



SSE plc's financial report for the year to 31 March 2012

16 May 2012

	Mar 2012	Mar 2011	Change	Mar 2010
Total Recordable Injury Rate ¹	0.11	0.12	- 8%	0.14
Working days lost through injuries	53	171	- 118 days	73

Full-Year Dividend	80.1p	75.0p	+ 6.8%	70.0p
Adjusted Profit Before Tax*	£1,335.7m	£1,310.1m	+ 2.0%	£1,290.1m
Adjusted Profit After Tax*	£1,122.3m	£1,041.9m	+ 7.7%	£1,016.0m
Adjusted Earnings Per Share*	112.7p	112.3p	+ 0.4%	110.2p
Investment and Capital Expenditure	£1,706.9m	£1,443.7m	+ 18.2%	£1,315.2m

Customer Minutes Lost (SHEPD)	73	78	- 5 mins	74
Customer Minutes Lost (SEPD)	60	64	- 4 mins	65
Energy Supply Customers (GB and Ire)	9.55m	9.65m	- 1%	9.35m
GB customer complaints to third parties	896	1,161	- 23%	1,231
Power Station Availability (Gas)	94%	88%	+ 7%	94%
Power Station Availability (Coal)	89%	84%	+ 6%	92%
Capacity for Renewable Energy ²	3,020MW	2,450MW	+ 570MW	2,370MW

¹Per 100,000 hours worked ²Including pumped storage

Lord Smith of Kelvin, Chairman of SSE, said:

"There are three issues over which SSE has no control but which in one way or another touched every part of its business in 2011/12 - upheaval in global energy markets, widespread economic uncertainty and the weather. Higher wholesale gas prices, falling demand for energy and a succession of winter storms presented major challenges for the wholesale, retail and networks parts of SSE.

"The fact that, despite all of this, SSE has again delivered increases in the full-year dividend and in adjusted profit before tax* demonstrates the resilience inherent in its balanced model of market-based and economically-regulated businesses, and the robustness of its strategy of focusing on operations and investment in each of those businesses. It also demonstrates the commitment and professionalism of the people who work for SSE throughout the UK and Ireland.

"For some people, 'profit' and 'dividend' are contentious words when it comes to energy, but profit and dividend allow SSE to employ people, pay tax, make investments that keep the lights on and provide an income return that shareholders like pension funds need.

"At the same time, SSE recognises that it must continually earn the right to make a profit and pay dividends, so 2012/13 and beyond will be about continuing the work to earn the trust of customers in retail and business markets, meeting the needs of energy network customers and investing in assets to support secure and lower carbon supplies of energy in the future. If this is achieved, there can be every confidence that SSE will extend further its record of annual above-inflation dividend growth, with an increase of at least 2% more than inflation for 2012/13."

* In line with SSE's approach since September 2005, this financial report describes adjusted operating profit before exceptional items, remeasurements arising from IAS 39, and after the removal of taxation and interest on profits from jointly controlled entities and associates, unless otherwise stated. In addition, it describes adjusted profit before tax before exceptional items, remeasurements arising from 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, remeasurements arising from IAS 39, deferred tax and hybrid coupon payments.

DELIVERING THE DIVIDEND

Operating Profit* by Segment				
	Mar 12 - £	Mar 12 - % split	Mar 11 - £	Change - £
Networks	£737.1m	44%	£690.5m	+ £46.6m
Retail	£321.6m	19%	£400.5m	- £78.9m
Wholesale	£607.9m	37%	£571.5m	+ £36.4m

STRATEGY

Delivering sustained real growth in the dividend

- Full-year dividend up 6.8% to 80.1p per share
- Dividend covered 1.41 times by adjusted earnings per share*
- Thirteenth successive full-year dividend increase
- Targeting full-year dividend increase of at least RPI inflation +2% in 2012/13
- Targeting annual dividend increases above RPI inflation in 2013/14 and beyond

FINANCE

Sticking to well-established financial principles

- Adjusted profit before tax* up 2.0% to £1,335.7m
- Thirteenth successive increase in adjusted profit before tax*
- Capital and investment expenditure up 18.2% to £1,706.9m
- Adjusted net debt and hybrid capital up 14.7% to £6.76bn
- Average debt maturity of 9.3 years

