final dividend of 42.4p, compared with 39.9p in the previous year, an increase of 6.3%. This will make a full-year dividend of 60.5p, compared with 55p last year, an increase of 10.0%.

The expected full-year dividend in respect of 2007/08, of 60.5p, compares with 35.0p for 2002/03, an increase of 72.9% in five years. This represents a compound annual growth rate during that period of 11.6%.

The full-year dividend payment to shareholders for 2007/08 is covered 1.73 times by SSE's adjusted profit after tax\*, compared with 1.68 times in the previous year.

### **Future Dividend**

SSE's target remains the delivery of at least 4% annual real growth in the dividend paid to shareholders in respect of 2008/09 and 2009/10. The acquisition of Airtricity in February 2008, and the investment opportunities it yields, are expected to help SSE maintain this track record of dividend growth well into the second decade of this century.

### **Investor Timetable**

Annual Report 2008 on website	5 June 2008
AGM	24 July 2008
Ex-dividend date	20 August 2008
Record date	22 August 2008
Payment date	26 September 2008
Interim results	12 November 2008

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**There will be an analysts' presentation starting at 09:00BST on Thursday 29 May 2008 at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB.**

**Webcast facility:** This is available by going to: [www.scottish-southern.co.uk](http://www.scottish-southern.co.uk) then click on Investor Centre.

### **Telephone Conference Call**

UK Dial in	0845 113 0049
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Replay facility (for one week)	
UK local rate no: UK dial-in	0845 245 5205
UK International no: International dial-in:	+44 (0) 1452 550 000
UK pin (access) no	49360568

## **GENERATION AND SUPPLY**

### **Generation and Supply Introduction**

SSE owns around 10,500 megawatts (MW) of electricity generation capacity, including its share of joint ventures. This makes it the second largest electricity generator across the UK and Ireland. The capacity comprises almost 4,500MW of gas- and oil-fired capacity, 4,000MW of coal-fired capacity (with biomass 'co-firing' capability), and over 2,000MW of renewable (hydro, wind and dedicated biomass) capacity. This gives SSE diversity in fuels and, as a result, greater optionality in the overall management of its power stations.

As at 31 March 2008, SSE supplied energy to 8.45 million customers within Great Britain's competitive electricity and gas supply market, with growth continuing in the new financial year. This makes it the second largest supplier of energy in the UK, and the fastest-growing. Its responsibility to those customers is to procure the electricity and gas they need and to arrange for it to be distributed to them through the relevant networks. Under the British Electricity Trading and Transmission Arrangements (BETTA) wholesale gas and wholesale electricity are transacted like any other commodity in a fully-competitive market. SSE purchases gas and, where appropriate, some electricity via bilateral contracts and through the wholesale market – the latter complementing the electricity produced from its own generation portfolio.

Under its integrated Generation and Supply business model, SSE's power stations and fuel supply contracts are used to support performance in electricity supply, mainly through using flexibility and optionality to respond to customer demand and market conditions. Generation and Supply is, therefore, assessed as a single value chain and this approach means, amongst other things, that more sustained value can be created from SSE's balanced portfolio of assets, contracts and customers than would be the case on a stand-alone basis.

In January 2008, Ofgem 'confirmed that Britain's competitive market in energy is working'. A month later, however, it launched an investigation into the markets in electricity and gas for households and small businesses, using its powers under the Enterprise Act 2002. While it has stated it has 'no clear evidence' of failure of the market, it is carrying out the investigation in response to 'public concern'. Ofgem expects to reach initial conclusions by September 2008. In SSE's view, Ofgem's original belief that there is no clear evidence of failure of the market is correct; indeed, the market is very competitive and provides customers with an excellent degree of choice across all aspects of electricity and gas supply.

In April 2008, Ofgem launched another investigation, into SSE and Scottish Power Limited, under section 18 of the Competition Act 1998 and Article 82 of the EC Treaty. It said its decision was based on a formal complaint alleging abuse of an alleged dominant position in the electricity generation sector at times of constraint on the Great Britain transmission system, as well as informal enquiries. SSE is co-operating fully with Ofgem. It remains confident that its actions in electricity generation have always been consistent with the operation of a competitive market and believes that this process can be brought to a speedy conclusion.

### **Generation and Supply Performance Overview**

Operating profit in Generation and Supply rose by 12.7%, from £642.6m to £724.2m, contributing 52.3% of SSE's total operating profit during the year. Total revenue for Generation and Supply was £14.26bn, which accounted for 89% of SSE's total revenue in 2007/08, of which £5.61bn was in relation to sales of electricity and gas to industrial, commercial and domestic customers. The financial performance of Generation and Supply has been reported excluding the impact of IAS 39 revaluations because SSE does not believe this represents underlying business performance.

During 2007/08, SSE generated 45.8TWh of electricity, including power stations in which it has ownership or contractual interest. In addition, Airtricity's wind farms produced 0.8TWh of electricity during 2007/08, including 0.15TWh after its acquisition by SSE in February 2008. SSE also purchased 9.9TWh of electricity via long-term contracts with other generators, including British Energy. In the year, it supplied 28.2TWh of electricity to its domestic and small business customers and 27.5TWh was supplied under contract to industrial and commercial customers. Any net balances were traded in the wholesale electricity market.

The continuing growth achieved by SSE's integrated Generation and Supply business is the outcome of the company's investment in and acquisition of a diverse range of electricity generating assets and a growth of almost four million in the number of energy supply customers over the past six years, following its sustained policy of responsible pricing.

# GENERATION

## Generation Objectives

In May 2007, the Energy White Paper pointed out that the UK will need substantial investment in new generation capacity over the next two decades. It also pointed out that the UK's diverse generation mix avoids exposure to the risks associated with heavy dependency on a single fuel or technology type, helps to maintain secure supplies of energy and provides the country's electricity system with the flexibility to accommodate variations in demand and to respond to changes in fossil fuels.

The same points apply to SSE's portfolio. Its key objectives in Generation are to ensure that it has a diverse portfolio of power stations, available to generate electricity and support security of supply, with the maximum possible efficiency, in response to customer demand and market conditions, while complying fully with all safety standards and environmental regulations. It is this diversity which enables SSE to manage the risks associated with primary fuel procurement at a time of volatile and rising prices.

In support of these objectives, SSE completed the acquisition of Airtricity in February 2008 for a final enterprise value of £1,349.1m. The acquisition was the largest completed by SSE since its formation in 1998. It is designed, amongst other things, to further balance SSE's electricity generation portfolio, reduce its exposure to volatile commodity prices for fossil fuels and provide a major new range of investment opportunities from which to secure growth over the next decade.

At the same time, SSE's investment in Generation will go beyond renewable energy. It will continue to examine opportunities across all aspects of Generation to ensure it has optionality in plant technology, timing of investment and construction and scale of development.

To support future and current assets, SSE has also established an Engineering Centre to provide both an effective long-term asset management and investment planning capability across its Generation portfolio and a platform for the future growth of the portfolio.

## Gas-fired Generation - Operations

Good performance in BETTA is dependent on plant availability to generate electricity. During 2007/08, SSE's principal wholly-owned gas-fired power stations (Fife, Keadby, Medway and Peterhead) achieved an average of 95% of their maximum availability to generate electricity, excluding planned outages, the same as in the previous year.

During 2007/08, SSE extended its power purchase agreements with Seabank Power Limited, in which it also has a 50% stake. The agreements were due to expire in 2009 and 2011, but have now been extended to 2018, with the option of a further extension to 2023. The new contracts represent a significant milestone in the long-term development of SSE's portfolio.

## Gas-fired Generation - Investment

With its high thermal efficiency, relatively low cost and short construction times, combined cycle gas turbine (CCGT) technology is set to remain the benchmark technology for some years to come. Work on the construction of Marchwood Power Ltd's new 840MW CCGT plant in Southampton is now well under way. Marchwood Power is a joint venture between SSE and ESBI International, in which SSE has 50% of the equity (£43m) and 50% of the debt (£160m) – of which £55m was invested by 31 March 2008. All of the station's output, however, will be contracted to SSE. With a net thermal efficiency in excess of 58%, it will be one of the most efficient in the UK. As it was procured before the upsurge in capital costs seen in the electricity generation sector over the past two years, it will also be one of the best value new power station developments under way in the UK.

The 22km high pressure gas pipeline between Lockerley and Marchwood has now been installed, and the next key milestone will be the installation of the first gas turbine generator, which is expected to take place shortly. The plant therefore remains on course to be completed and in commercial operation in time for the winter of 2009/10.

In December 2007, consent was given under Section 36 of the Electricity Act 1989 to Barking Power Ltd for the extension of the existing CCGT power station at Dagenham. The proposed extension will provide a further 470MW to the existing 1,000MW capacity. SSE has a 30.4% stake in Barking Power Ltd and so the extension would effectively add around 140MW to its portfolio of generation assets. A decision on whether to proceed with it is likely to be made during 2009, following a tender for the plant and construction work and final agreement on offtake arrangements and financing.

SSE had identified the potential to substitute existing plant at its Peterhead power station with new state-of-the-art equipment, increasing the modern CCGT capacity at Peterhead to the station's effective grid limit of 1,520MW. The front-end engineering design (FEED) study is now completed and SSE has decided not to proceed with this particular project at this time, partly because of the onerous nature of the transmission charges that would apply to it.

Nevertheless, SSE is actively seeking to identify an option for an additional CCGT plant, either at one of its existing power station sites or an alternative 'brown field' site. Future investment decisions of this kind will have to reflect the likely impact of the EU's legally-binding target of 20% for the proportion of all energy to be derived from renewable sources by 2020. As the amount of electricity generated from renewable sources increases, gas-fired and coal-fired power stations are likely to run at lower load factors than has historically been the case and will have to be increasingly flexible. At the same time, the value inherent in the flexibility of SSE's power stations should increase. These factors will have to be considered when investment decisions are made.

#### **Coal and Biomass Generation - Operations**

The Ferrybridge and Fiddler's Ferry power stations, each with a capacity of almost 2,000MW, achieved 91% of their maximum availability to generate electricity, excluding planned outages, during 2007/08, compared with 92% in the previous year. This slight reduction reflects an increase in two-shift operation of the plant and integration work with the Flue Gas Desulphurisation (FGD) projects currently running at both stations.

The stations can also 'co-fire' fuels from renewable sources (biomass), thus displacing fossil fuels and reducing the impact of carbon emissions resulting from their operation, using direct injection technology. The resulting electricity output qualifies for Renewable Obligation Certificates (ROCs). During the year, their output qualifying for ROCs was 368GWh, compared with 741GWh in the previous year. This reflects outages relating to the installation of FGD equipment and difficulties relating to the 'bioswirl' facility at Ferrybridge.

There have been issues with respect to these co-firing facilities, including the fact that the availability of the biomass fuel (principally by-products from other processes) has proved to be lower than expected, so SSE recognised an impairment charge of £12.2m in respect of the original expenditure on the co-firing facilities.

At the same time, however, the new facilities mean that SSE is now the UK's leading user of biomass co-firing. In January 2008, the UK government announced decisions to 'band' the Renewables Obligation, so that, from 1 April 2009, electricity output resulting from co-firing will receive 0.5 ROCs per MWh. This compares with the 0.25 ROCs originally proposed. The cap on such co-firing will be retained, so that electricity suppliers can only meet up to 10% of their Renewables Obligation from this technology.

#### **Coal and Biomass Generation – Investment**

Although CCGT will be the benchmark technology in the coming years, it is clear that coal-fired electricity generation will remain a key part of the UK's energy mix for many years to come, albeit within appropriate environmental constraints. As the UK Secretary of State for Business put it in March 2008, fossil fuels will continue to play an important role in ensuring the flexibility of the electricity generation system, 'with coal a key source of that flexibility as we increase the proportion of renewable energy in our electricity mix'.

The Large Combustion Plant Directive (LCPD) aims to reduce acidification, ground level ozone and particles to below the Emission Limit Value thresholds for sulphur dioxide, nitrogen

oxides and dust from plants including power stations. In line with that, SSE has opted in to the Directive all of the capacity at Fiddler's Ferry and half of the capacity at Ferrybridge and so is installing FGD equipment at the stations in an investment expected to total around £225m. By making them compliant with the LCPD emissions levels, the stations' contribution to the security of the UK's energy supplies is being extended and SSE will continue to have the country's most diverse electricity generation portfolio.

Although progress in recent months has been slower than expected, the installation of FGD at both stations is expected to be completed, as originally envisaged, during this year. To achieve that, SSE is working very closely with the main contractor to improve performance through to the end of the project. In line with that, construction activities are now well-advanced and the first units at both sites are now scheduled to begin hot commissioning in late summer.

The LCPD actually came into effect on 1 January 2008 and, in the meantime, SSE has an agreement with the Environment Agency to enable it to operate Fiddler's Ferry for 1,270 hours to 15 September 2008 and also Ferrybridge for 1,270 hours to 15 September 2008, under a derogation from Article 5 of the LCPD. As a result, the stations operated with a lower than usual load factor in the early months of 2008.

In order to comply with the LCPD after 2015, SSE will have to install advanced nitrogen oxide abatement equipment at Fiddler's Ferry and at the capacity at Ferrybridge fitted with FGD. This will require a substantial investment, but it is unlikely to commence before 2011/12 and the first stage is included in SSE's expected capital expenditure for the next five years.

In view of the ongoing role for coal-fired electricity generation in the UK, SSE believes that there may be a need to replace the capacity (1,000MW) at Ferrybridge which is scheduled to close in 2015. Having discounted 'retrofit' options in the autumn of 2007, it is currently developing options for a new 800MW unit at the site using the Supercritical Boiler technology. The high temperatures and pressures which feature in this technology deliver a significant increase in thermal efficiency, from a typical 35% for existing plant to around 45%, thereby delivering a significant reduction in the carbon dioxide emissions per kilowatt-hour of electricity produced.

Any plant would be made 'capture ready', enabling it to be fitted with carbon capture and storage (CCS) equipment. SSE has a long-standing and active interest in developments in CCS and, following the launch of the UK government's CCS competition in November 2007, submitted in March 2008 an outline project proposal to operate by 2012 a post-combustion plant fitted to 50-100MW of an existing sub-critical coal unit at Ferrybridge power station. This would allow the necessary design and operational knowledge to be developed to enable commercial-sized units (300-400MW of flue gas treatment) to be offered on a commercial basis on an earlier timetable than proposals based on installation to new Supercritical plant which is unlikely to be available before 2015. SSE believes its proposal provides an achievable and important step in the technological development of CCS.

Plant construction lead times for coal-fired (and gas-fired) generation are lengthening as the global demand for power generation equipment continues to heighten, and that global demand could have a significant impact on the price of such equipment. This, allied to the volatile nature of commodity prices for coal and gas, makes investment decisions in these areas increasingly complex. At the same time, it supports the value of existing assets and assets already under development, including those which rely on renewable sources to produce energy.

#### **Coal and Biomass Generation - Sustainability**

The overall sustainability of SSE's coal-fired power stations will be further enhanced upon the completion of the plasterboard factory being developed at Ferrybridge by Lafarge Plasterboard Ltd and the ash separation plant being developed at Fiddler's Ferry by RockTron Limited.

Creating around 70 new jobs, the Lafarge factory at Ferrybridge will use the source of gypsum produced as a result of FGD, process it and despatch it from the site as plasterboard. The factory is expected to be operational later this year.

Over a period of up to 25 years, the RockTron plant at Fiddler's Ferry will remove and process all fresh ash produced by the power station, and much of that currently stored in lagoons at the site, up to a total of around 800,000 tonnes per annum. The ash will be processed into its constituent parts which become marketable products, with the largest volume being used as cement substitutes. Without processing, ash disposal would begin to attract landfill duty and associated environmental liabilities. The plant is expected to be operational before the end of 2008.

### **EU Emissions Trading Scheme**

Phase II of the EU Emissions Trading Scheme (EU ETS) started on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE received an allocation of 16.3 million tonnes per annum. This can be compared with its Phase I allocation of 19.6 million tonnes per annum. SSE's Phase II allocation as a percentage of its Phase I allocation is around 83%, compared with around 80% across the electricity sector as a whole. In addition, the Environment Agency has confirmed that Marchwood Power Ltd has an allocation of five million tonnes reserved to it from when it is commissioned to the end of Phase II.

SSE does not believe such allocations represent any kind of 'windfall'. Before the introduction of EU ETS on 1 January 2005, power stations could emit carbon dioxide free of charge. After that date, they had to operate within tighter emissions limits. Where those limits have had to be breached – often to ensure the stability of the country's electricity system – electricity generators, including SSE, have had to purchase permits to emit carbon dioxide.

In other words, EU ETS represents an additional – and, over the long term, growing – cost for electricity generators, and is not a 'windfall'. It is expected to grow on the basis that the UK government and the EU remain convinced that a price for carbon that reflects the environmental costs of electricity production and consumption is the best means of encouraging investment in low- and zero-carbon technologies.

In line with this, in January 2008, the EU set out proposals for the EU ETS after 2012. It suggested that all of the carbon dioxide emissions allowances for electricity producers should be auctioned. The proposals are subject to approval by the EU Council of Ministers and the European Parliament and so they have some way to go before they are adopted policy for implementation.