NETWORKS

Keeping the lights on and supporting growth

- Operating profit* up 6.7% to £737.1m
- Capital investment in electricity networks up 48.5% to £489.0m
- Electricity transmission Regulated Asset Value up 37.5% to £770m
- Total network RAV (inc share of SGN) up 9.3% to £5.86bn
- 'Fast track' for Electricity Transmission Price Control

RETAIL

Earning the right to make a profit

- Operating profit* down 19.7% to £321.6m
- All 10 *Building Trust* commitments delivered; further commitments made
- Total energy customer accounts (GB and Ire) down 100,000 to 9.55 million
- Agreement to acquire 130,000 customers in NI from Phoenix Holdings Limited
- GB gas consumption (ave) down 19.9%; electricity consumption (ave) down 6.9%

WHOLESALE

Securing the energy people and businesses need

- Operating profit* up 6.4% to £607.9m
- 570MW (net) of additional capacity for renewable energy operational
- Output from gas-fired power stations down 26%; from coal-fired stations up 24%
- Output of renewable energy (hydro and wind) up 73%
- £42.6m operating profit* from Gas Production (£4.6m from two months in 2010/11)

STRATEGY

Continuing strategy for dividend growth

SSE's core purpose is to provide the energy people need in a reliable and sustainable way. In fulfilling this purpose, SSE requires the support of the shareholders who have invested in its shares, and it continues to believe their investment should be remunerated through the payment of dividends, for four key reasons:

- receiving and reinvesting dividends is the biggest source of an investor's return over the long term;
- dividends provide income for those investors who do not wish to reinvest them;
- dividend targets provide a transparent means with which to hold management to account; and
- a long-term commitment to dividend growth demands a disciplined, consistent and long-term approach to operations, investments and acquisitions.

As a result of this, SSE's strategy remains the delivery of sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of economically-regulated and market-based businesses in energy production, storage, distribution, supply and related services, mainly in the UK and Ireland.

The objective of delivering annual above-inflation increases in the dividend paid to shareholders means SSE has a clear, measurable and practical goal which sets the long-term financial context for its operational and investment decisions.

Sticking to financial principles to underpin dividend growth

The requirement on SSE to maintain a disciplined, consistent and long-term approach to the management of business activities is underpinned by a series of long-standing financial principles:

- **strength:** maintenance of a strong balance sheet, evidenced by commitment to the criteria for a single A credit rating;
- **rigour:** rigorous analysis to ensure investments are well-founded and achieve returns greater than the cost of capital;
- **discipline:** deployment of a selective and disciplined approach to acquisitions, which should enhance earnings per share over the medium and long term; and
- **measurement:** use of the economics of purchasing the company's own shares in the market as the first measurement against which financial decisions are taken.

The application of these principles supports the fulfilment of SSE's first financial responsibility to shareholders: the delivery of sustained real dividend growth.

Delivering dividend growth for a thirteenth successive year

For 2011/12, the Board is recommending a final dividend of 56.1p per share, making a full-year dividend of 80.1p, an increase of 6.8% on the previous year. The full-year dividend is:

- covered 1.41 times by SSE's adjusted earnings per share*;
- more than three times the first full-year dividend paid by SSE, in 1999; and
- more than twice the full-year dividend paid eight years ago, in 2004.

The recommended full-year dividend increase of 6.8% represents the thirteenth successive above-inflation dividend increase since SSE paid its first full-year dividend in 1999. SSE is now one of just five continuing FTSE 100 companies to have delivered better-than-inflation dividend growth every year during this period, and ranks third amongst that group in terms of compound annual growth rate.

Of the 48 companies which have been FTSE 100 constituents since 1998, when SSE joined the Index, SSE is ranked 10th for Total Shareholder Return.

Targeting sustained dividend growth over the long term

As Capita Registrars Dividend Monitor, published in February 2012, stated, a 'company's value depends, most fundamentally, on the ability of the firm to make money and return it to shareholders. Ultimately, dividends are the principal way in which corporate profits are distributed.' It is in recognition of this that SSE's key financial objective is the delivery of annual above-inflation increases in the dividend paid to shareholders, and its targets are to deliver:

- a full-year dividend increase of at least 2% more than RPI inflation for 2012/13; and
- annual above-RPI inflation dividend increases from 2013/14 onwards.

In this context, inflation is defined as the average annual rate across each of the 12 months to March.

SSE's policy is that dividend targets should be:

- set in a way which is consistent with SSE's financial principles (see above);
- realistic and attainable, so there can be the fullest possible confidence in their achievability; and
- consistent with maintaining dividend cover over the medium term within a range around 1.5 times, which is close to the average dividend cover which SSE has achieved in the most recent four years.

Maintaining a balanced range of energy businesses through which to achieve dividend growth

SSE has adopted new reportable segments covering Networks, Retail and Wholesale businesses and is the only company listed on the London Stock Exchange which owns, operates and invests in such a balanced group of economically-regulated energy businesses, such as electricity networks, and market-based energy businesses, such as energy supply and electricity generation. The balance between these activities means that:

- while energy is at their core, SSE has a diverse range of businesses;
- within those businesses, SSE has a diverse range of assets; and
- to add to those assets, SSE has a diverse range of investment options.

This balance, diversity, growing asset base and range of investment options means that SSE has a broad platform from which to deliver the levels of profitability and the long term value required to support sustained real dividend growth. In addition, the risks to the achievement of that growth are contained by that balance and by the diversity of SSE's businesses, assets and investment options.

Moreover, the fact those businesses, assets and investment options are almost entirely in Great Britain, Northern Ireland and the Republic of Ireland means that SSE is able to combine diversity with a depth of experience, knowledge and understanding of the markets in which it operates.

Sustaining dividend growth through a period of change

Energy markets in Great Britain and Ireland are increasingly shaped by the EU Climate Change and Renewable Energy Package, which aims to achieve by 2020:

- a reduction of at least 20% in the levels of greenhouse gas emissions across the EU, compared with 1990 levels; and
- an increase to at least 20% of all energy consumption being generated from renewable sources.

In addition, the EU has a non-binding target to achieve a 20% reduction in energy consumption by 2020 through improvements in energy efficiency and in June 2011 the European Commission proposed an Energy Efficiency Directive. The proposed Directive is broad in scope and would replace a number of existing Directives.

The EU Package provides the context for four major developments which are under way in public policy and regulation and which will affect SSE's operations and investments for years to come:

- Ofgem's new 'RIIO' model for the economic regulation of energy networks in Great Britain is now going through the key tests of actual Price Control Reviews;
- the Retail Market Review in Great Britain, being undertaken by Ofgem, is designed to deliver improvements in the operation of the retail markets for electricity and gas;
- the UK Government's White Paper, *Planning our electric future*, sets out a series of proposed reforms to the market arrangements for electricity generation in Great Britain; and
- energy markets on the island of Ireland are undergoing a process of harmonisation to support further the development of competition, for the benefit of customers.

At the heart of these developments is the energy 'trilemma' – the need for supplies of energy that are secure, sustainable and affordable. There are three other significant factors with which energy companies such as SSE have to deal:

- as the decline of oil and gas production from the UK Continental Shelf continues, there is a continuing integration of UK energy prices into the wider global market, which means macro economic and geopolitical factors are important;
- demand for energy in the UK and Ireland is, rightly, on a downward trend through the effects of investment in, and greater awareness of, energy efficiency measures, more efficient appliances and price sensitivity on the part of customers; and
- the expectation that the decarbonisation of the economies in the UK and Ireland will present opportunities for flexible and skilled employment that is sustainable in every sense.

As well as dealing with geopolitical, macro economic and energy-specific issues, SSE acknowledged, in a submission to the UK and Scottish Governments in February 2012, that it would have to decide whether the additional risk of regulatory and legislative change with regard to Scotland, raised by the forthcoming referendum on its future, means it should apply a risk premium to any investment proposal in Scotland and assess the impact of such a premium on whether or not to proceed with the proposed investment.

Setting the right long-term priorities to achieve dividend growth

SSE has identified five long-term priorities across its balanced range of businesses which reflect, and are consistent with, the changes under way at global, EU and UK and Irish levels and with addressing the energy 'trilemma'. The long-term priorities are:

- efficiency, responsiveness and innovation in energy networks;
- gaining and retaining the trust of a growing number of household energy customers;
- breadth and depth in the provision of energy-related services to businesses and other organisations;
- competitive and sustainable energy procurement; and
- flexible and 'greener' electricity production.

In focusing on these priorities, SSE will maintain a strong emphasis on its six core values, the 'SSE SET' of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork. It believes these values are especially significant because energy is something which people *need* rather than *want* and so the highest possible standards in its operations and investments are essential.