In 2007/08, emissions of carbon dioxide from SSE's power stations and from the contracted output share of emissions from power stations in which it has a contractual relationship totalled 22.7 million tonnes, compared with 25.8 million tonnes in the previous year. It purchased carbon dioxide emissions allowances totalling 6.7 million tonnes in 2007/08, beyond that provided under the National Allocation Plan.

Under the Clean Development Mechanism (CDM) established under Article 12 of the Kyoto Protocol, companies can meet their carbon emissions reduction targets by purchasing Carbon Emissions Reduction Certificates (CERs) from CDM-approved carbon reduction projects in the developing world.

During 2007/08, SSE entered into agreements with companies in China and Brazil to purchase around three million CERs over a period of up to five years. The CERs relate to wind farms and hydro schemes and therefore mirror SSE's strategy in the UK. While the large majority of SSE's investment in reducing carbon emissions will continue to be in the UK, it will continue to seek opportunities to expand its activities in this area.

## **Renewable Energy – Overview**

Tackling climate change and securing future supplies are the twin goals of energy policy in the UK, Ireland and throughout the European Union (EU). In line with that, the EU's adoption of a legally-binding target of 20% for the proportion of all energy to be derived from renewable sources by 2020, supported by a draft Directive, will clearly lead to a dramatic increase in the amount of renewable energy that will be required by that date. The EU targets currently mean the UK will have to increase its renewable energy proportion of all energy demand from 1.3% to 15%. For Ireland, the increase is from 3.1% to 16%. In practice, this is likely to mean that around 40% of the countries' electricity requirements will have to be met from renewable sources.

As the EU Energy Commissioner stated in January 2008: 'In a time of growing oil prices and climate change concerns, renewable energy sources is an opportunity that we cannot miss. They will help us to reduce our carbon dioxide emissions and strengthen our security of supply'. Against this background, SSE will seek to enhance and create value for shareholders from the development of an international business focusing on renewable energy. An international business will provide SSE with the opportunity to gain experience of operating in a number of countries, as well as providing greater diversity within its renewable energy portfolio.

Following the acquisition of Airtricity, and the ongoing development of its own portfolio of projects, SSE now owns and operates over 2,000MW of capacity for generating electricity from renewable sources, comprising: over 1,350MW of capacity in hydro electric schemes (including pumped storage); around 600MW of wind farms; and the UK's largest dedicated biomass energy facility at Slough (80MW). Of this capacity, 260MW is in the Republic of Ireland, with the remainder being in the United Kingdom.

Looking ahead, the expected completion of onshore and offshore wind farm developments and the Glendoe hydro electric scheme should increase SSE's renewable energy capacity in the UK and Ireland to over 2,500MW by the end of 2010 and to 4,000MW by the end of 2013.

As well as its obvious environmental credentials, renewable energy also significantly reduces SSE's exposure to escalating prices for fossil fuels for the straightforward reason that – in the case of hydro and wind – the fuel used to generate electricity is indigenous and free.

## **Hydro Generation - Operations**

Total output from SSE's hydro electric stations (excluding pumped storage) during 2007/08 was 3,518GWh. This compares with 3,767GWh in the previous year, which was the fourth highest on record, and with the 10-year average of 3,250GWh. As at 31 March 2008, the amount of water held in SSE's reservoirs which could be used to generate electricity was 73% of the maximum, compared with 75% on the same date last year, enough to generate 655GWh of electricity.

The output of refurbished hydro electric stations with capacity of up to 20MW, and of all new stations commissioned after 2002, qualifies for ROCs and SSE has just over 400MW of capacity in this category. Of the total hydro output in 2007/08, just over 1,700GWh qualified for ROCs. Assuming average 'run off' of water into SSE's reservoirs during the year, the ROC-qualifying output from hydro generation is expected to be around 1,600GWh in 2008/09.

In October 2007, and following discussions with SSE and others, the Scottish Environment Protection Agency published the Significant Water Management Issues consultation report, an intermediate step in the preparation of the river basin management plan for Scotland under the Water Framework Directive. The outcome of this consultation will help shape the way the water environment is regulated, and SSE believes that, ultimately, the Directive can be implemented without reducing the output of renewable energy.

### **Hydro Generation - Investment**

The construction of what will be SSE's second largest conventional hydro electric station at Glendoe, near Loch Ness, is now entering its final phase. The 960 metre-long dam is expected to be completed in the autumn and commissioning of the single 100MW turbine is expected to take place early in the New Year. It therefore remains on course for electricity to be generated by the end of this financial year. At that point, SSE's hydro electric capacity, including pumped storage will reach over 1,450MW.

With an installed capacity of 100MW, Glendoe will produce around 180GWh of electricity qualifying for ROCs in an average year. When synchronised, it will be able to start generating 100MW of electricity in 30 seconds. The final investment at Glendoe is likely to be over £140m, of which £128m had been incurred by the end of March 2008.

In addition to Glendoe, SSE has applied for consent to build new 'run-of-river' hydro electric schemes near Crianlarich (2.5MW) and Wester Ross (3.5MW). SSE continues to believe there is potential to develop a small number of new, larger hydro electric schemes in the Highlands, and given the significance of the recently-adopted EU targets it is exploring again the scope to develop at least one of these potential sites and is currently identifying the site most likely to overcome the various planning obstacles and secure consent.

The vast majority of SSE's hydro electric stations were built in the 1950s and early 1960s and are the subject of a rolling programme of investment to prolong their working life and improve their operational efficiency, with a total value of around £15m per annum.

### **Wind Generation - Operations**

SSE's wind farms at Tangy (now 19MW following its extension), Spurness (currently 8MW), Artfield Fell (20MW) and Hadyard Hill (120MW) produced 350GWh of ROC-qualifying output in 2007/08, compared with 384GWh in 2006/07.

These wind farms are all in Scotland and, following its acquisition of Airtricity, SSE now owns capacity at two other Scottish wind farms which produced electricity during 2007/08: Ardrossan (12MW); and Braes of Doune (36MW). It also now owns and operates two wind farms in Northern Ireland which produced electricity during the year: Bin Mountain (9MW); and Tappaghan (19MW). The total ROC-qualifying output from this capacity in 2007/08 as a whole was 189GWh, of which 39GWh was attributable to SSE following the acquisition of Airtricity.

In addition, SSE's 10 wind farms in the Republic of Ireland produced 645GWh of electricity during 2007/08, of which 110GWh was attributable to SSE following the acquisition of Airtricity.

The output from SSE's wind farms in the UK and the Republic of Ireland is expected to be significantly greater in 2008/09 than in the preceding year based on recently-constructed wind farms such as Dalswinton and Drumderg producing power and new plant currently in construction being commissioned.

### **Wind Generation – Investment Overview**

Airtricity is now SSE's renewable energy development division, and has been combined with SSE's existing wind and hydro development team to provide a significantly enhanced capability in this vital area.

When it entered into the agreement to acquire Airtricity in January 2008, the combined business had 875MW of onshore wind farm capacity in operation, in construction or with consent for development. Since then, consent has been granted for a number of developments and construction work has been completed at some others. As a result, SSE now has almost 1,030MW of onshore wind farm capacity in these categories, an addition of more than 150MW since January 2008. This means the pipeline of opportunities in renewable energy which the acquisition highlighted is being realised. It also means that SSE now has over 3,000MW of renewable energy capacity in operation, under construction or with consent.

SSE said, when it acquired Airtricity, that it expected to have over 3,500MW of operating renewable capacity in the UK and Ireland in 2013. Following a comprehensive review of its renewable energy projects, SSE now expects this to be around 4,000MW. On this basis, it will double in five years its renewable energy capacity in the UK and Ireland. During 2008/09 alone, it will start construction work at a number of wind farms in Scotland and elsewhere.

The achievement of this new target is subject to projects securing all of the necessary approvals in a timely manner, adequate electricity network capacity and to the maintenance of a stable public policy framework which encourages investment in renewable energy. Subject to that, SSE expects its portfolio in 2013 will comprise, in addition to almost 1,500MW of hydro electric schemes: around 2,000MW of onshore wind farms; over 250MW of offshore wind farms; and around 250MW of waste-to-energy and biomass developments.

In addition to the above, SSE is now pursuing onshore and offshore wind farm developments in Europe and onshore developments in China which could add well over 500MW to its renewable energy portfolio by 2013.

#### **Wind Generation – Investment in the UK and Ireland**

The delivery of an additional 2,000MW of renewable capacity in the UK and Ireland by 2013 is likely to require capital investment of over £2.5 billion in onshore wind, offshore wind and hydro electric schemes over the next five financial years, with investment currently expected to peak in 2010/11.

This investment programme includes the 504MW Greater Gabbard offshore wind farm. Construction work will begin shortly and on completion, it will be the world's largest offshore wind farm.

The development of the wind farm was carried out by Greater Gabbard Offshore Wind Ltd, a 50:50 joint venture between Airtricity and Fluor. Having secured the construction contract, Fluor agreed to sell its 50% stake in the joint venture to SSE for £40m in cash in May 2008. SSE intends to sell 50% of the project equity later this year. A turbine reservation agreement with Siemens Wind Power A/S for the supply of 140 3.6MW turbines was secured in 2007 and both parties subsequently agreed the turbine supply contract and the five-year service and warranty contract for the development.

The wind farm will be commissioned in two phases, with the entire construction scheduled to be completed in 2011. It is expected to have a load factor of over 40%, based on site-specific data collected since 2005.

The development, excluding the connection, is expected to require investment of around £1.3bn. SSE will fund its 50% share from either its balance sheet or through non-recourse project finance. It also expects to take 50% of the output of Greater Gabbard, with the remainder being the subject of a separate agreement with another power purchaser.

A major construction project of this kind, in potentially challenging conditions, is not without risks but these have been managed through the procurement and project management strategies which have been adopted.

The overall investment profile for the next five years is subject to a number of factors, including constraints on the supply of wind turbines and the impact of those constraints on their procurement. Nevertheless, the turbine supply position is expected to improve over the next few years, and SSE's enhanced significance as a wind farm developer following the acquisition of Airtricity should enable it to secure good value from suppliers. It is also exploring new sources for wind turbines, including China. In line with that, it is working with a Chinese manufacturer on the introduction of its turbines into the European market next year.

The target for 2013 does not include the proposal by SSE and Viking Energy Ltd, the company established to represent Shetland Islands Council's interests in wind farm development, to develop on Shetland's Central Mainland a wind farm with around 600MW of

capacity. An application for consent to build the wind farm is now expected to be submitted to Scottish Ministers later this year. It also does not include the proposal by SSE for a 94MW wind farm on the Isle of Lewis, which, if consented, is not expected to be operational before the end of 2013.

### **Biomass**

In December 2007, SSE completed the acquisition of Slough Heat and Power from SEGRO plc for a total cash consideration of £49.5m. Slough Heat and Power is an integrated energy business, which includes a combined heat and power (CHP) plant with current generating capacity of 80MW. The CHP plant is the UK's largest dedicated biomass energy facility and its main fuel sources are wood chips, biomass and waste paper. The site has its own fuel processing plant, which takes delivery of waste paper products and converts them into useable fuel.

Part of the plant is contracted under the Non Fossil Fuel Obligation. It produced 144GWh of output qualifying for ROCs, during 2007/08, of which 19GWh was attributable to SSE. The acquisition gives SSE a platform from which to build up its interest in biomass and waste-to-energy, which it believes will become increasingly important over the next decade.

### **Investment in New Markets**

In addition to its wind and hydro investments in the UK and Ireland, SSE is also expecting to invest around £500m in renewable energy in new markets: onshore and offshore wind farms in Europe (principally Portugal, Sweden, Italy and Germany where there are particular opportunities for growth in renewables); onshore wind farms in China; waste-to-energy (principally in the UK); and emerging technologies. This investment will largely be on an equity basis, with non-recourse debt expected to account for around 75% of the total cost of the investment.

For example, in April 2008, SSE – through Airtricity – entered into a 50:50 joint venture with Gothia Vind which is expected to lead to the development of new wind farms in western Sweden. Based near Gothenburg, Gothia Vind is a specialist wind energy developer. The joint venture is aiming to develop around 200MW of wind farm capacity in western Sweden, with the first wind farm scheduled to be in operation around 2011. The development of this capacity is expected to require equity investment by Airtricity and Gothia Vind of around €30m each over the next few years, with non-recourse debt in this instance expected to account for around 80% of the total cost of the investment.

While the acquisition of Airtricity has extended the scope of SSE's renewable energy interests to continental Europe and to China, thereby giving it development and operational activity in new geographical locations, that activity will remain very focused and disciplined. SSE will be specific about the new markets which it is tackling and longer-term developments will depend upon clearly demonstrated success in attaining shorter-term goals, such as those set for 2013.

### **Investment in Emerging Technologies**

As well as investing in technologies which already have the scale to make a substantial contribution to meeting energy needs in the near future, SSE has a range of investments in emerging technologies. The development of secure, reliable and cost-effective low carbon energy technologies towards commercial deployment is a key priority for the UK government and is part of SSE's strategy to remain the UK's leading generator of electricity from renewable sources. Participation in emerging technology developments helps SSE to be at the forefront of, and to adapt to, the changes in energy production and consumption that are likely to occur over the next decade.

Of the emerging technologies, solar is likely to be critical and SSE has a 12.3% stake in Solarcentury, the UK's leading independent solar photovoltaics company. SSE is Solarcentury's preferred installer and the two companies have been appointed by the UK Department for Business to supply and install solar panels on Britain's public buildings as part of its £50m Low Carbon Buildings Programme.

SSE also has a 50% stake in Aquamarine, the marine energy company which is developing wave power and tidal power devices for comprehensive testing at the European Marine Energy Centre in Orkney.

In March 2008, SSE and Intelligent Energy announced the formation of a joint venture company which will develop clean and reliable fuel cell-based CHP systems for the light industrial, commercial and residential markets in the UK and Ireland. In addition, in April 2008, SSE acquired a 21% stake in Logan Energy Limited, in return for £375,000 and goodwill brought to the new business, which will focus on fuel cell installation and maintenance.

This was followed in April 2008 by an agreement to invest up to £15m in cash for a 20% stake in Geothermal International, the UK's leading supplier of ground-source heating and cooling systems, from existing shareholders. From being established in 2000, it has installed over 1,300 ground source heat pump systems, amounting to over 90MW of installed capacity.

Since the start of 2007/08, through equity and loans, SSE has committed to investing over £60m in a variety of emerging technologies designed to deliver secure, reliable and cost-effective low carbon energy systems, of which £13.8m was invested by the end of March 2008.

### **Review of Carbon Intensity Target**

In the light of its enhanced renewable energy capability, SSE has reviewed its target of reducing the amount of carbon dioxide per kilowatt hour of electricity, produced at power stations in which it has an ownership or contractual interest, by 20% over the ten years to 2016. The base year for SSE's carbon intensity target is 2005/06, because it was the first full year after it acquired coal-fired power stations at Fiddler's Ferry and Ferrybridge.

SSE is now targeting a reduction in carbon intensity of 50%, to around 300g/kWh, over the period from 2005/06 to 2020. As with the previous target, SSE will report on its progress against the 50% target each year, and in 2007/08 carbon intensity on this basis was just under 500g/kWh. The decisions SSE takes and the investments it makes will be guided by its new target. Like most long-term targets, achievement will be influenced to some extent by circumstances outside its control.

### **Nuclear Power**

SSE's first responsibility to its customers is to maintain supplies of energy, in a way that is compatible with wider climate change and energy security issues. Of the total electricity supplied by SSE during 2007/08, around 15% was derived from nuclear power stations, which are owned and operated by other generators.

In its submission to the UK government consultation on the future of nuclear power in 2007, SSE said there is value in the UK making available the nuclear option, along with a diverse range of other generation options, provided there is a stable framework in place for investors and an appropriate degree of public confidence in all aspects of nuclear power is maintained. In other words, it believes that one more tranche of nuclear power stations will be necessary, but that the deployment of such power stations should be minimised through the maximum exploitation of renewable sources of energy.

Against this background, SSE may work with other parties to help secure the development of new nuclear power stations, through appropriate contractual support or investment. In practice, however, any investment is unlikely to be made before the next decade – and any new nuclear power stations are unlikely to be commissioned before the start of the decade after that.

### **Generation Priorities for 2008/09 and beyond**

During 2008/09, and beyond, SSE's key objectives in Generation will be to ensure that its diverse portfolio of power stations is available to generate electricity, with the maximum possible efficiency, in response to customer demand and market conditions, while complying fully with all safety standards and environmental regulations.

The achievement of these objectives is now supported by an SSE-wide Engineering Centre, which has been established to provide an effective long-term asset management, engineering strategy and investment planning capability across SSE's growing range of electricity generation and gas storage assets.

SSE will also be working to ensure that all generation plant is well-maintained, with timely investment in asset replacement and refurbishment projects and that the new generation projects proceed on time and on budget. As is the case throughout the generation sector, these projects and plans may be subject to the impact of increasing capital costs and skills shortages as worldwide demand for electricity infrastructure continues to rise.

During 2008/09, major questions will continue to be asked about the sustainability of electricity production in the UK, Ireland, the EU and elsewhere. SSE is a major investor in minimising the environmental impact of gas- and coal-fired generation and in renewable energy (especially following the acquisition of Airtricity) and emerging technologies and making progress with these investments will be a central priority for SSE in 2008/09 and beyond.

Over the five years to 2013, it expects to invest over £4 billion across its entire generation portfolio, including investment in existing assets. This investment will be designed to abate the environmental impact of existing assets and extend their lives and to deliver new assets, principally in renewable energy but also – as in the case of Marchwood – thermal generation.

As a result, SSE will have a growing, but balanced, portfolio of electricity generation assets, with a diminishing environmental impact and with relatively less exposure to fossil fuel price volatility.

## **ENERGY SUPPLY**

### **Energy Supply Objectives**

Energy supply in the UK is changing dramatically, with companies having to operate in volatile markets, which reflect depletion of North Sea oil and gas fields, soaring global demand and competition for all types of energy and, during 2007/08, the passing of the \$100 per barrel oil price milestone. All of this culminated in persistently high wholesale prices for electricity and gas during 2007/08. These pressures are compounded by the rising transmission, distribution and environmental costs which suppliers have to meet.

The UK's energy market remains the most competitive in the EU and G7, according to a report by the Oxford Economic Research Associates (OXERA) published in January 2008 which monitored the competitiveness of the energy market by assessing a range of factors. In welcoming the report, the UK Secretary of State for Business said: 'Creating an open and competitive energy market has meant that UK consumers have consistently benefited from amongst the lowest energy prices in Europe.'

Figures from Ofgem show that the switching rate for gas and electricity suppliers reached more than five million in 2007. This was the highest level of switching for five years. As the Ofgem Chief Executive stated: 'Suppliers who don't offer competitive prices and good service will lose customers.'

In an industry where switching is commonplace and the cost of regaining customers is significant, SSE's objective is to grow its Energy Supply business by offering consistently competitive prices and providing sector-leading service so that it is able to retain and gain customers. It also aims to broaden its relationship with those customers through the provision of added value products and services relevant to them and their needs.

### **Pricing Policy for Domestic Electricity and Gas Customers**

Over the past few years, SSE has adopted a responsible pricing policy. The policy means that SSE seeks to be the last, or one of the last, of the major suppliers to increase prices if it has to and the first, or one of the first, to reduce prices if it can. The consistent application of

this policy means that SSE's customers have paid an average total of around £430 less for their electricity and gas during the last four years than have customers of the UK's largest supplier, British Gas. SSE was the only major supplier not to introduce a price increase during 2007/08, although price rises were implemented on 1 April 2008. It intends to maintain its responsible pricing policy going forward.

### **Customer Numbers**

The implementation of its responsible pricing policy helped SSE achieve a net gain of 700,000 energy customers during 2007/08, taking the total to 8.45 million as at 31 March 2008, comprising 5.28 million electricity customers and 3.17 million gas customers. Within the total, SSE's business customers now cover over 400,000 sites throughout Great Britain and 1.8 million customers have 'loyalty' products such as energyplus Argos, which rewards customers with money-off discount vouchers.

The growth secured during the year enabled SSE to overtake E.on UK to become the UK's second largest supplier according to the Datamonitor Market Share Monitor. SSE has gained almost four million energy supply customers since the start of 2002, when it was the UK's fifth largest supplier.

In addition to electricity and gas customers, SSE now has 165,000 talk with telecoms customers and 70,000 shield gas boiler maintenance customers. This means its total customer base in Great Britain was almost 8.7 million as at 31 March 2008. It also has 38,000 mainly commercial electricity customers in the Irish all-island market.

In July 2007, Ofgem published its Domestic Retail Market Report, which confirmed that SSE is the UK's most successful supplier in terms of the share of the electricity supply market held by 'incumbent' suppliers in the 14 regions of Great Britain. It stated that SSE had 80% of the electricity customers in the Scottish Hydro Electric area, 70% of the customers in the SWALEC area and 62% of the customers in the Southern Electric area. The next highest share held by an incumbent supplier was 61%. This has again confirmed the value of SSE's three regional energy supply brands.

### **Customer Service Performance**

Central to success in a highly-competitive market such as Energy Supply is maintaining the highest possible standards of customer service. Despite the significant growth in customer numbers, SSE secured during 2007/08 another reduction, of 27% to 615, in the number of customer complaints sent to energywatch for resolution. This compares with 3,400 five years ago, in 2002/03. SSE continues to have the lowest number of complaints sent to energywatch for resolution and, in September 2007, it was announced that it had come top in an energywatch survey of small business customers' satisfaction with their energy suppliers.

In October 2007, uSwitch.com reported that SSE was ranked top for customer satisfaction for the fourth time in a row in its latest independent Customer Satisfaction Report and it described SSE as 'simply the best'.

In the result of the JD Power 2007 UK Electricity and Gas Customer Satisfaction Study announced in November 2007, SSE was ranked the top-performing supplier in both electricity and gas. This was the first time one supplier had achieved the top ranking in both sectors. In electricity, it was the only supplier to achieve overall customer satisfaction which was 'significantly better' than average; and in gas it was one of just two suppliers to deliver 'significantly better' than average customer satisfaction.

### **Customer Service Developments**

SSE's objective is to build on its position as the UK's leading energy supplier for customer service, and thereby be in a strong position to retain and gain customers. In line with that, it is introducing a new Domestic Energy Customer Charter, building on the original Charter which it launched in 2006.

The new Charter maintains the 'commitment-based' approach to general customer enquiries which was central to the approach contained in the first Charter, with the emphasis on

ensuring that as many customers as possible have their issues resolved at the first point of contact. It also sets out improved standards for responding to customers' enquiries and also confirms SSE's responsible pricing policy.

Customer service performance is now supported by the combination, from September 2007, of telephony and billing systems so that they now recognise a customer's phone number and bring up their details on the screen in front of the customer service adviser. This saves an average of 30 seconds per call and adds the equivalent of around 100 extra people to take calls.

It is in line with research which has confirmed that the key frustrations for customers are the length of time they spend on hold when seeking help over the telephone and being passed to more than one company representative. In other words, while technology has its part to play in supporting service delivery, customers like to interact directly with company representatives. SSE has, therefore, broadened the role of its advisers and actively extended call times to ensure there is a full understanding of customers' requirements.

### **Vulnerable Customers**

The single biggest contribution which energy suppliers can make to helping vulnerable customers is to keep prices as low as possible for as long as possible, and this principle is one of the reasons for SSE's responsible pricing policy.

SSE also believes that any 'social' tariff offered by suppliers is only meaningful if it is clearly the lowest-cost tariff that they make available to any type of customer, on any type of payment plan or sign-up method. Its energyplus care tariff and package of services means eligible customers receive at least a 20% discount from their energy tariff in addition to other help including benefit entitlement checks, free energy efficient appliances and home insulation, where appropriate. SSE is aiming to make the tariff available on 100,000 customer accounts by the end of March 2009.

In April 2008, SSE and the other major energy suppliers entered into a three-year agreement with the UK government to offer increased assistance to the fuel poor and groups vulnerable to fuel poverty. Under the agreement, SSE will operate existing and new schemes with a total value of around £16m in the first phase, up to 31 March 2009. The UK government has stated that given the substantial commitment that an agreement of this kind represents, it will not expect or ask companies to do more on social assistance over the period 2008-11.

These schemes will be designed to assist the fuel poor and those vulnerable to fuel poverty. They will feature a variety of approaches such as 'social' tariffs, including energyplus care, charitable donations, bespoke services for vulnerable customers, work with advocate organisations and community-based programmes. In support of this agreement, SSE has published a Code of Practice for Vulnerable Customers, following consultation with consumer and voluntary organisations.

### **Renewable Energy**

In common with all other electricity suppliers, SSE provides information to its customers on the fuel mix of their electricity supply. The intention is that the provision of this information should enable customers to make informed choices about the environmental impact of the electricity they buy. Based on the latest information available at 31 March 2008, SSE's customers were supplied by a higher proportion of renewable energy (10.2%) than customers of any other major supplier. The average proportion of renewable energy supplied by the other major suppliers was 4.5%.

### **Product Marketing**

Energy supply remains intensely competitive and, in addition to responsible pricing and best-in-sector customer service, product development and marketing – sometimes working with other organisations – has an important part to play in gaining and retaining customers' loyalty.

SSE has a suite of energyplus 'loyalty' products, ranging from energyplus Argos, which rewards customers with money-off discount vouchers, to energyplus Pulse, which supports

the British Heart Foundation. Of SSE's 8.45 million energy supply customers, around 1.8 million now have 'loyalty' products – an increase of around one third during the year.

The Energy White Paper said 'the starting point for our energy policy is to save energy'. It said the government would 'empower consumers to make more informed energy choices' and it also referred to trials of smart meters and real-time displays which enable people to track their energy use, and in which SSE has been selected to participate.

In short, the structure of energy consumption is going to change significantly and SSE believes that customers' greater awareness of the need for energy efficiency represents an opportunity. Against this background, it has launched the better plan – a unique energy programme which enables and encourages customers to commit to using less energy, supported by the provision of a real-time unit displaying electricity consumption. The better plan rewards them for doing so with vouchers enabling them to get money off their energy bills, A-rated electrical and gas appliances and energy efficiency measures. Around 40,000 customers have already joined the better plan.

### **Energy Performance Certificates**

The UK government is progressively introducing Energy Performance Certificates (EPCs) for house sales and commercial and rented properties. The certificates are commissioned by the seller or their agent from an accredited energy assessor, who visits the property to collect the relevant data and who creates the certificate. Ultimately, there could be a requirement for up to 7.5 million surveys each year.

SSE is recruiting qualified Domestic Energy Assessors to develop a new nationwide business to provide customers with EPCs and other related services which will complement its activities in energy supply, energy efficiency and energy services. The launch of the new business is another part of SSE's strategy to work with customers to actively manage their energy consumption.

### **Ireland**

The all-island electricity market comprises 2.6 million customers. There are also around 750,000 gas customers. Following the acquisitions of Airtricity and also CHP Supply Ltd, SSE had just over 38,000 mainly commercial electricity customers at 31 March 2008. SSE will build on this customer base to expand its presence in the commercial sector, begin supplying electricity to domestic customers and, in due course, begin supplying gas. With its experience of competing successfully in the energy supply market in Great Britain, SSE believes it is well-placed to make an impact on the all-island market.

### **Energy Supply Priorities in 2008/09 and beyond**

During 2008/09, and beyond, SSE will seek to capitalise further on its strong regional brands, best-in-sector customer service, responsible pricing policy and range of value-adding offers to increase further its number of energy supply customers in Great Britain.

Central to this will be the development and deployment of further improvements to the level of service offered to customers, leading to higher standards and fewer complaints. This will include improvements in SSE's ability to communicate electronically with customers. The successful launch of new products, sometimes in partnership with other organisations, will be a key priority. There will also be a focus on providing enhanced support for vulnerable customers.

SSE's priority in the Irish all-island market will be to consolidate and integrate its recently-acquired supply businesses, thereby providing the basis from which to grow customer numbers significantly in the future.

During 2008/09, significant questions will continue to be asked about the affordability of electricity and gas, in the context of intense global competition for energy. SSE's response will be to maintain its policy of responsible pricing, promote energy efficiency, reinforce the standard of its customer service and enhance its support for its most vulnerable customers.

Longer-term, continuing trends in technology, and customers' use of it, are likely to lead to a material change in the number of energy supply customers who wish to deal with their supplier online. This, in turn, means that suppliers will be required to have the optimum range of products and tariff structures and, perhaps, affinity arrangements. Over the next few years, SSE expects to make significant investment and progress in each of these areas which, allied to its long-standing focus on responsible pricing and customer service, is designed to deliver continuing long-term growth in its energy supply business.

## **NETWORKS**

### **Networks Introduction**

SSE owns Southern Electric Power Distribution, Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission. Under the current arrangements, these companies are the subject of incentive-based regulation by the Office of Gas and Electricity Markets (Ofgem), which sets for periods of five years the index-linked prices they can charge for the use of their electricity networks, their capital expenditure and their allowed operating expenditure, within a framework known as the Price Control. Ofgem also places specific incentives on companies to improve their efficiency and quality of service.

Overall, Ofgem seeks to strike the right balance between attracting investment in electricity and gas networks, encouraging companies to operate them as efficiently as possible and ensuring that prices ultimately borne by customers are no higher than they need to be. In electricity, the current Distribution Price Control runs until 31 March 2010 and the current Transmission Price Control runs until 31 March 2012.

As at 31 March 2008, SSE estimates that Ofgem's valuation of the assets of its electricity distribution and transmission businesses, the Regulated Asset Value (RAV), was £2.7bn, based on Ofgem's methodology, including just over £300m for transmission. On this basis, SSE is the UK's third largest electricity distribution company.

SSE also has an equity interest of 50% in, and provides corporate and management services to, Scotia Gas Networks (SGN), which owns Southern Gas Networks and Scotland Gas Networks. These companies own and operate the medium and low pressure gas distribution networks in their areas of the UK. They are the subject of incentive-based regulation similar to that which applies in electricity. A new Price Control for the five years to 31 March 2013 came into effect on 1 April 2008.

SGN estimates that the RAV of the networks it owns was around £3.5bn, based on Ofgem's methodology, as at 31 March 2008. This makes it the UK's second largest gas distribution company. SSE's share of this RAV is £1.75bn which, when added to its electricity network businesses, gives SSE a total RAV of £4.45bn.

In March 2008, Ofgem announced plans to review the 20-year old regime governing the regulation of electricity and gas networks. The review will examine whether the 'current approach will continue to deliver customers reliable, well-run networks with good service at reasonable prices amid growing investment challenges faced by the energy networks in the future'. Ofgem has stated that the range of possible recommendations emerging from the review runs from no change to substantial change, and that where change is recommended, there will be full consultation. Because the review will not report until 2010, and because any proposed changes will be subject to consultation, work on the Distribution Price Control Review for 2010-15 is expected to be unaffected.

After electricity and gas, Telecoms is SSE's third networks business; unlike the other two, it is not the subject of economic regulation. It operates a national telecoms network for commercial and public sector customers which extends to around 8,000km throughout Great Britain.

### **Energy Systems Performance Overview**

Operating profit\* in Energy Systems, including gas distribution, increased from £471.1m to £544.4m, contributing 39.4% of SSE's total operating profit.

The amount of electricity transmitted and distributed through SSE's networks and the amount of gas distributed through SGN's networks is determined by the weather, by customers' demand for energy and by the availability of the networks themselves. Variations in the volume of energy distributed have an impact on the income earned by SSE's energy systems businesses.

During 2007/08, Southern Electric Power Distribution, Scottish Hydro Electric Power Distribution, Scottish Hydro Electric Transmission and SGN all distributed more units of energy than in the previous year, which was marked by unusually high temperatures.

If, in any year, regulated energy networks companies' revenue is greater (over recovery) or lower (under recovery) than is allowed under the relevant Price Control, the difference is carried forward and the subsequent prices the companies may charge are adjusted.

### **Power Systems Objectives**

SSE's objective in power systems is to ensure that they are managed as efficiently as possible, including maintaining tight controls over operational expenditure and delivering effectively capital expenditure, so that the number and duration of power cuts experienced by customers is kept to a minimum.

Through good performance in areas such as customer service and innovation, SSE seeks to earn additional incentive-based revenue under the various Ofgem-sponsored schemes. Over time, its objective is to grow the RAV of the networks businesses and secure increased revenue from them. Constructive engagement with the regulator, Ofgem, during the various Price Control Reviews, is central to this objective.

### **Southern Electric Power Distribution**

Southern Electric Power Distribution's operating profit\* increased by 3.9%, from £224.0m to £232.7m. During the year, it distributed 34.2TWh of electricity, compared with 33.9TWh in the previous year. The positive impact on profitability of this increase in the number of units distributed was supplemented by changes in their price.

Ensuring the reliability of the electricity networks it owns and operates is one of SSE's main priorities and the key measures of reliability are customer minutes lost and customer interruptions. The average number of minutes that customers in the Southern Electric Power Distribution area were without supply during the year was 67, compared with 72 in the previous year; and the number of supply interruptions per 100 customers was 66, compared with 75 in the previous year.

Performance in respect of both minutes lost and interruptions was ahead of the targets set by Ofgem under its Quality of Service Incentive Scheme (QSiS), which gives financial benefits to distribution network operators that deliver good performance for customers. This, together with income earned during 2007/08 under other incentive arrangements, is expected to lead to SSE receiving additional revenue totalling £10.5m during the next two financial years.

### **Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission**

Operating profit\* for Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission increased by 4.3%, from £144.0m to £150.2m. In the Scottish Hydro Electric area, 8.8TWh of electricity were distributed during the year, compared with 8.5TWh distributed in the previous year. As in the Southern Electric area, the positive impact on profitability of this increase in the number of units distributed was supplemented by changes in their price.