This means that safety must come first. SSE believes that the effective management of safety issues is a barometer of effective management of all operational and investment-related activities. In 2011/12, its Total Recordable Injury Rate per 100,000 hours worked was 0.11, compared with 0.12 in 2010/11 and 0.14 in 2009/10. The total number of working days lost in SSE as a result of injuries occurring during the year was 53, compared with 171 in the

previous year. The Total Recordable Injury Rate and total number of working days lost as a result of injuries occurring during 2011/12 were the lowest that SSE has had.

In addition, and in keeping with its commitment to sustainability, SSE's target for every year is zero environmental incidents which result in it being served with an enforcement notice or prosecution by a government-sponsored environment protection agency. There were no such incidents during 2011/12, the second successive year in which this was achieved.

The prospects for dividend growth in 2012/13 and beyond

The economic outlook for the UK and Ireland in 2012/13 continues to be uncertain, and the global nature of energy markets means that SSE, like every other company in the sector, has to be prepared to manage the energy consequences of exceptional and unpredictable macro-economic, geopolitical or other events of potentially global significance.

Against this uncertain background, and with its strategic focus on efficiency in operations and investment, SSE's core operational priorities during 2012/13 are to:

- carry out all work in a safe and responsible manner, with a lower Total Recordable Injury Rate;
- maintain strong cost control throughout all business activities;
- distribute electricity and (through Scotia Gas Networks) gas with the minimum possible interruptions to supplies;
- demonstrate responsiveness and innovation in the management of electricity and gas networks;
- develop and sustain long-term partnerships and contracts with business customers and other large organisations;
- improve the standards of service delivered to energy supply customers and continue the drive to build trust in it as an energy supplier;
- work with the UK government and Ofgem to secure a stable and competitive framework for electricity generation and energy supply in Great Britain;
- optimise the management of its portfolio of energy assets and contracts and of its energy procurement; and
- ensure power stations maintain a high level of flexibility and fuel efficiency to generate electricity in response to customers' needs and market conditions.

SSE's main **investment priorities** are to support sustainable earnings and dividend growth by:

- making significant progress in its programme of capital investment in electricity and (through Scotia Gas Networks) gas networks, including electricity transmission;
- commissioning assets in renewable energy, including completion of the wind farm development at Clyde;
- meeting development and construction goals in its investment programme, including identifying opportunities for possible new fuel-efficient gas-fired power stations; and
- improving the flexibility and efficiency of its existing fleet of thermal power stations and maintaining options for future development.

The delivery of a strong operational performance and the achievement of its investment priorities should enable SSE to discharge its first financial responsibility to shareholders in 2012/13: an increase of at least 2% more than RPI inflation in the full-year dividend. It should also put SSE in a good position to deliver dividend increases that are greater than RPI inflation from 2013/14 onwards.

FINANCE

Changing Reportable Segments

In its Annual Report 2011, SSE said that its reporting requirements may evolve and during 2011/12 it completed a review of the reportable segments contained within its financial statements. The review was undertaken following the creation of SSE's Management Board in January 2011 and resulting changes in the way that SSE manages, reviews and reports internally its businesses.

The previous segments – Energy Networks, Generation and Supply and Other Energy and Utility Services – have been replaced with the following:

- Networks – the economically-regulated transmission and distribution of electricity and gas and other related networks;
- Retail – the supply of electricity, gas and other services to household and business customers; and
- Wholesale – the production, storage and generation of energy and energy portfolio management.

These are consistent with the principle that components of a business qualify as separate reporting segments if they are capable of earning revenue and incurring expenses in their own right.

SSE believes that the adoption of these segments will add further transparency to its business and to the financial performance of each part of it. In particular, the new segments are consistent with SSE's continuing work to build customers' trust in energy supply, where there will now be separate reporting of profit.

Increasing Adjusted Profit Before Tax*

These financial results for the year to 31 March 2012 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus has consistently been, and remains, on profit before tax before exceptional items, remeasurements arising from IAS 39, and after the removal of taxation on profits from jointly controlled entities and associates.

This 'adjusted profit before tax'* was first adopted as a key performance indicator by SSE in 2005/06 and it:

- reflects the underlying profits of SSE's business;
- reflects the basis on which the business is managed; and
- avoids the volatility that arises from IAS 39.

The tables below reconcile SSE's adjusted profit before tax* to its reported profit before tax and set out the position after tax and in respect of adjusted earnings per share*. The volatility that arises from IAS 39 is also demonstrated.