The average number of minutes that customers were without supply during the year was 72, compared with 77 in the previous year. The number of supply interruptions per 100 customers was 69, compared with 79 in the previous year. Performance in respect of both minutes lost and interruptions was ahead of Ofgem's QSiS targets. This, together with income earned in 2007/08 under other incentive arrangements is expected to lead to SSE receiving additional revenue of £5.5m during the next two financial years.

### **Electricity Network Investment and RAV Growth**

The key responsibility of SSE's electricity networks businesses is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. The Distribution Price Control Review for 2005-10 resulted in substantially increased allowances for capital expenditure to maintain and improve the networks' performance. This will enable SSE to increase its revenue from its networks, and the efficient delivery of this enhanced investment programme was one of SSE's priorities for 2007/08.

During the year, SSE's capital expenditure on electricity networks was £264.4m, compared with £204.5m in the previous year. The most significant electricity distribution project being undertaken by SSE is the construction of two new underground cable 132kV circuits from Bramley to Basingstoke in Hampshire, designed to ensure the electricity network can meet maximum demand for 650,000 customers served by the Bramley and Fleet grid supply points. The 10km route includes 4km of urban roads, directional drills under rural water courses and large open cut crossings through the main railway line cutting in Basingstoke. It also requires development work at two substations. The total cost of the project is over £16m and it is on course for completion before the end of this year.

The most significant electricity transmission project on which work is actually getting under way is the Inverarnan substation, which will provide 200MW additional export capacity for electricity generated from renewable sources in Argyll. This is a joint project with Scottish Power Transmission. SSE's investment is around £12m.

Since the start of the current Distribution Price Control in April 2005, SSE has invested £556m in its distribution networks (which excludes metering) and a further £88m in its transmission network. It estimates that the RAV of its distribution and transmission businesses is now £2.7bn. The expected total growth in the RAV over the whole of the 2005-10 Distribution Price Control period, based on Ofgem's methodology, is forecast to be almost £500m, taking it to around £3bn in 2010. This excludes any major transmission investment. In line with this, SSE expects to invest almost £300m in its electricity networks in 2008/09.

### **Future Transmission Developments**

As the licensed transmission company for the north of Scotland, SSE is required to ensure there is sufficient network capacity for those seeking to generate electricity from renewable sources. In January 2008, the Scottish Government designated electricity network reinforcement to support renewable energy development as one of nine proposed 'National Developments' in the draft second National Planning Framework. Designation as National Developments in the Framework establishes these projects as being in the national interest.

SSE believes the project to replace the electricity transmission line connecting Beauly in the Highlands with Denny in the Central Belt of Scotland is in line with its responsibilities as a licensed transmission company and is also in the national interest. A year-long Public Inquiry into the project was completed in February 2008. The Scottish Minister for Enterprise, Energy and Tourism stated in the Scottish Parliament in September 2007 that Ministers do not expect to receive the report of the Inquiry until late 2008 and that a determination is unlikely before early 2009. It is now likely that the construction of SSE's share of the replacement line will require investment in excess of £300m.

As the UK Business Council for Sustainable Energy said in its paper on implementing the EU renewable energy target in the UK, the consenting and completion of the Beauly-Denny rebuild is essential to releasing the upgrade potential of the existing Scottish transmission system. By rebuilding the weakest part of a north of Scotland transmission ring, it will allow the other elements to that ring to be re-conductored and re-insulated (avoiding any need for new overhead line routes) to increase the capability for renewable energy capacity in the north of Scotland to over 6GW, compared with around 2.2GW currently connected.

SSE has undertaken a public consultation exercise on its draft proposals for the possible development of a new high voltage electricity transmission cable capable of accommodating

power from wind farms on Shetland and connecting it to the existing mainland transmission network at Blackhillock in Moray.

The Scottish Government is exploring subsea electricity network options through two offshore transmission studies: the Irish Scottish Links on Energy Study and the North Sea Energy Grid. Before its acquisition by SSE, Airtricity was an early advocate of proposals to develop a European offshore grid to facilitate the export of renewable energy. SSE is well-placed to contribute to the development of new grid options and will continue to work on them with Scottish Ministers and officials and other stakeholders.

In September 2007, the European Commission published its third package of proposals to further liberalise the EU's energy market. The package includes options for electricity and gas transmission networks: the full ownership unbundling of transmission from production and supply in both electricity and gas; or the designation of an independent system operator (ISO) that would operate, maintain and develop the networks, which would make it possible for existing vertically-integrated companies to retain network ownership. SSE believes that the ISO model in Great Britain has worked well and could be successfully replicated elsewhere in the EU. Discussions on this issue are continuing, with a view to EU governments reaching agreement on a way forward later this year.

#### **Electricity Distribution and Transmission Priorities in 2008/09 and beyond**

During 2008/09, and beyond, SSE's first objective in electricity distribution and transmission will be to maintain safe and reliable supplies of power and to restore supplies as quickly as possible in the event of interruptions, so performance in terms of customer minutes lost and customer interruptions will continue to be critical.

This will be supported by delivery of continuous improvement initiatives, following the implementation of a review of internal processes and customer-facing operations that took place during 2007/08. Ofgem has already stated that encouraging electricity distribution companies to be 'more responsive to the needs of customers' will be amongst its key priorities for the forthcoming Distribution Price Control Review for 2010-15.

Over the next year, detailed work will begin on the Review, where Ofgem's other key priorities include giving companies 'strong incentives to help tackle climate change' and 'delivering good value for consumers by ensuring that companies provide secure and more sustainable networks'. Ofgem also pointed out that it is likely that there will be growth in renewable and small-scale 'distributed' generation, which could see much more generation connecting directly to the distribution, as opposed to the transmission, network.

During 2008/09, important questions will be asked about the reliability of the UK's electricity networks and their fitness for purpose in the context of the need to accommodate output from renewable energy schemes. Key priorities for SSE during the year will include the efficient delivery of the next phase of the major programme of investment in the networks. This will be targeted at upgrading them so as to benefit the greatest number of customers. It will also undertake work in advance of what is hoped to be a successful outcome from the Public Inquiry into the Beaulieu-Denny transmission line proposal. In total, SSE currently expects to invest around £1.75bn in its electricity networks over the next five years.

Longer-term, Ofgem's review of the regulatory regime for energy networks, with its focus on the growing investment challenges, the implications of greater distributed generation, customer service and cutting the regulatory burden represent an opportunity to build on the strengths of the existing system which SSE, operating at the efficiency frontier in electricity networks, should be able to influence and capitalise on.

#### **Scotia Gas Networks – Financial**

SGN, in which SSE holds 50% of the equity, owns and operates the Scotland and the Southern gas distribution networks. The networks comprise around 74,000km of gas mains, delivering gas to around 5.7 million industrial, commercial and domestic customers. SSE receives 50% of the distributable earnings from SGN, in line with its equity holding, and also provides it with corporate and management services.

SSE's share of SGN's adjusted operating profit was £161.5m during 2007/08, compared with £103.1m in the previous year. This reflects an increase in the volume of gas transported, changes in prices for transporting gas (following the under-recovery of revenue in 2006/07) and greater efficiencies yielding a reduction in operating costs.

Around 23% of SGN's operating profit was derived from the non-regulated activities of its contracting, connections and commercial services divisions, and these continued to perform well.

#### **Scotia Gas Networks – Operational**

During 2007/08, the gas transportation volume for SGN's network in Scotland was 59.5TWh and for its Southern network the volume was 110TWh. This compares with 57TWh and 105TWh respectively in the previous year.

SGN's objective is to be at the frontier of safety, customer service and efficiency in gas distribution. In September 2007, Ofgem published a comparison of efficiency rankings in which Scotland Gas Networks was ranked the second most efficient of the eight distribution networks and Southern Gas Networks the third. This compares with seventh and sixth respectively when the two networks were acquired by SGN in 2005.

In March 2008, the number of lost-time injuries in SGN fell to 0.15 per 100,000 hours worked, compared with 0.21 in March 2007. The focus on customer service helped SGN deliver a reduction in the number of complaints about it sent to energywatch for resolution of 67%, to 25. The introduction of new front office management systems, reducing the total number of systems from over 50 to 11, has been successfully completed. This means SGN now has free-standing systems which are capable of supporting more efficient deployment of resources. When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of over £40m. Over the last three years, many of these services have been brought within SGN and another major contract will end when SGN's gas network 'System Control' goes live in two phases, starting later this year.

SGN also owns and operates SGN Connections and SGN Contracting. Amongst other things, these businesses carry out work previously done by contractors and give SGN greater scope to improve the efficiency, and reduce the cost, of the work it carries out.

It has also established SGN Metering, which is an Ofgem-accredited Meter Asset Manager. SGN Metering now owns and manages a portfolio of around 46,000 gas meters which it has installed in the Southern and Scotland network areas and it will own and manage all new meters fitted. In February 2008, SGN Metering secured a £15m per annum contract from National Grid Metering to deliver domestic metering work in the Scotland and Southern areas for up to three years. This was followed by a £3m, two-year contract to deliver metering work in the industrial and commercial sector. These contracts provide streams of work which can be carried out during the down-time associated with SGN's emergency work.

SGN's approach of in-sourcing work and the expansion of its gas network and other activities means it now directly employs 3,750 people, compared with 2,000 when it acquired its two distribution networks in June 2005. Its three-year pay and productivity deal for employees, which was agreed during 2006/07, has allowed the introduction of more flexible working patterns and associated efficiency gains. These include the removal of restrictive practices and their replacement by a consistent framework for terms and conditions. Work pattern rotas can now be determined by local management, and site start and finish provisions have been introduced to enhance productivity.

#### **Scotia Gas Networks - Investment**

During the year, SGN invested £179.8m in capital expenditure projects, compared with £120.4m in the previous year. It also invested £199.2m in mains and services replacement expenditure works, compared with £174.8m in the previous year, under the 30:30 mains

replacement programme which was started in 2002. This requires that all iron gas mains within 30 metres of homes and premises must be replaced over a 30-year period, and in 2007/08, SGN replaced just over 900km of its metallic gas mains with modern polyethylene pipes.

Following this investment, SGN estimates that the RAV of the networks it owns was around £3.5bn as at 31 March 2008 – which is significantly above their enterprise value when they were acquired in June 2005.

The Gas Distribution Price Control for 2008-13 provides the opportunity for SGN to increase significantly investment in its Scottish and Southern gas distribution networks, thereby reinforcing their safety and reliability and securing another significant increase in their RAV. By 2013, SGN estimates its RAV will be around £4.8bn. In line with that, it expects to invest around £170m in capital expenditure projects and around £210m in replacement expenditure works during 2008/09.

#### **Scotia Gas Networks Priorities in 2008/09 and beyond**

SSE's priority in gas distribution will continue to be to provide SGN with the corporate and management services to support its ongoing reform of procedures, processes and practices which are designed to improve performance and effectiveness. The successful delivery of SGN's gas network 'System Control' is a key priority over the next two years.

#### **Telecoms Networks**

##### **Introduction to Telecoms**

After electricity and gas, Telecoms is SSE's third networks business. It combines SSE Telecom and Neos Networks and operates an 8,000km UK-wide telecoms network, providing services to other telecoms providers, companies and public sector organisations. This includes 3,240km of fibre optic cabling which SSE owns; the remainder is leased fibre and microwave radio.

The business offers customers a national telecoms network, and has a UK-wide sales force and a competitive range of products targeted at commercial and public sector customers. As a subsidiary of SSE, it is also able to position itself as one of the UK's most financially secure telecoms network operators, which gives an important competitive advantage.

##### **Telecoms Operations**

SSE's combined Telecoms business achieved an operating profit\* of £14.3m during 2007/08, an increase of 2.9% (excluding the telecoms site assets disposed of in August 2007, operating profit was £13.1m, an underlying increase of 28.4%).

The improvement in performance during 2007/08 was mainly the result of higher sales achieved by Neos, and important contracts were signed with a diverse range of major organisations, such as AT&T and Carphone Warehouse. In January 2008, a significant order was received from Zen Internet, one of the leading UK internet service providers.

##### **Telecoms Investment**

In July 2007, SSE entered into an agreement with The Wireless Infrastructure Company Limited, under which it sold its telecoms sites assets, involving over 220 tower sites, for a total consideration of £79m, excluding working capital, at a gain before tax of £55m. The assets disposed of contributed approximately 0.3% of SSE's profit in 2006/07. The disposal reflected SSE's commitment to complete the refocusing of its telecoms business on network-related, as opposed to site-related, services.

In line with this, in October 2007, SSE acquired a 1,100km fibre optic network from TeliaSonera International Carrier UK Ltd for a total consideration of £12.5m. The asset acquired by SSE comprises a duct containing fibre running between London, Bristol, Manchester and Leeds plus 10 operational repeater sites. Included in the acquisition are extensions in seven cities around England. It provides SSE with owned fibre capacity

throughout the UK, together with local connectivity that could be integrated into its existing network. In December 2007, SSE supplemented this with the acquisition of 160km of telecom duct network within London. The acquisitions have provided Neos Networks with one of the most extensive wholly-owned telecom duct fibre footprints in the UK.

Neos has upgraded its optical core network to enable point-to-point services at up to 40 Gigabits per second and has also started to upgrade its ethernet platform (a frame-based technology connecting computer systems to form a network) to provide customers with high speed, scalable and flexible connectivity – committing a total investment of over £8m to be made over five years. This will support future new business growth.

#### **Telecoms Priorities in 2008/09 and beyond**

SSE's priority in Telecoms in 2008/09 is to complete the integration of assets acquired during 2007/08 and to continue to grow its sales, using its already-established nationwide network, with its competitive range of products targeted at commercial and public sector customers. Longer-term, its ambition is to become the UK's leading alternative telecoms network company.

## **ENERGY-RELATED SERVICES**

#### **Introduction to Energy-Related Services**

In addition to being involved in Generation, Supply and Networks, SSE also provides an additional range of other energy-related services which complement its other businesses: Contracting, Connections and Metering; Energy and Home Services; and Gas Storage. These are important services, on which customers depend, so that their increasingly complex energy requirements can be met.

## **CONTRACTING, CONNECTIONS AND METERING**

#### **Contracting, Connections and Metering Overview**

Contracting, Connections and Metering delivered operating profit\* of £55.6m during 2007/08, compared with £51.6m in the previous year.

#### **Introduction to Contracting**

SSE's Contracting business, Southern Electric Contracting (SEC), has three main areas of activity: industrial, commercial and domestic mechanical and electrical contracting; electrical and instrumentation engineering; and public and highway lighting. Now employing over 4,000 people, it is one of the largest mechanical and electrical contracting businesses in the UK. It operates from 64 regional offices throughout Great Britain and also trades as SWALEC Contracting in Wales and Scottish Hydro Contracting in Scotland.

#### **Contracting Performance during 2007/08**

SEC made significant progress against its key priorities for the year of broadening further its geographical presence and ensuring there continues to be good performance in the long-term contracts which are central to its ongoing business development.

For a nominal consideration, it acquired Hills Electrical and Mechanical plc, a business with an annual turnover of £45m operating in all parts of the UK. The acquisition complements SEC's existing businesses whilst strengthening its position as a leading mechanical and electrical contractor. It expands SEC's number of branch offices from 57 to 64, and provides it with a national business supporting the retail sector.

SEC also acquired Seeboard Trading Limited, which finances and operates street lighting maintenance and replacement projects for three local authorities under the Private Finance Initiative (PFI). The three local authorities are the London Borough of Islington, the London Borough of Ealing and Dorset County Council. The projects cover around 90,000 street lighting columns and they all have at least 20 years to run.

In partnership with the asset finance division of The Royal Bank of Scotland, SEC already has PFI contracts to replace and maintain around 210,000 street lighting columns for four local authorities in England: Stoke on Trent City Council; Leeds City Council; and Newcastle City and North Tyneside Councils. These contracts all have over 20 years to run and, when combined with the contracts acquired via Seaboard Trading Limited, mean SSE's interest in PFI contracts extends to 300,000 lighting columns.

In addition to the PFI replacement and maintenance contracts, SSE has contracts with 22 local authorities in England, Wales and Scotland to maintain over one million street lights. It is the largest street lighting contractor in the UK, and in 2007/08 secured its first-ever contract in north-west England, with St Helens Council.

During 2007/08 SEC's order book exceeded £100m for the first time. The order book has been supported by significant contract wins with a number of leading organisations such as National Air Traffic Service (NATS) and the VT Group. To support future growth, SEC is developing the services it offers to customers, and during 2007/08 it launched a new business area for solar and photovoltaic products. It also recruited almost 200 apprentice electricians during the year and expects to recruit more apprentices during 2008/09.

#### **Contracting Priorities in 2008/09 and beyond**

The first priority for SEC in 2008/09 is to ensure that it delivers a high standard of service to all customers in all of the sectors in which it operates, given such a major proportion of its business is 'repeat'. It will also seek to complete the integration of businesses acquired during 2007/08 and secure further increases in its order book, with a growing focus on emerging technologies and renewable energy installation capability. In line with this, a trial will be launched to promote the installation of solar and photovoltaic products on to domestic rooftops. To position itself for long-term growth, it expects to recruit more apprentices. That long-term growth should result, over the next few years, in SEC's operations being further extended throughout Great Britain and, over time, Ireland.