	Mar 12 £m	Mar 11 £m	Mar 10 £m	Mar 09 £m
Adjusted Profit before Tax*	1,335.7	1,310.1	1,290.1	1,253.7
Movement on derivatives (IAS 39)	(509.0)	1,423.3	399.8	(1,262.1)
Exceptional items	(551.6)	(625.0)	-	102.7
Tax on JCEs and Associates	(6.6)	3.3	(51.3)	(40.4)
Interest on convertible debt	-	-	-	(0.6)
Reported Profit before Tax*	268.5	2,111.7	1,638.6	53.3
Adjusted Profit before Tax*	1,335.7	1,310.1	1,290.1	1,253.7
Adjusted current tax charge	(213.4)	(268.2)	(274.1)	(300.4)
Adjusted Profit after Tax*	1,122.3	1,041.9	1,016.0	953.3

Reported Profit after Tax ¹	197.8	1,504.5	1,235.5	112.3
Number of shares for basic and adjusted EPS (million)	937.8	927.6	921.9	883.0
Adjusted EPS*¹	112.7p	112.3p	110.2p	108.0p
Basic EPS	21.1p	162.2p	134.0p	12.7p

¹ Includes a deduction for hybrid debt coupon payment of £65.5m in the year to March 2012.

Factors affecting Adjusted Profit before Tax* in 2011/12

Adjusted profit before tax* rose by 2.0%, from £1,310.1m to £1,335.7m in the year to 31 March 2012. The level of adjusted profit before tax* was constrained by four main factors (comparisons with the year to 31 March 2011 unless otherwise stated):

- the wholesale cost of gas, which was typically around 20% higher;
- 'spark' spreads (the difference between the cost of gas and the price of the electricity produced from it), which were around 75% lower;
- the decision to shield household customers from rising wholesale energy prices for as long as practical before eventually implementing a price increase in September; and
- the actual reduction in average consumption of both electricity (6.9%) and gas (19.9%) by household customers in the GB market.

In addition, there was a 5.4% reduction in operating profit* in Electricity Distribution due to the timing of revenue recovery.

Despite these factors, growth in adjusted profit before tax* was still achieved, for four main reasons:

- a significant rise (73%) in the output of renewable energy (hydro and wind), reflecting more favourable weather conditions and an increase in the amount of on- and offshore wind farm capacity which SSE has in operation;
- operating profit of £42.6m from the gas production assets acquired by SSE towards the end of 2010/11;
- an increase of 54.5% in the operating profit* of Electricity Transmission, reflecting the increase in its asset base resulting from capital invested; and
- greater allowed revenue in Scotia Gas Networks, supporting an increase of 43.5% in that business' contribution to adjusted profit before tax*.

All of this illustrates that SSE continues to benefit from maintaining a balance between economically-regulated and market-based businesses because it is able to continue to deliver increases in adjusted profit before tax* even when, as in 2011/12, there are significant issues to be managed within individual businesses. It also illustrates that major benefits from SSE's programme of investment in new assets are now emerging and making a positive contribution to sustaining growth in adjusted profit before tax*.

Impact of the movement on derivatives (IAS 39)

At 31 March 2012, there was a net derivative financial liability in SSE's balance sheet arising from IAS 39 of £17.6m, before tax, compared with a net asset of £438.8m, before tax, at 31 March 2011. This consists of:

- a liability following the valuation of financial instruments used by SSE to hedge its exposure to financial risks such as interest rates; and
- an asset relating to the forward commodity purchase contracts for gas, coal, oil, carbon and wholesale electricity that SSE, like all major energy suppliers, has to enter into to ensure that the future requirements of its customers are met.

IAS 39 requires SSE to record these contracts at their 'fair value' at each balance sheet date. This involves comparing the contractual price for commodities against the prevailing forward

market price at 31 March. On that date this year, the average contractual price was lower than the market price (in other words, the contracts were 'in the money'). The actual value of the contracts will be determined as the relevant commodity is delivered to meet customers' energy needs. For around 70% of the total energy volume, this will be over the next 12 months. As a result, SSE believes the movement in fair value of the contracts is not relevant to the underlying performance in 2011/12.

The movement on derivatives under IAS 39 of £509m shown in the table above and on the face of the Income Statement is primarily due to the change in the commodity contract position between the 'in the money' positions on 31 March 2011 and 31 March 2012, when the average contractual price continued to be lower than the prevailing forward market price, but not as much as previously. SSE sets out these movements in fair value separately, as re-measurements, as the extent of the actual profit or loss arising over the life of the contracts giving rise to this liability will not be determined until they unwind.

Exceptional items

The pre-tax exceptional items totalling £551.6m relate to the Wholesale (£491.6m) and Retail (£60.0m) segments and are mainly non-cash.

In the Wholesale segment, changing market conditions have resulted in impairment and other charges being made against the value of some electricity generation plant, CO₂ emissions allowances, goodwill relating to gas storage assets and gas and oil production prospects. In particular, following a sustained period of low 'spark' spreads, SSE decided to undertake a comprehensive programme of maintenance and upgrade work to support more flexible operations at Keadby and Medway power stations from 2013 onwards. This means the way in which the stations will operate and be remunerated in the future will change. Other issues include a small write down at Ferrybridge power station, due to the early use of allowed running hours under the Industrial Emissions Directive, and a write-down in the value of on- and offshore wind assets in continental Europe

In the Retail segment, restructuring and related costs arising from SSE's decision to stop all of its doorstep sales operations in Great Britain have been recognised as exceptional. The value of some Metering assets has also been impaired in anticipation of the expected introduction of smart meters.

Delivering Adjusted Profit Before Tax* in 2012/13

Adjusted profit before tax* is an important measure of performance in any given year, but it is not an end in itself. SSE does not have the goal of maximising profit in any single year or over any particular period. It takes a longer-term view, believing that profit is a means to an end: sustained real growth in the dividend, the delivery of which is its first financial responsibility to shareholders.

At the same time, SSE has delivered 13 successive increases in adjusted profit before tax* since it first reported full-year results in 1999. As in any other year, SSE's adjusted profit before tax* for 2012/13 as a whole will be determined by issues such as:

- the management of the overall energy portfolio, in the context of geopolitical and macro-economic issues;
- the interaction between wholesale prices for energy and fuel and the prices for the electricity and gas charged to customers;
- the availability of its operating thermal power stations to generate electricity;
- the output of renewable energy from its hydro electric stations and wind farms; and
- the actual and underlying level of customers' energy consumption.

In terms of 2012/13, SSE continues to believe that its balanced range of market-based and economically-regulated energy businesses, and the diversity of opportunities within those businesses, should enable it to deliver a level of adjusted profit before tax* capable of supporting the achievement of its principal financial objective, a full-year dividend increase of at least 2% more than RPI inflation, while maintaining dividend cover in a range around 1.5 times.

SSE will provide an update on its financial, operational and investment progress during 2012/13 when it presents its results for the six months to 30 September 2012. Its expectation at the start of each financial year is that it will not provide an outlook for adjusted profit before tax* before the publication of its fourth quarter Interim Management Statement, not least because its principal financial objective is dividend growth, and that remains the case for 2012/13.

Monitoring Adjusted Earnings Per Share*

To monitor financial performance over the medium term, SSE continues to focus on adjusted earnings per share* because it has the straightforward benefit of defining the amount of profit after tax that has been earned for each Ordinary Share and so reflects a clear view of underlying financial performance.

In 2011/12, SSE's adjusted earnings per share were 112.7p, based on 937.8 million shares, compared with 112.3p, based on 927.6 million shares, in the previous year. As stated in SSE's Annual Report 2011, the charge for the hybrid debt coupon is presented within dividends and reflected within adjusted earnings per share*.

Dividend

Increasing the Dividend for 2011/12

SSE's first financial responsibility to its shareholders is to remunerate their investment through the delivery of sustained, above-inflation increases in the dividend. The Board is recommending a final dividend of 56.1p, compared with 52.6p in the previous year, an increase of 6.7%. This will make a full-year dividend of 80.1p, which is:

- an increase of 6.8% compared with 2010/11;
- a real terms increase of 2%, based on the average annual rate of RPI inflation in the UK between April 2011 and March 2012, which meets the target set for the year;
- the thirteenth successive above-inflation dividend increase since the first full-year dividend paid by SSE, for 1998/99;
- more than three times the first full-year dividend paid by SSE, for 1998/99; and
- covered 1.41 times by SSE's adjusted earnings per share*.

SSE is now one of just five companies to have delivered better-than-inflation dividend growth every year since 1999, while remaining part of the FTSE 100 for at least 50% of that time, and ranks third amongst that group in terms of compound annual growth rate over that time.