#### **Introduction to Connections**

SSE's national Connections business provides electricity, gas and water connections and designs, finances, builds, owns and operates gas, electricity and telecommunications networks throughout the country.

#### **Connections Performance During 2007/08 – Electricity**

Continued expansion of its Connections business was among SSE's priorities for 2007/08, and during the year it completed 42,800 electrical connections, compared with 44,600 in the previous year.

In addition, it has continued to develop its portfolio of electricity networks outside the Southern Electric and Scottish Hydro Electric Power Distribution areas. It now owns and manages 33 energised electricity networks outside these two areas, with development work ongoing at a number of these, and a further 12 are under construction, including Eurocentral and West Prestonpans in Glasgow, Valleywood and St Davids in Wales and Castlewood in Nottingham. In total, SSE has just over 400MW of energised networks capacity, including 180MW currently under construction. Key clients are from the UK land development sector and currently include the London Development Agency, Laing O'Rourke, Persimmon and Hammersons. This remains a relatively new business for SSE, but it became profitable during 2007/08.

#### **Connections Performance During 2007/08 - Gas**

SSE's Connections business is also a licensed gas transporter. Trading as SSE Pipelines, it installs, owns and operates gas mains and services on new housing and commercial developments throughout the UK. The number of new premises connected to its gas networks has continued to grow, and during the year, it connected a further 8,000 premises, taking the total number of connections to over 53,000. During 2007/08, it began construction of its biggest pipeline project to date – to supply up to 1,000 new-build residential properties at a development in Bedford.

## **Water**

In October 2007, Ofwat announced that SSE's subsidiary, SSE Water (SSEW), will become the first new company to offer both water and sewerage services since privatisation in 1989. This followed the granting of an 'inset' appointment to SSEW, which allows for one supplier of water and sewerage services to be replaced by another for a defined geographical area, in this case a housing development near Salisbury. Ofwat said: 'SSE has a proven track record for its high levels of customer service. Ofwat expects SSEW to set a benchmark in the water industry for similar high levels of customer service'.

SSE is already experienced in designing, installing and operating multi-utility infrastructures. The granting of inset appointments will enable it to provide a more comprehensive multi-utility solution to customers in the property development and house-building sectors, through being able to install, own, operate and supply water and sewerage services alongside SSE's existing electricity and gas services.

Construction work at the development near Salisbury began in December, and the early evidence suggests that the 'one-stop' approach to infrastructure installation on larger sites is a very good way forward for developers. Once the water infrastructure is completed, SSE will own and operate the network, having the same responsibilities as any other water company: issuing bills; reading meters; testing water quality and cleaning blocked sewers.

SSE expects to make further applications for inset appointments in other areas, and made a second one – in respect of a development at Llanilid Park (Valleywood) in Wales – in February 2008.

## **Connections Priorities for 2008/09 and beyond**

The Connections business' focus will be on the successful delivery of a growing number of utility connections and on continuing to expand its range of electricity networks outside the Southern Electric and Scottish Hydro Electric Power Distribution areas, reinforcing its position as a leading provider of utility infrastructure solutions to the UK land development sector. Another key priority will be the successful completion of the water installation at Salisbury, securing other 'inset' appointments and building up the 'one-stop' approach to infrastructure provision.

## **Introduction to Metering**

SSE's Metering business provides services to most electricity suppliers with customers in central southern England and the north of Scotland and has undertaken a programme of in-sourcing of meter reading operations and meter operator work in other parts of the UK. It supplies, installs and maintains domestic meters and carries out metering work in the commercial, industrial and generation sectors. It also offers data collection services to the domestic and SME sectors.

## **Metering Performance during 2007/08**

In total, SSE owns 3.7 million meters and changes around 250,000 meters each year as they reach the end of their useful life or to meet customer requests for changed functionality. During 2007/08, it collected around 5.8 million electricity readings and 2.3 million gas readings, up from 4.3 million and 1.4 million respectively in the previous year.

SSE's Metering activities expanded significantly during 2007/08, with the in-sourcing of meter reading operations in south-west England and central and southern Scotland and meter operator work in south Wales, resulting in the transfer of 200 employees to SSE. This will take the total in the Metering business to over 800, and doubling its geographic coverage.

During 2008/09, SSE will in-source meter reading and meter operations work in south-east England and also meter operator work in south-west England and central and southern Scotland. This will result in the transfer of almost 150 employees to SSE via a mixture of TUPE transfer and new recruitment.

The ongoing development of SSE's Metering business is designed to achieve both efficiency gains and high standards of service for SSE's customers and to support the energy supply business.

SSE is the leading participant in the UK-government sponsored two-year Energy Demand Reduction Project, under which almost 30,000 SSE customers will be taking part in energy-saving trials. These include around 8,000 customers receiving state-of-the-art smart meters. Ultimately, smart meters will allow energy suppliers to communicate directly with their customers, remove the need for meter readings and ensure entirely accurate bills with no estimates, helping customers to reduce their consumption of energy. The results of the trials will provide evidence to support the future roll-out of smart electricity and gas meters.

The first smart meters were installed in Perthshire in February 2008. Although some other high volume roll-outs have occurred elsewhere in the world, none have attempted such a level of complexity, using this level of leading-edge technology. Customers involved in this trial will be able to manage gas and electricity usage through a mixture of in-home remote displays, graphs on bills and website information.

In March 2008, SSE invested £1m in Onzo Limited, in return for a 24.5% share of the business. Onzo is a newly-established data systems development business, with specific intellectual property relating to the development of display devices that support smart metering systems. The devices provide real-time information about energy consumption and have the potential to provide data down to the individual appliance level.

In this context, SSE welcomed the decision by the UK government to include within the Energy Bill broad enabling powers to support a national roll-out of smart meters. These powers should allow a detailed framework for a roll-out to be developed and implemented over the next decade.

#### **Metering Priorities in 2008/09 and beyond**

For Metering, the key priority is the successful completion of the 'in-sourcing' of work in south-east and south-west England and central and southern Scotland. This will be another key milestone in SSE's long-term objective of building a national metering business. It is also important that SSE's participation in the Energy Demand Research Project, with its focus on 'smart' metering technologies, is successful, and during 2008/09 SSE expects to install around 8,000 smart meters as part of it.

### **ENERGY AND HOME SERVICES**

#### **Introduction to Energy and Home Services**

The UK energy market is still focused on the delivery of units of energy but a market is beginning to emerge for the supply of energy services – warmth, light and power. SSE's goal is to deliver products and services which go beyond the meter, helping it to gain, retain and develop long-term relationships with customers.

More fundamentally, over time, a new model is likely to be created whereby homes and other buildings are developed and designed so they need as little energy as possible. Energy services and SSE's related investments in emerging technologies are about preparing for that new model.

#### **Energy Services Performance During 2007/08**

Customers are increasingly interested in managing their own energy use and SSE provides bespoke energy solutions featuring on-site or off-site dedicated wind turbines, solar thermal systems, solar photovoltaic systems and ground-source heat pumps. SSE's Energy Services division operates and maintains site-wide energy infrastructures of this kind that improve environmental performance over conventional alternatives.

In addition, business customers of SSE now have over 50MW of on-site installed Combined Heat and Power (CHP) generation capacity, generating heat and power in a single process. Current developments include The Warren, in south-east London, where Berkeley Homes

Group is building 460 apartments, a nursery unit, primary care trust and commercial units. Under the ESCO (Energy Services Company) Agreement, SSE is responsible for designing and installing an energy centre, including a CHP plant. SSE will also undertake all associated heat, electricity and gas infrastructure, metering and billing customer services, long-term operations and maintenance services and all fuel procurement requirements.

SSE's main contractor on this development is Vital Energi Utilities Ltd, and in October 2007 SSE entered into an agreement to invest £6m for a 30% share of the business. Vital Energi specialises in the design, supply and installation of CHP and District Heating systems in the commercial, industrial and residential sectors.

SSE's home services team offers a range of maintenance and protection services for customers' gas and electrical systems and a full range of gas and electrical installation services. Its **shield** gas boiler, central heating and wiring protection service is now almost two years old and had already attracted 70,000 customers by the end of March 2008. This growth is expected to continue and the number of postcode areas covered by the service has now reached 43, with a further five postcode areas due to be added in 2008/09.

The home services offered by SSE also include the **talk with** telecoms service, which now has 165,000 customers and is profitable. SSE and BT have entered into a partnership that sees BT become the provider of integrated voice and broadband services to SSE for resale to its UK customers. Under the terms of the three-year agreement, BT Wholesale will support SSE's plans to become a high quality, national provider of integrated communications services. The service is expected to launch this summer.

### **Energy Services Priorities in 2008/09 and beyond**

The market for these home and other energy services is evolving, but it is one in which rapid change is likely as – for example – demand for low- and zero-carbon homes grows. As the needs of customers become more complex, SSE's approach is to provide a growing range of dependable services and thereby position itself to be a successful – and national – provider as the production and consumption of energy changes over the next decade.

## **GAS STORAGE**

### **Introduction to Gas Storage**

It is generally recognised that the UK has insufficient gas storage. This under capacity reflects the reliance it was able to place in past years on gas production from the North Sea. As North Sea gas declines, UK imports will continue to increase and this means there will be a growing reliance on gas storage facilities to help provide security of supply. Such facilities therefore have a long-term value.

SSE owns and operates the UK's largest onshore gas storage facility at Hornsea in East Yorkshire. Nine salt caverns have been leached into a salt layer 1.8 kilometres below the surface, creating 325 million cubic metres (mcm) of gas storage capacity. Gas can be injected at a rate of 2mcm per day and withdrawn at a rate of 18mcm per day, which is equivalent to the requirements of around four million homes.

The services offered at Hornsea provide customers with a reliable source of flexibility with which to manage their gas supply/demand balance and respond to market opportunities. Capacity is sold in Standard Bundled Units (SBU), of which Hornsea has 195 million available in total, and each SBU provides capacity to inject gas into the facility, store gas there and withdraw gas from it.

### **Gas Storage - Operations**

Gas Storage delivered an operating profit\* of £50.9m, compared with £55.9m in the previous year (which SSE said in its Annual Report 2007 was a high point in gas storage profitability). The value of, and demand for, gas storage facilities in the UK has, however, continued to be

high, and incidents at the Bacton gas terminal and the Grangemouth oil refinery again demonstrated the importance of gas storage in securing UK energy supplies.

One of SSE's priorities for 2007/08 was to ensure that Hornsea maintained its excellent record of dependability, and during the year it was 100% available to customers, except in instances of planned maintenance. This enabled customers to manage their gas market risks and respond to gas trading opportunities.

### **Gas Storage - Investment**

The joint venture with Statoil (UK) Ltd to develop, at Aldbrough, near Hornsea, what will become the UK's largest onshore gas storage facility is continuing to make progress, albeit at a slower rate than expected when the development work started in 2004 and also when the project was reviewed at the start of 2007/08.

SSE's investment in Aldbrough is now expected to total around £175m, reflecting the increased length of time required to complete the development and the significant inflationary pressures seen throughout the UK construction industry. With a total new capacity of around 420mcm, of which SSE will have ownership interest in 280mcm, Aldbrough will provide valuable gas storage for the UK. Its flexibility is demonstrated by the fact that it will enable gas to be injected at a rate of up to 30mcm per day and withdrawn at a rate of 40mcm.

The first three of the nine caverns at Aldbrough are scheduled to enter commercial operation in the autumn. The first gas has been introduced to site and dewatering of the first caverns will commence shortly.

SSE and Statoil (UK) Ltd have secured consent from East Riding of Yorkshire Council to increase the storage capacity at the Aldbrough site beyond that currently under development. They are now able to develop a further nine gas storage caverns, taking the total to 18. If developed in full, this would approximately double the amount of gas that can be stored, to over 800mcm. Construction of the extension would, therefore, help to ensure that the UK can meet gas demand during periods of high energy usage.

SSE would contribute 50% of the cost of the extension in return for ownership of 50% of the capacity. On completion of the extension, SSE would have effective ownership of over 800mcm of gas storage capacity, including Hornsea. Site preparation work has been completed and a final decision on whether to proceed with this development is expected to be taken during 2008/09.

### **Gas Storage Priorities in 2008/09 and beyond**

SSE's priorities in Gas Storage during 2008/09 are to: maintain its excellent record of reliability at Hornsea; ensure that the first of the new caverns at Aldbrough are available for commercial storage; and make a decision on whether to proceed with the Aldbrough extension. Longer-term, SSE will also continue to look for other opportunities to add to its gas storage capability.

## **INVESTMENT AND CAPITAL EXPENDITURE**

### **Introduction to Investment and Capital Expenditure**

SSE has a substantial capital and investment programme, with the objective of upgrading existing assets and developing new assets and thereby continuing the ongoing expansion of the scale and the scope of its activities. It is a key means by which SSE seeks to generate future cash flows and enhance and create value for shareholders. All investments are expected to achieve returns which are greater than the cost of capital and are expected to enhance earnings.

### **Investment in 2007/08**

Capital and investment expenditure (excluding SGN) totalled £810.3m during 2007/08, including £28.1m in respect of Marchwood Power Ltd, compared with £663.4m in the previous year. Including SSE's share of SGN's capital and replacement expenditure, the total was £1.0bn.

Within its overall total, capital and investment expenditure of £16.9m was incurred by SSE through Airtricity after it was acquired in February 2008. Over 2007/08 as a whole, Airtricity's capital and investment expenditure was around €240m.

Capital expenditure in Power Systems was £264.4m, compared with £204.5m in the previous year, in line with the investment focus described under 'Electricity Network Investment'. In addition, there was investment of £276.5m for growth in Generation during the year, with the progress of the Marchwood development, construction work being carried out at Glendoe hydro electric scheme and Drumderg wind farm and the installation of FGD equipment and other work at Fiddler's Ferry and Ferrybridge.

As well as Power Systems and Generation, £40.9m was invested in the ongoing development of the new gas storage facility at Aldbrough. Of its expected total investment of around £175m, SSE has so far invested £140m at Aldbrough.

Within the total, capital expenditure for growth, including Marchwood, was £537.2m during 2007/08. This mainly comprised electricity generation and gas storage.

### **Future Investment Priorities in 2008/09 and beyond**

In the five years from April 2003, SSE's capital and investment expenditure totalled £2.65bn, and in the period following its investment in gas distribution in June 2005, SSE's share of SGN's capital and replacement expenditure was £453.5m.

Capital and investment expenditure will continue to be substantial during 2008/09, at around £1.3bn, and subsequently. Over the five years to 2013, it is projected to total around £6.7bn and will be focused on projects in line with SSE's core purpose of providing energy in a reliable and sustainable way.

Around 45% of this investment is expected to be directed towards renewable energy developments. In addition, SSE expects to invest around £1.2 billion in gas- and coal-fired generation, around £1.75 billion in electricity networks and around £600m in a number of other areas, such as gas storage. The result of this will be a significantly enhanced asset base and additional cash flows, which will support future dividend growth.

## **FINANCIAL MANAGEMENT AND BALANCE SHEET**

### **Treasury Policy**

SSE's operations are financed by a combination of retained profits, bank borrowings, bond issuance and commercial paper. As a matter of policy, a minimum of 50% of SSE's debt is subject to fixed or inflation-linked rates of interest. Within this policy framework, SSE borrows as required on different interest bases, with derivatives and forward rate agreements being used to achieve the desired out-turn interest rate profile.

At 31 March 2008, after taking account of interest rate swaps, 65.7% of SSE's borrowings were at fixed or inflation-linked interest rates. This fixed-rate component was unusually low due to the high amount of short-term debt on the balance sheet, arising primarily from the acquisition of Airtricity. In the medium-term, SSE targets a fixed rate component of around 80-85%.

Borrowings are made in both Sterling and Euro to reflect the underlying currency denomination of assets and cashflows within SSE. All other foreign currency borrowings are swapped back to Sterling.

The United Kingdom remains SSE's main area of operation, although business activities in overseas markets – most notably in the Republic of Ireland – have grown during the year. Transactional foreign exchange risk arises in respect of procurement contracts, fuel and carbon purchasing, commodity hedging and energy trading operations, and long-term service agreements for plant. Its policy is to hedge all material transactional foreign exchange exposures through the use of forward currency purchases and/or derivative instruments. Indirect exposures created by SSE's gas purchasing are similarly hedged on an ongoing basis.

Translational foreign exchange risk arises in respect of overseas investments and hedging in respect of such exposures is determined as appropriate to the circumstances on a case-by-case basis.

### Net Debt and Cash Flow

As at 31 March 2008, SSE's net debt was £3.666bn, compared with £2.233bn at 31 March 2007, an increase of £1.433bn. This largely reflects the £1.349bn acquisition of Airtricity, together with other capital and investment expenditure undertaken during the year. Cash generated from operating activities was over 30% higher than in the previous year, reflecting increased profitability and improvement in working capital.

### Borrowings and Facilities

SSE's liquidity policy is to ensure that it has committed borrowings and facilities equal to at least 105% of forecast debt over a rolling 12 month period. On 31 March 2008 it had available undrawn committed bank borrowing facilities of £1.1bn, which mature in June and November 2009.

The objective for SSE is to maintain a balance between continuity of funding and flexibility, with debt maturities staggered across a broad range of dates. Its average age of debt as at 31 March 2008 was 8.6 years, compared with 13.8 years as at 31 March 2007. This year-on-year reduction in term reflects the unusually high amount of short-term debt on the balance sheet at 31 March 2008, arising primarily from the acquisition of Airtricity.

SSE's debt structure continues to be strong, with around £2.1bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans relating to Airtricity. A total of 47.1% of SSE's borrowings will mature in the 12 months to March 2009, the majority of which relates to bank borrowings raised to finance the acquisition of Airtricity. It is expected that this debt will be re-financed in the capital markets during the course of this year.

### Net Finance Costs

The table below reconciles reported net finance costs to adjusted net finance costs, which SSE believes is a more meaningful measure. In line with this, SSE's adjusted net finance costs during 2007/08 were £154.3m, compared with £151.8m in the previous year.

	<b>March 08 £m</b>	<b>March 07 £m</b>
Reported net finance costs (Note 6)	32.8	48.1
add/(less)		
Share of JCE*/Associate interest	127.6	117.9
Interest on convertible debt	(4.6)	(3.6)
Exceptional foreign exchange loss	(22.2)	-
Movement on derivatives	20.7	(10.6)
<b>Adjusted net finance costs</b>	<b>154.3</b>	<b>151.8</b>
Return on pension scheme assets	141.4	130.1
Interest on pension scheme liabilities	(117.4)	(107.2)
Notional interest arising on discounted provisions	(3.6)	(1.4)
<b>Adjusted interest costs**</b>	<b>174.7</b>	<b>173.3</b>

\*Jointly Controlled Entities

\*\*Adjusted finance income and costs for interest cover calculation

The average interest rate for SSE, excluding JCE/Associate interest, during the year was 5.23%, compared with 5.31% in the previous year. Based on adjusted interest costs, underlying interest cover was 11.7 times, compared with 11.0 times the previous year, and including interest related to SGN it was 7.9 times (7.1 times in the previous year).

Within the adjusted net finance costs of £154.3m, the element relating to SGN's net finance costs was £82.7m (compared with £70.6m in the previous year), after netting loan stock interest payable to SSE. Its contribution to SSE's profit before tax was, therefore, £78.8m, compared with £32.5m in the previous year.

### Tax

To assist the understanding of SSE's tax position, the adjusted current tax charge is calculated as follows:

	<b>March 08 £m</b>	<b>March 07 £m</b>
Reported tax charge	210.6	301.5
add back:		
Share of JCE/Associate tax	10.7	33.8
less:		
Deferred tax	(31.5)	(25.6)
Exceptional tax	127.4	(27.1)
<b>Adjusted current tax charge</b>	<b>317.2</b>	<b>282.6</b>

The effective adjusted current tax rate, based on adjusted profit before tax, was 25.8%, compared with 26.2% in the previous year, on the same basis. The impact of SSE's higher capital expenditure programme and the changes introduced in Budget 2007 are likely to have a positive effect on the effective current tax rate in the coming years.

The reported tax charge was 19.4%, compared with 26.6% in the previous year. This reflects the restatement of the deferred tax position following the Corporation Tax rate change introduced in Budget 2007.

SSE's contribution to government revenues, including Corporation Tax, Employers' National Insurance Contributions and Business Rates totalled £517.1m during 2007/08, compared with £459.5m in the previous year, an increase of 12.5%. This includes joint ventures and associates and compares with dividends paid to shareholders during the year of £502.8m.

### Balance Sheet

In line with its core financial principles, SSE continues to maintain one of the strongest balance sheets in the global utility sector. This gives it significant competitive advantages, allowing it to pay interest at lower rates than would otherwise be the case and also enables it to respond speedily to opportunities which emerge to invest in, or acquire, assets. The tumultuous events witnessed in global financial markets during 2007/08 have again demonstrated the risks associated with inappropriately large levels of debt and have underlined the importance of maintaining a strong financial profile.

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension scheme liabilities of £134.9m and a pension scheme asset of £85.8m are recognised in the balance sheet at 31 March 2008, gross of deferred tax. This means there was a reduction of £42.8m in net liabilities compared with the position at March 2007, from £91.9m to £49.1m.

During 2007/08, employer cash contributions to the Scottish Hydro Electric scheme amounted to £13.4m. Contributions to the Southern Electric scheme, including deficit repair contributions of £35.5m, amounted to £60.2m. As part of the Distribution Price Control for 2005-2010, it was agreed that allowances for 76% of deficit repair contributions should be recoverable via price-controlled revenue.

At 31 March 2008, there was a net liability arising from IAS 39 of £117.3m, before tax, compared with a net asset of £45.0m, before tax, at 1 April 2007.

#### **Purchase of Own Shares and Convertible Bond Maturity**

During 2007/08, SSE purchased 16.66 million of its own shares for cancellation, which contributed to the enhanced earnings per share delivered during the year. The weighted average price per share (before costs) was £14.30, with the purchase prices ranging from £13.87 to £14.74. The aggregate consideration was £238.2m (excluding fees) and the purchases represented 1.9% of the called-up share capital of the company.

The Directors of SSE are seeking at the Annual General Meeting on 24 July 2008 renewal of their authority to purchase, in the market, the Company's own shares should it result in an increase in SSE's earnings per share and be in the best interests of shareholders generally. Any shares repurchased under this authority may be cancelled or retained as treasury shares to accommodate requirements for shares under SSE's incentive schemes. SSE does not currently hold any treasury shares.

SSE also has an outstanding 3.75% convertible bond which matures on 29 October 2009, which had an initial nominal value of £300m. To date, holders have exercised their option to exchange their bonds for Ordinary Shares in the company at £9 per share, in respect of bonds totalling £220.7m of nominal value. New shares issued as a consequence of these conversions total 24.5 million. A nominal value of £79.3m or 26.4% of the original bond issue, remains outstanding. The total number of shares in issue at 31 March 2008 was 870.1 million.

#### **Financial Management and Balance Sheet Priorities in 2008/09 and beyond**

SSE's financial management and balance sheet priorities in 2008/09 and beyond are to adhere to its six key financial principles: delivery of sustained real dividend growth; effective management of core businesses; rigorous analysis to ensure investments are well-founded and, where appropriate, innovative; maintenance of a strong balance sheet; deployment of a selective and disciplined approach to acquisitions; and use of purchase in the market of the company's own shares as the benchmark against which financial decisions are taken.

## **CORPORATE RESPONSIBILITY**

### **Introduction**

Shareholders expect companies not simply to be profitable, but to be responsible in how those profits are made. For SSE, this means that its Generation activities should be as sustainable as possible and that the energy it supplies should be as affordable as possible. In addition, its networks should be reliable and its energy-related services dependable.

### **Principal Risks**

The principal risk factors to which SSE is potentially exposed were reviewed by the Board in March 2008. They are: the operation of assets, equipment and processes; capital investment risks in respect of major projects; financial risks, such as interest rate and commodity exposure, including a lack of liquidity in traded markets; the impact of public policy or regulatory developments in the areas of energy and the environment; resource shortages, in terms of people with the relevant skills and in terms of equipment and materials, including fossil fuels; the impact of the weather on SSE's interests in the generation of electricity from renewable sources, in energy supply and in energy distribution; and an economic slowdown. The latter risk potentially affects both the level of business activity and bad debt write-offs.

At a corporate level, SSE seeks to address these risks by: maintaining the strongest possible focus on the consistent delivery of excellence across all aspects of its operations; rigorous management and scrutiny of major projects; adhering to the series of well-defined and established financial principles set out under 'Financial Overview'; strong oversight by a Risk Committee; full and transparent engagement with Ministers, elected members and officials in the relevant executives and legislatures; upgrading its human resources and procurement functions to ensure SSE has access to the best possible people and equipment; maintaining a variety of energy production, distribution and supply businesses, with actively-managed fuel procurement where appropriate; and effective credit management.

In summary, SSE's principal risk management approach is its fundamental strategy: operating and investing in a balanced range of regulated and non-regulated energy and utility businesses. This limits both the extent of any single risk and the value associated with it and the need to limit the value at risk is at the heart of SSE's decision-making processes.

The investigations and reviews being undertaken by Ofgem, and a number of UK government policy developments, could reinforce some perceptions of the extent of the risk associated with the impact of public policy or regulatory developments. SSE is fully engaged with all key stakeholders and believes that Ofgem and the UK government fully understand the need for a clear and stable policy and regulatory framework. It also believes that, fundamentally, the framework in the UK is supportive of SSE's core purpose of providing energy in a reliable and sustainable way.

At an operational level, comprehensive procedures for internal control and risk management are in place throughout SSE. These procedures are actively maintained and regularly reviewed through an audit programme which addresses the full spectrum of SSE's potential risks. This is complemented by an ongoing programme of business improvement initiatives designed to secure continuous progress in processes and procedures and further improve the overall management and performance of SSE, avoiding undue business concentration.

### **Safety and the Environment**

SSE aims to create value for shareholders by running the business with a strong emphasis on safety and on sustainability – achieving growth while safeguarding the environment. During 2007/08, the number of lost time and reportable accidents within the company was 11, or 0.04 per 100,000 hours worked, compared with 0.05 in 2006/07 and with 0.17 five years ago, in 2002/03. The number of serious, or potentially serious, road traffic accidents involving employees driving company vehicles was 0.18 per 100 vehicles, compared with 0.29 in 2006/07.

In 2008/09, SSE will report its safety performance on the basis of the Total Recordable Injury Rate, as its central workplace safety indicator.

A significant issue for SSE is process safety – the engineering and management skills focused on preventing major incidents arising from the use of, amongst other things, fossil fuels. Its approach in this area has been comprehensively reviewed in the light of the report of the Baker Panel into the BP incident at Texas City published in early 2007.

SSE's target for any given year is zero reportable environmental incidents. There was one such incident during 2007/08. In January 2008, the Environment Agency served an enforcement action on SSE for failure to make sufficient progress on an agreed programme of improvements at its Smurfit Townsend Hook CHP plant in Kent.

### **Corporate Responsibility Index and Business in the Environment Index**

Business in the Community's Corporate Responsibility Index provides an authoritative benchmark for companies to evaluate their management practice in four key areas of corporate responsibility (community, environment, marketplace and workplace) and performance in a range of environmental and social impact areas material to their business.

The results of the Index for 2007, in which 111 companies participated, and which was the most challenging yet, were published in May 2008. SSE's score was 98.0%, compared with

98.5% in the previous year, putting the company in the highest possible performance band of 'Platinum'. Within the main Index is the Business in the Environment Index, SSE's score was 99.0%, compared with 99.5% in the previous year.

### **Teamwork**

On 31 March 2008, SSE employed 16,892 people, an increase of 3,465 on the previous year. The progress made by SSE is due to the professionalism, commitment and teamwork of its employees. For that reason, and to mark the tenth anniversary of SSE's formation in 1998, every person who was employed by SSE on 31 March 2008, and who is still in employment on 1 August 2008 will receive a special award comprising: an offer, free of charge, of 10 shares in the company; an online voucher worth £200 for SSE's retail business; and an additional day's holiday.

The acquisitions of Airtricity and Slough Heat and Power brought to SSE talented teams of people with skills and knowledge which are already complementing the well-established capabilities of the people already in SSE.

### **Board**

Sir Kevin Smith, who joined SSE as a non-Executive Director in 2004, has decided not to seek re-election to the Board at this year's Annual General Meeting and will step down from it at the conclusion of the Meeting. At that point, the Board of SSE will comprise four Executive Directors and four non-Executive Directors, plus the Chairman.

### **Corporate Responsibility Priorities in 2008/09 and beyond**

SSE's priorities in 2008/09, and beyond, are to: manage its principal risks effectively; make further progress towards its ultimate goal of injury-free working; avoid environmental incidents; make progress towards securing a reduction in the carbon dioxide intensity of electricity produced at power stations in which it has an ownership or contractual interest; and maintain SSE as a fulfilling place to work.

### **Disclaimer**

This preliminary results statement contains forward-looking statements about financial and operational matters. Because they relate to future events and are subject to future circumstances, these forward-looking statements are subject to risks, uncertainties and other factors. As a result, actual financial results, operational performance and other future developments could differ materially from those envisaged by the forward-looking statements.

**Consolidated Income Statement**  
for the year ended 31 March 2008

		2008			2007		
	Note	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 5) £m	Total £m	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 5) £m	Total £m
<b>Revenue</b>	4	15,256.3	-	15,256.3	11,867.1	-	11,867.1
Cost of sales		(13,509.8)	(187.8)	(13,697.6)	(10,247.7)	61.3	(10,186.4)
<b>Gross profit</b>		1,746.5	(187.8)	1,558.7	1,619.4	61.3	1,680.7
Operating costs		(605.7)	-	(605.7)	(557.5)	-	(557.5)
Other operating income		0.1	55.0	55.1	-	33.0	33.0
<b>Operating profit before jointly controlled entities and associates</b>		1,140.9	(132.8)	1,008.1	1,061.9	94.3	1,156.2
Jointly controlled entities and associates:							
Share of operating profit		242.6	-	242.6	169.2	0.9	170.1
Share of interest		(127.6)	-	(127.6)	(117.9)	-	(117.9)
Share of movement on derivatives		-	4.2	4.2	-	5.5	5.5
Share of tax		(41.9)	31.2	(10.7)	(31.8)	(2.0)	(33.8)
<b>Share of profit on jointly controlled entities and associates</b>		73.1	35.4	108.5	19.5	4.4	23.9
<b>Operating profit</b>	4	1,214.0	(97.4)	1,116.6	1,081.4	98.7	1,180.1
Finance income	6	202.6	-	202.6	193.4	-	193.4
Finance costs	6	(233.9)	(1.5)	(235.4)	(230.9)	(10.6)	(241.5)
<b>Profit before taxation</b>		1,182.7	(98.9)	1,083.8	1,043.9	88.1	1,132.0
Taxation	7	(306.8)	96.2	(210.6)	(276.4)	(25.1)	(301.5)
<b>Profit for the year</b>		875.9	(2.7)	873.2	767.5	63.0	830.5
<b>Attributable to:</b>							
Equity holders of the parent		875.6	(2.7)	872.9	767.5	63.0	830.5
Minority interest		0.3	-	0.3	-	-	-
Basic earnings per share	9			101.1p			96.5p
Diluted earnings per share	9			101.0p			93.9p
Adjusted earnings per share	9			105.6p			92.5p
Dividends paid in the year	8			£502.8m			£411.3m

The accompanying notes are an integral part of these accounts.

**Consolidated Balance Sheet**  
as at 31 March 2008

	Note	2008 £m	2007 £m
<b>Assets</b>			
Property, plant and equipment		6,334.3	5,042.1
Intangible assets:			
Goodwill		659.0	293.2
Other intangible assets		256.9	12.9
Investments in associates and jointly controlled entities		917.8	702.3
Other investments		6.0	4.1
Retirement benefit assets	12	85.8	128.1
Deferred tax assets		43.1	66.0
Derivative financial assets	13	318.9	54.5
<b>Non-current assets</b>		<u>8,621.8</u>	<u>6,303.2</u>
Intangible assets		340.9	177.7
Inventories		251.2	214.1
Trade and other receivables		3,400.3	2,266.7
Cash and cash equivalents	14	255.3	56.1
Derivative financial assets	13	1,106.5	452.9
<b>Current assets</b>		<u>5,354.2</u>	<u>3,167.5</u>
<b>Total assets</b>		<u>13,976.0</u>	<u>9,470.7</u>
<b>Liabilities</b>			
Loans and other borrowings	14	1,847.6	474.8
Trade and other payables		3,601.9	2,340.4
Current tax liabilities		220.8	199.2
Provisions		9.5	8.0
Derivative financial liabilities	13	1,229.4	351.9
<b>Current liabilities</b>		<u>6,909.2</u>	<u>3,374.3</u>
Loans and other borrowings	14	2,073.6	1,803.8
Deferred tax liabilities		967.3	923.7
Provisions		107.3	104.4
Trade and other payables		490.1	327.7
Retirement benefit obligations	12	134.9	220.0
Derivative financial liabilities	13	313.3	120.9
<b>Non-current liabilities</b>		<u>4,086.5</u>	<u>3,500.5</u>
<b>Total liabilities</b>		<u>10,995.7</u>	<u>6,874.8</u>
<b>Net assets</b>		<u>2,980.3</u>	<u>2,595.9</u>
<b>Equity:</b>			
Share capital		435.1	431.0
Share premium	10	315.7	99.1
Capital redemption reserve	10	22.0	13.7
Equity reserve	10	3.9	14.6
Hedge reserve	10	2.3	(10.5)
Translation reserve	10	25.4	-
Retained earnings	10	2,175.6	2,048.0
<b>Total equity attributable to equity holders of the parent</b>		<u>2,980.0</u>	<u>2,595.9</u>
Minority Interest	10	0.3	-
<b>Total Equity</b>		<u>2,980.3</u>	<u>2,595.9</u>

**Consolidated statement of recognised income and expense**  
For the year ended 31 March 2008

	2008 £m	2007 £m
Gains/ (losses) on effective portion of cash flow hedges (net of tax)	11.6	(22.6)
Transferred to income statement on cash flow hedges (net of tax)	8.0	-
Effective net investment hedge (net of tax)	(21.1)	-
Actuarial (loss) / gain on retirement benefit schemes (net of tax)	(18.7)	33.2
Exchange difference on translation of foreign operations	46.5	-
<b>Jointly controlled entities and associates:</b>		
Share of (losses) / gains on effective portion of cash flow hedges (net of tax)	(6.8)	5.5
Share of actuarial gains / (loss) on retirement benefit schemes (net of tax)	16.4	(1.4)
<b>Net income / (expense) recognised directly in equity</b>	<b>35.9</b>	<b>14.7</b>
Profit for the year	<u>873.2</u>	<u>830.5</u>
<b>Total recognised income and expense for the year</b>	<b>909.1</b>	<b>845.2</b>
<b>Attributable to:</b>		
Equity holders of the parent	<b>908.8</b>	845.2
<b>Minority interests</b>	<b>0.3</b>	-
	<u>909.1</u>	<u>845.2</u>

**Consolidated Cash Flow Statement**  
for the year ended 31 March 2008

	2008 £m	2007 £m
<b>Cash flows from operating activities</b>		
Profit for the year after tax	873.2	830.5
Taxation	210.6	301.5
Movement on financing and operating derivatives	167.1	(50.7)
Exchange loss in relation to foreign investment	22.2	-
Finance costs	233.9	230.9
Finance income	(202.6)	(193.4)
Share of jointly controlled entities and associates	(108.5)	(23.9)
Pension service charges less contributions paid	(44.4)	(31.6)
Depreciation and impairment of assets	267.8	239.1
Amortisation and impairment of intangible assets	32.5	57.2
Deferred income released	(15.1)	(15.1)
(Increase) in inventories	(25.9)	(48.7)
(Increase) in receivables	(616.0)	(225.0)
Increase in payables	725.5	40.4
(Decrease)/increase in provisions	(6.4)	25.7
Charge in respect of employee share awards (before tax)	10.8	6.8
Profit on disposal of property, plant and equipment	(65.3)	(5.0)
Loss on disposal of replaced assets	0.4	1.7
<b>Cash generated from operations</b>	<b>1,459.8</b>	<b>1,140.4</b>
Dividends received from jointly controlled entities	35.1	22.7
Interest income	61.2	63.4
Interest costs	(108.6)	(118.8)
Income taxes paid	(283.6)	(212.2)
Payment for consortium relief	(7.6)	(26.6)
<b>Net cash from operating activities</b>	<b>1,156.3</b>	<b>868.9</b>
<b>Cash flows from investing activities</b>		
Purchase of property, plant and equipment	(798.8)	(564.1)
Purchase of software and other intangibles	(16.9)	(3.7)
Deferred income received	8.9	12.4
Proceeds from sale of property, plant and equipment	100.6	13.0
Loans to jointly controlled entities	(5.6)	(5.5)
Purchase of Airtricity (note 11)	(1,302.2)	-
Purchase of Slough Heat and Power	(49.5)	-
Purchase of businesses and subsidiaries	(16.2)	-
Cash acquired in purchases	597.3	-
Initial investment in Marchwood Power	-	(5.0)
Loans repaid by jointly controlled entities	10.8	33.8
Loans repaid by associates	-	0.8
Increase in other investments	(14.5)	(2.8)
<b>Net cash from investing activities</b>	<b>(1,486.1)</b>	<b>(521.1)</b>
<b>Cash flows from financing activities</b>		
Proceeds from issue of share capital	2.2	9.2
Repurchase of ordinary share capital for cancellation	(237.0)	-
Dividends paid to company's equity holders	(502.8)	(411.3)
Employee share awards share purchase	(12.4)	(8.2)
New borrowings	2,275.1	236.5
Borrowings acquired in purchases	(543.0)	-
Repayment of borrowings	(466.6)	(169.4)
<b>Net cash from financing activities</b>	<b>515.5</b>	<b>(343.2)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>185.7</b>	<b>4.6</b>
Cash and cash equivalents at the start of year	48.4	43.8
Net increase/(decrease) in cash and cash equivalents	185.7	4.6
Effect of foreign exchange rate changes	9.0	-
<b>Cash and cash equivalents at the end of year</b>	<b>243.1</b>	<b>48.4</b>

## Notes to the Preliminary Statement

### For the year ended 31 March 2008

#### 1. Financial Information

The financial information set out in this announcement does not constitute the Group's statutory accounts for the years ended 31 March 2008 or 2007 within the meaning of Section 240 of the Companies Act 1985. Statutory accounts for 2007 have been delivered to the Registrar of Companies and those for 2008 will be delivered in due course. Both sets of accounts have been prepared under International Financial Reporting Standards as adopted by the EU (adopted IFRS). The auditors have reported on those financial statements; their reports were (i) unqualified; (ii) did not include references to any matters to which the auditors drew attention by way of emphasis without qualifying their reports; and (iii) did not contain statements under sections 237(2) or (3) of the Companies Act 1985. This preliminary announcement was authorised by the Board on 28 May 2008.

#### 2. Basis of preparation

The financial information set out in this announcement has been prepared under the historical cost convention excepting assets and liabilities stated at fair value and in accordance with International Financial Reporting Standards and its interpretations as adopted by the European Union (adopted IFRS). The accounting policies adopted by the group in this financial information are consistent with those used in the financial statements for the year ended 31 March 2008. Certain comparative balance sheet items have been reclassified as current and non-current assets or liabilities to enhance understanding of the prior year results and to aid comparability with the current year presentation. No revision of valuations has been made. The financial statements are presented in pounds sterling.

#### 3. Basis of consolidation of the Group

The financial information consolidates the results and net assets of Scottish and Southern Energy plc and its subsidiaries together with the Group's share of the results and net assets of its jointly controlled entities and associates.

The results of subsidiary undertakings acquired or sold are consolidated from the date that control commences until the date control ceases using the purchase method of accounting.

The Group's share of the total recognised gains and losses of associates are included on an equity accounted basis from the date that significant influence commences until the date significant influence ceases.

Investments in jointly controlled entities are accounted for under the equity method of accounting from the date that joint control commences until the date joint control ceases. Jointly controlled operations are businesses which use assets and liabilities that are separable from the rest of the Group. In these arrangements, the Group accounts for its own share of property, plant and equipment, carries its own inventories, incurs its own expenses and liabilities and raises its own finance.

#### 4. Segmental information

##### Primary reporting format – business segments

The primary segments are as reported for management purposes and reflect the day-to-day management of the business. The Group's primary segments are the distribution and transmission of electricity in the North of Scotland, the distribution of electricity the South of England (together referred to as Power Systems), the generation and supply of electricity and sale of gas in Great Britain and Ireland (Generation and Supply). The Group's 50% equity share in Scotia Gas Networks plc, a business which distributes gas in Scotland and the South of England, is included as a separate segment where appropriate due to its significance.

Analysis of revenue and operating profit by segment is provided below. All revenue and profit before taxation arise from operations within Great Britain and Ireland.

##### a) Revenue by segment

	Total revenue		Intra-segment revenue		External revenue	
	2008	2007	2008	2007	2008	2007
	£m	£m	£m	£m	£m	£m
<b>Power Systems</b>						
Scotland	283.6	270.4	108.4	99.1	175.2	171.3
England	434.0	407.4	194.6	189.6	239.4	217.8
	<b>717.6</b>	<b>677.8</b>	<b>303.0</b>	<b>288.7</b>	<b>414.6</b>	<b>389.1</b>
<b>Generation and Supply</b>	<b>14,263.0</b>	<b>10,977.9</b>	<b>13.1</b>	<b>15.4</b>	<b>14,249.9</b>	<b>10,962.5</b>
<b>Other businesses</b>	<b>1,017.8</b>	<b>859.4</b>	<b>426.0</b>	<b>343.9</b>	<b>591.8</b>	<b>515.5</b>
	<b>15,998.4</b>	<b>12,515.1</b>	<b>742.1</b>	<b>648.0</b>	<b>15,256.3</b>	<b>11,867.1</b>

Revenue from the Group's investment in Scotia Gas Networks (SSE share being 2008 - £361.2m; 2007 - £297.3m) is not recorded in the revenue line in the income statement.

## Notes to the Preliminary Statement

for the year ended 31 March 2008

### 4. Segmental information (continued)

#### b) Operating profit by segment

	2008				Total £m
	Adjusted £m	JCE / Associate share of interest and tax (i) £m	Before exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	
<b>Power Systems</b>					
Scotland	150.2	-	150.2	-	150.2
England	232.7	-	232.7	-	232.7
	<b>382.9</b>	<b>-</b>	<b>382.9</b>	<b>-</b>	<b>382.9</b>
Scotia Gas Networks plc	161.5	(139.3)	22.2	30.3	52.5
<b>Energy Systems</b>	<b>544.4</b>	<b>(139.3)</b>	<b>405.1</b>	<b>30.3</b>	<b>435.4</b>
<b>Generation and Supply</b>	<b>724.2</b>	<b>(29.9)</b>	<b>694.3</b>	<b>(182.7)</b>	<b>511.6</b>
<b>Other businesses</b>	<b>124.7</b>	<b>(0.3)</b>	<b>124.4</b>	<b>55.0</b>	<b>179.4</b>
	<b>1,393.3</b>	<b>(169.5)</b>	<b>1,223.8</b>	<b>(97.4)</b>	<b>1,126.4</b>
Unallocated expenses (ii)	(9.8)	-	(9.8)	-	(9.8)
	<b>1,383.5</b>	<b>(169.5)</b>	<b>1,214.0</b>	<b>(97.4)</b>	<b>1,116.6</b>

	2007				Total £m
	Adjusted £m	JCE / Associate share of interest and tax (i) £m	Before exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	
<b>Power Systems</b>					
Scotland	144.0	-	144.0	-	144.0
England	224.0	-	224.0	-	224.0
	<b>368.0</b>	<b>-</b>	<b>368.0</b>	<b>-</b>	<b>368.0</b>
Scotia Gas Networks plc	103.1	(122.2)	(19.1)	3.8	(15.3)
<b>Energy Systems</b>	<b>471.1</b>	<b>(122.2)</b>	<b>348.9</b>	<b>3.8</b>	<b>352.7</b>
<b>Generation and Supply</b>	<b>642.6</b>	<b>(27.1)</b>	<b>615.5</b>	<b>94.9</b>	<b>710.4</b>
<b>Other businesses</b>	<b>125.2</b>	<b>(0.4)</b>	<b>124.8</b>	<b>-</b>	<b>124.8</b>
	<b>1,238.9</b>	<b>(149.7)</b>	<b>1,089.2</b>	<b>98.7</b>	<b>1,187.9</b>
Unallocated expenses (ii)	(7.8)	-	(7.8)	-	(7.8)
	<b>1,231.1</b>	<b>(149.7)</b>	<b>1,081.4</b>	<b>98.7</b>	<b>1,180.1</b>

(i) The adjusted operating profit of the Group is reported after removal of the Group's share of interest, fair value movements on financing derivatives and tax from jointly controlled entities and associates. The share of Scotia Gas Networks plc interest includes loan stock interest payable to the consortium shareholders (£35.4m; 2007 - £35.8m), other interest payable (£82.7m; 2007 - £70.6m) and tax (£21.2m; 2007 - £15.8m). The Group has accounted for its 50% share of this, £35.4m (2007 - £35.8m), as finance income (note 6).

(ii) Unallocated expenses comprise corporate office costs which are not directly allocable to particular segments.

## Notes to the Preliminary Statement

for the year ended 31 March 2008

### 5. Exceptional items and certain re-measurements

#### i) Exceptional items

During the year, the Group disposed of telecoms sites assets to the Wireless Infrastructure Company Limited, for a total potential consideration of £79.0m. The gain recognised on this disposal is £55.0m. This gain has been disclosed separately in the income statement.

The Group incurred an unhedged translation loss of £22.2m on € denominated debt held in relation to the acquisition of Airtricity Holdings Limited (see note 11). This has been recognised as exceptional following the Group's decision to restructure the borrowings associated with this element of the acquisition in order to match sterling exposures with sterling funding. As a consequence this translation loss is a non-recurring item.

In previous years, the Group financial statements included net dividends received in relation to the administration of TXU Europe Energy Trading Limited which had been placed into administration in 2002 (2007 - £33.0m). In addition to this, in previous years, the Group recognised its share of the net dividend from the administration of TXU Europe Energy Trading Limited received by an associate company, Barking Power Limited, separately within share of operating profit from jointly controlled entities and associates (2007 - £0.9m before tax).

#### ii) Certain re-measurements

Certain re-measurements arising from the adoption of IAS 39 are disclosed separately to aid understanding of the underlying performance of the Group. This category includes the movement on derivatives as described in note 13.

#### iii) Taxation

The Group has separately recognised the tax effect of the exceptional items and certain re-measurements summarised above. In addition to this, the Group has also separately disclosed the effect of the announced change in the base corporation tax rate of 30% to 28%, which is effective from 1 April 2008. This has an impact on any temporary differences which exist at 1 April 2008 (note 7).

These transactions can be summarised thus:

	2008 £m	2007 £m
Exceptional items		
Distributions from TXU administrator (net of tax in associates)	-	33.6
Disposal of Telecoms Mast Assets	55.0	-
Share of change in corporation tax in jointly controlled entities and associates	32.4	-
Exceptional loss on translation	(22.2)	-
	<u>65.2</u>	<u>33.6</u>
Certain re-measurements		
Movement on operating derivatives (note 13)	(187.8)	61.3
Movement on financing derivatives (note 13)	20.7	(10.6)
Share of movements on derivatives in jointly controlled entities (net of tax)	3.0	3.8
	<u>(164.1)</u>	<u>54.5</u>
<b>(Loss)/profit before taxation</b>	<u>(98.9)</u>	<u>88.1</u>
Exceptional items		
Effect of change in corporation tax on deferred tax liabilities and assets	55.4	-
Taxation on other exceptional items	(9.9)	(9.9)
	<u>45.5</u>	<u>(9.9)</u>
Taxation on certain re-measurements	50.7	(15.2)
<b>Taxation</b>	<u>96.2</u>	<u>(25.1)</u>
<b>Impact on profit for the year</b>	<u>(2.7)</u>	<u>63.0</u>

## Notes to the Preliminary Statement

for the year ended 31 March 2008

### 6. Net finance costs

Recognised in income statement

	Before Exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	2008 £m	Before Exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	2007 £m
<b>Finance income:</b>						
Return on pension scheme assets	141.4	-	141.4	130.1	-	130.1
Interest income from short term deposits	4.9	-	4.9	3.8	-	3.8
Other interest receivable:						
Scotia Gas Networks loan stock	35.4	-	35.4	35.8	-	35.8
Other jointly controlled entities and associates	10.8	-	10.8	9.5	-	9.5
Other receivable	10.1	-	10.1	14.2	-	14.2
<b>Total finance income</b>	<b>202.6</b>	<b>-</b>	<b>202.6</b>	<b>193.4</b>	<b>-</b>	<b>193.4</b>
<b>Finance costs:</b>						
Bank loans and overdrafts	(52.5)	-	(52.5)	(34.0)	-	(34.0)
Other loans and charges	(81.2)	-	(81.2)	(98.2)	-	(98.2)
Interest on pension scheme liabilities	(117.4)	-	(117.4)	(107.2)	-	(107.2)
Accretion of convertible debt component	(4.6)	-	(4.6)	(3.6)	-	(3.6)
Notional interest arising on discounted provisions	(3.6)	-	(3.6)	(1.4)	-	(1.4)
Foreign exchange translation of monetary assets and liabilities	2.1	(22.2)	(20.1)	-	-	-
Less: interest capitalised	23.3	-	23.3	13.5	-	13.5
<b>Total finance costs</b>	<b>(233.9)</b>	<b>(22.2)</b>	<b>(256.1)</b>	<b>(230.9)</b>	<b>-</b>	<b>(230.9)</b>
Changes in fair value of financing derivative assets or liabilities designated at fair value through profit or loss	-	20.7	20.7	-	(10.6)	(10.6)
<b>Net finance costs</b>	<b>(31.3)</b>	<b>(1.5)</b>	<b>(32.8)</b>	<b>(37.5)</b>	<b>(10.6)</b>	<b>(48.1)</b>
Finance income	202.6	-	202.6	193.4	-	193.4
Finance costs	(233.9)	(1.5)	(235.4)	(230.9)	(10.6)	(241.5)
<b>Net finance costs</b>	<b>(31.3)</b>	<b>(1.5)</b>	<b>(32.8)</b>	<b>(37.5)</b>	<b>(10.6)</b>	<b>(48.1)</b>

Adjusted net finance costs are arrived at after the following adjustments:

	2008 £m	2007 £m
Net finance costs	(32.8)	(48.1)
(add)/less:		
Share of interest from jointly controlled entities and associates		
Scotia Gas Networks loan stock	(35.4)	(35.8)
Other jointly controlled entities and associates	(92.2)	(82.1)
	(127.6)	(117.9)
Accretion of convertible debt component	4.6	3.6
Exceptional foreign exchange translation loss	22.2	-
Movement on financing derivatives (note 13)	(20.7)	10.6
<b>Adjusted finance income and costs</b>	<b>(154.3)</b>	<b>(151.8)</b>
(add)/less:		
Return on pension scheme assets	(141.4)	(130.1)
Interest on pension scheme liabilities	117.4	107.2
Notional interest arising on discounted provisions	3.6	1.4
Adjusted finance income and costs for interest cover calculation	(174.7)	(173.3)

## Notes to the Preliminary Statement

for the year ended 31 March 2008

### 7. Taxation

#### Analysis of charge recognised in the income statement:

	2008			2007		
	Before Exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	Total £m	Before Exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	Total £m
<b>Current tax</b>						
UK corporation tax	315.3	13.6	328.9	286.5	9.9	296.4
Adjustments in respect of previous years	(18.9)	-	(18.9)	(19.9)	-	(19.9)
Total current tax	<u>296.4</u>	<u>13.6</u>	<u>310.0</u>	<u>266.6</u>	<u>9.9</u>	<u>276.5</u>
<b>Deferred tax</b>						
Current year	11.4	(54.4)	(43.0)	7.1	15.2	22.3
Effect of change of UK corporation tax rate	-	(55.4)	(55.4)	-	-	-
Adjustments in respect of previous years	(1.0)	-	(1.0)	2.7	-	2.7
Total deferred tax	<u>10.4</u>	<u>(109.8)</u>	<u>(99.4)</u>	<u>9.8</u>	<u>15.2</u>	<u>25.0</u>
Total taxation charge	<u>306.8</u>	<u>(96.2)</u>	<u>210.6</u>	<u>276.4</u>	<u>25.1</u>	<u>301.5</u>

The charge for the year can be reconciled to the profit per the income statement as follows:

	2008		2007	
	£m	%	£m	%
Group profit before tax	1,083.8		1,132.0	
Less: share of results of associates and jointly controlled entities	(108.5)		(23.9)	
<b>Profit before tax</b>	<u>975.3</u>		<u>1,108.1</u>	
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2007 – 30%)	292.6	30.0	332.4	30.0
Tax effect of:				
Expenses not deductible for tax purposes	5.6	0.6	1.5	0.1
Non taxable income	(0.4)	-	(6.3)	(0.6)
Effect of change of UK corporation tax rate	(55.4)	(5.7)	-	-
Impact of foreign tax rates and foreign dividends	(0.6)	(0.1)	-	-
Adjustments to tax charge in respect of previous years	(21.0)	(2.1)	(17.1)	(1.5)
Consortium relief not paid for	(9.7)	(1.0)	(8.9)	(0.8)
Utilisation of tax losses	(0.5)	(0.1)	(0.1)	-
<b>Group tax charge and effective rate</b>	<u>210.6</u>	<u>21.6</u>	<u>301.5</u>	<u>27.2</u>

The adjusted current tax charge is arrived at after the following adjustments:

	2008		2007	
	£m	%	£m	%
Total taxation charge	210.6	21.6	301.5	27.2
Effect of adjusting items (see below)	-	(4.5)	-	0.7
	<u>210.6</u>	<u>17.1</u>	<u>301.5</u>	<u>27.9</u>
(add)/less:				
Share of current tax from jointly controlled entities and associates	20.8	1.7	16.0	1.5
Exceptional items	(9.9)	(0.8)	(9.9)	(0.9)
Effect of change of UK corporation tax rate	55.4	4.5	-	-
Tax on movement on derivatives	50.7	4.1	(15.2)	(1.4)
Deferred tax (excluding share of jointly controlled entities)	(10.4)	(0.8)	(9.8)	(0.9)
Adjusted current tax charge and effective rate	<u>317.2</u>	<u>25.8</u>	<u>282.6</u>	<u>26.2</u>

The adjusted effective rate is based on adjusted profit before tax being:

	2008	2007
	£m	£m
Profit before tax	1,083.8	1,132.0
(add)/less:		
Exceptional items and certain re-measurements	98.9	(88.1)
Share of tax from jointly controlled entities and associates	41.9	31.8
Accretion of convertible debt component	4.6	3.6
Adjusted profit before tax	<u>1,229.2</u>	<u>1,079.3</u>

## Notes to the Preliminary Statement

for the year ended 31 March 2008

### 8. Dividends

	2008 £m	2007 £m
<b>Amounts recognised as distributions from equity</b>		
Final dividend for the previous year of 39.9p (2007 – 32.7p) per share	345.5	281.3
Interim dividend for the current year of 18.1p (2007 – 15.1p) per share	157.3	130.0
	<u>502.8</u>	<u>411.3</u>
Proposed final dividend for the current year of 42.4p (2007 – 39.9p) per share	<u>368.9</u>	343.9

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. The final dividend paid, £345.5m (39.9p, 2007 – 32.7p), was declared on 31 May 2007, approved at the Annual General Meeting on 27 July 2007 and was paid to shareholders on 21 September 2007. An interim dividend of £157.3m (18.1p, 2007 – 15.1p) was paid on 25 March 2008.

### 9. Earnings per share

#### Basic earnings per share

The calculation of basic earnings per share at 31 March 2008 is based on the net profit attributable to ordinary shareholders and a weighted average number of ordinary shares outstanding during the year ended 31 March 2008. All earnings are from continuing operations.

#### Adjusted earnings per share

Adjusted earnings per share has been calculated by excluding the charge for deferred tax and exceptional items and certain re-measurements.

	2008		2007	
	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence
<b>Basic</b>	<b>872.9</b>	<b>101.1</b>	830.5	96.5
Exceptional items and certain re-measurements (note 5)	2.7	0.3	(63.0)	(7.3)
Basic excluding exceptional items and certain re-measurements	<u>875.6</u>	<u>101.4</u>	767.5	89.2
Adjusted for:				
Deferred tax (note 7)	10.4	1.2	9.8	1.1
Deferred tax from share of jointly controlled entities and associates results	21.1	2.5	15.8	1.8
Accretion of convertible debt component	4.6	0.5	3.6	0.4
<b>Adjusted</b>	<u><b>911.7</b></u>	<u><b>105.6</b></u>	<u>796.7</u>	<u>92.5</u>
<b>Basic</b>	<b>872.9</b>	<b>101.1</b>	830.5	96.5
Convertible debt interest (net of tax)	9.8	1.1	10.7	1.2
Dilutive effect of convertible debt	-	(1.2)	-	(3.8)
<b>Diluted</b>	<u><b>882.7</b></u>	<u><b>101.0</b></u>	<u>841.2</u>	<u>93.9</u>
Exceptional items and certain re-measurements (note 5)	2.7	0.3	(63.0)	(7.0)
Diluted excluding exceptional items and certain re-measurements	<u><b>885.4</b></u>	<u><b>101.3</b></u>	<u>778.2</u>	<u>86.9</u>

The weighted average number of shares used in each calculation is as follows:

	2008 Number of shares (millions)	2007 Number of shares (millions)
For basic and adjusted earnings per share	863.2	860.9
Effect of exercise of share options	2.0	1.8
	<u>865.2</u>	<u>862.7</u>
Effect of dilutive convertible debt	8.8	33.3
For diluted earnings per share	<u>874.0</u>	<u>896.0</u>

**Notes to the Preliminary Statement**  
for the year ended 31 March 2008

**10. Reserves**

	Share premium account £m	Capital redemption reserve £m	Equity reserve £m	Translation reserve £m	Retained earnings £m	Hedge reserve £m	Minority interest £m	Total £m
At 1 April 2007	99.1	13.7	14.6	-	2,048.0	(10.5)	-	2,164.9
Profit for the year	-	-	-	-	872.9	-	0.3	873.2
Effective portion of changes in fair value of cash flow hedges	-	-	-	-	-	11.6	-	11.6
Transferred to income and expense on cash flow hedges	-	-	-	-	-	8.0	-	8.0
Net investment hedge charge to equity	-	-	-	(21.1)	-	-	-	(21.1)
Premium on issue of shares	2.0	-	-	-	-	-	-	2.0
Repurchase of shares	-	8.3	-	-	(239.8)	-	-	(231.5)
Convertible bond converted to equity	214.6	-	(10.7)	-	-	-	-	203.9
Exchange differences on translation of foreign operation	-	-	-	46.5	-	-	-	46.5
Actuarial gains on retirement benefit schemes (net of tax)	-	-	-	-	(17.4)	-	-	(17.4)
Jointly controlled entities:								
Share of change in fair value of effective cash flow hedges	-	-	-	-	-	(6.8)	-	(6.8)
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	16.4	-	-	16.4
Dividends to shareholders	-	-	-	-	(502.8)	-	-	(502.8)
Credit in respect of employee share awards	-	-	-	-	10.8	-	-	10.8
Investment in own shares	-	-	-	-	(12.4)	-	-	(12.4)
Current and deferred tax recognised in equity in respect of employee share awards	-	-	-	-	(0.1)	-	-	(0.1)
<b>At 31 March 2008</b>	<b>315.7</b>	<b>22.0</b>	<b>3.9</b>	<b>25.4</b>	<b>2,175.6</b>	<b>2.3</b>	<b>0.3</b>	<b>2,545.2</b>

The hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedge derivative instruments related to hedged transactions that have not yet occurred.

The equity reserve comprises the equity component of the Group's convertible bond.

The translation reserve comprises exchange translation differences on foreign currency net investments offset by exchange translation differences on borrowings and derivatives classified as net investment hedges under IAS 39.

## Notes to the Preliminary Statement

### for the year ended 31 March 2008

#### 11. Acquisition of Airtricity

On 15 February 2008, the Company acquired 100% of the issued share capital in Airtricity Holdings Limited ('Airtricity') for a combined consideration of £1,349.1m (€1,801.4m). The principal activity of Airtricity is the development, construction and operation of offshore and onshore wind generation assets in the UK, the Republic of Ireland and elsewhere in Europe. The acquired group is also a significant supplier of electricity in Ireland. In addition, Airtricity has wind development opportunities in China.

The total value of the businesses acquired was £1,010.8m (€1,349.7m). This included cash assets of €793.2m including the remaining proceeds of Airtricity's disposal of its North American business in late 2007. The transaction was initially funded by a combination of cash and short term bank borrowings. The consideration was in cash (£1,302.2m) with an element of deferred consideration.

The analysis of assets and liabilities acquired and the fair value of the acquisition is shown below. All intangible assets acquired were recognised at their respective fair values. The residual over the net assets acquired is recognised as goodwill.

The provisional book values and fair values of the assets and liabilities acquired were as follows:

	Carrying value of acquired entities £m	Fair value of Acquired entities £m
Intangible fixed assets	62.5	228.2
Property, plant and equipment	401.4	707.0
Investment in jointly controlled entities	49.8	119.7
Derivatives and other financial assets	(1.9)	13.2
Cash and cash equivalents	594.0	594.0
Other net current assets/(liabilities)	15.3	17.4
Loans and borrowings	(517.3)	(522.3)
Deferred tax	(3.0)	(146.4)
<b>Net assets</b>	<b>600.8</b>	<b>1,010.8</b>
Goodwill		<b>338.3</b>
Total consideration		<b>1,349.1</b>

The book values of assets and liabilities have been adjusted to align with the fair value of assets and liabilities acquired. The adjustments to intangible assets mainly relate to the acquired wind farm development portfolio and the adjustments to property, plant and equipment relate to the operational and under construction wind farm assets. Goodwill has arisen in relation to the future development potential of the Airtricity businesses including synergies relating to the purchase. Goodwill also includes recognition of deferred tax on the fair value adjustments made.

**Notes to the Preliminary Statement**  
for the year ended 31 March 2008

**12. Pensions**

**Valuation of combined Pension Schemes**

	Long- term rate of return expected at 31 March 2008 %	Value at 31 March 2008 £m	Long- term rate of return expected at 31 March 2007 %	Value at 31 March 2007 £m
Equities	8.0	939.6	8.0	1,253.6
Government bonds	4.5	481.5	4.5	378.6
Corporate bonds	6.9	343.0	5.4	221.4
Other investments	5.6	316.9	5.7	256.8
Total fair value of plan assets		<u>2,081.0</u>		2,110.4
Irrecoverable surplus		(210.6)		-
Present value of defined benefit obligations		<u>(1,919.5)</u>		<u>(2,202.3)</u>
<b>Deficit in the schemes</b>		<u>(49.1)</u>		<u>(91.9)</u>

**Movements in the defined benefit obligation are as follows:**

	2008 £m	2007 £m
At 1 April	(2,202.3)	(2,211.1)
Movements in the year:		
Service costs	(29.2)	(30.3)
Member contributions	(7.5)	(7.7)
Benefits paid	95.0	89.2
Interest on pension scheme liabilities	(117.4)	(107.2)
Actuarial gains / (losses)	341.9	64.8
<b>At 31 March</b>	<u>(1,919.5)</u>	<u>(2,202.3)</u>

**Movements in scheme assets during the year:**

	2008 £m	2007 £m
At 1 April	2,110.4	2,017.3
Movements in the year:		
Expected return on pension scheme assets	141.4	130.1
Assets distributed on settlement	(95.0)	(89.2)
Employer contributions	73.6	61.9
Member contributions	7.5	7.7
Actuarial (losses) / gains	(156.9)	(17.4)
Adjustment in relation to irrecoverable surplus	(210.6)	-
<b>At 31 March</b>	<u>1,870.4</u>	<u>2,110.4</u>

Included within the Scottish Hydro Electric Pension Scheme net asset is the impact of an irrecoverable surplus of £210.6m. The Scheme's surplus increased largely due to the increased yield on corporate bonds to such an extent that the Company was only able to recognise the surplus to the extent that it is recoverable.

## Notes to the Preliminary Statement

### for the year ended 31 March 2008

#### 13. Derivative financial assets and liabilities

For financial reporting purposes, the Group has classified derivative financial instruments into two categories, operating derivatives and financing derivatives. Operating derivatives include all qualifying commodity contracts including those for electricity, gas, oil, coal and carbon. Financing derivatives include all fair value and cash flow interest rate hedges, non-hedge accounted (mark-to-market) interest rate derivatives, cash flow foreign exchange hedges and non-hedge accounted (MTM) foreign exchange contracts. Non-hedge accounted contracts are treated as held for trading.

The net movement reflected in the Income Statement can be summarised thus:

	2008 £m	2007 £m
<b>Operating derivatives</b>		
Total result on operating derivatives (i)	135.7	(134.5)
Less: amounts settled in the year (ii)	<u>(323.5)</u>	195.8
<b>Movement in unrealised derivatives</b>	<u>(187.8)</u>	61.3
<b>Financing derivatives (and hedged items)</b>		
Total result on financing derivatives (i)	(116.8)	(117.7)
Less: amounts settled in the year (ii)	<u>137.5</u>	107.1
<b>Movement in unrealised derivatives</b>	<u>20.7</u>	(10.6)
<b>Net income statement impact</b>	<u>(167.1)</u>	50.7

(i) Total result on derivatives in the income statement represents the total amount (charged) or credited to the income statement in respect of operating and financing derivatives.

(ii) Amounts settled in the year represent the result on derivatives transacted which have matured or been delivered and have been included within the total result on derivatives.

Net derivative financial assets and (liabilities) are represented as follows:

	2008 £m	2007 £m
<b>Derivative financial assets</b>		
Non-current	318.9	54.5
Current	<u>1,106.5</u>	452.9
	<u>1,425.4</u>	507.4
<b>Derivative financial liabilities</b>		
Non-current	(313.3)	(120.9)
Current	<u>(1,229.4)</u>	(351.9)
	<u>(1,542.7)</u>	(472.8)
Fair value adjustment to hedged item (loans and borrowings)	-	10.4
	<u>(117.3)</u>	45.0

#### 14. Analysis of net debt

	At 1 April 2007 £m	Decrease in cash and cash equivalents £m	(Increase)/ decrease in debt £m	At 31 March 2008 £m
Cash and cash equivalents	56.1	199.2	-	255.3
Bank overdraft (i)	(7.7)	(4.5)	-	(12.2)
	<u>48.4</u>	<u>194.7</u>	<u>-</u>	<u>243.1</u>
Loans and borrowings	(2,287.9)	-	(1,632.7)	(3,920.6)
Finance lease creditors	(1.1)	-	0.5	(0.6)
Bank overdraft (i)	7.7	-	4.5	12.2
	<u>(2,281.3)</u>	<u>-</u>	<u>(1,627.7)</u>	<u>(3,909.0)</u>
<b>Net debt</b>	<u>(2,232.9)</u>	<u>194.7</u>	<u>(1,627.7)</u>	<u>(3,665.9)</u>

(i) Bank overdrafts are reported on the balance sheet as part of current loans and borrowings. For cash flow purposes, these have been included as cash and cash equivalents.