Targeting further dividend increases in 2012/13 and beyond

SSE's key financial objective will remain the delivery of increases in the dividend paid to shareholders, and its targets are to deliver:

- a full-year dividend increase of at least 2% more than RPI inflation for 2012/13; and
- annual dividend increases from 2013/14 onwards which are greater than RPI inflation.

Scrip Dividend Scheme option for shareholders

In 2010, SSE's shareholders approved for five years the provision of a Scrip Dividend Scheme, to give them the option to receive new fully paid ordinary shares in the company in place of their cash dividend payments. Scrip dividend take-up was as follows:

- **September 2011:** A total of 30,397 shareholders elected to receive the final dividend of 52.6p per ordinary share in respect of 22.6 million ordinary shares in the form of Scrip dividend. This resulted in the issue of 0.9 million new ordinary shares, fully paid, an increase of 0.1% on the issued share capital at the dividend record date of 29 July 2011.
- **March 2012:** A total of 30,504 shareholders elected to receive the interim dividend of 24.0p per ordinary share in respect of 318 million ordinary shares in the form of Scrip

dividend. This resulted in the issue of 6.27 million new ordinary shares, fully, paid, an increase of 0.67% on the issued share capital at the dividend record date of 27 January 2012.

This had the effect of reducing by £88.2m the amount of dividends paid in cash during 2011/12. The total number of shares in issue at 31 March 2012 was 944.7 million.

Investment and Capital Expenditure

Investment and Capex Summary	Mar 12 £m	Mar 11 £m
Electricity Transmission	228.7	117.4
Electricity Distribution	260.3	211.9
Other Networks	48.0	55.0
Total Networks	537.0	384.3
Total Retail	78.5	27.9
Thermal Generation	129.7	129.8
Renewable Generation	852.3	813.8
Gas Storage and Gas Production	57.1	52.6
Total Wholesale	1,039.1	996.2
Other	52.3	35.3
Total investment and capital expenditure	1,706.9	1,443.7
50% of SGN capital/replacement expenditure	202.2	199.7

Investing for sustained dividend growth

In November 2010, SSE said that it expected its investment and capital expenditure would be in the range of £1.5bn to £1.7bn in each of the five years to March 2015. In 2011/12, its capital and investment expenditure totalled £1,706.9m, compared with £1,443.7m in the previous year. During the year there was investment of:

- £228.7m in **electricity transmission**, of which £126.3m was spent on the work to replace SSE's section of the Beaulieu-Denny line;
- £260.3m in **electricity distribution**, the majority of which was spent on system upgrades;
- £129.7m in **thermal generation**, the majority of which was for maintenance and early development of future projects;
- £852.3m in **renewable generation**, the larger part of which was invested in the Clyde, Griffin and Gordonbush onshore wind farms; and
- £57.1m in **gas storage and gas production**, including investment in the new facility at Aldbrough, which is nearing completion.

Including investment of £134.2m in 2011/12, SSE's cumulative investment in the Greater Gabbard offshore wind farm is now £672.2m, excluding costs associated with the construction of the offshore transmission line.

Delivering an expanded asset base

In the five years to March 2012, SSE's investment and capital expenditure totalled just over £6.5bn. This has resulted in a significantly expanded asset base for SSE, including:

- completion of the 840MW Marchwood Power Station (SSE share – 50%);
- an increase of around 1,500MW in its capacity for generating electricity from wind farms (which produced around 3.2TWh of electricity in 2011/12);
- near-completion of the Aldbrough gas storage facility (SSE share – two thirds); and
- an increase of over £1bn in the RAV of its electricity networks.

The 100MW Glendoe hydro electric scheme was also commissioned during this period, in early 2009. It operated for less than a year before a tunnel blockage resulted in electricity

generation being stopped. The progress of repair work means electricity generation is expected to resume this summer.

SSE remains committed to constructing robust assets, from which revenue can be generated on a reliable, long-term basis and which deliver profit to support future dividend growth. This entails rigorous scrutiny and control of the costs of large capital projects and a clear focus on the return which completed projects should generate.

In line with this, SSE keeps the economic evaluation of its investment programme under close scrutiny to ensure that it continues to make the right investment decisions. It continues to be confident that an enhanced asset base and significant value are being created from its capital and investment expenditure programme as a whole, based on actual delivery of the projects within it and on the most up-to-date costs and schedules for projects.

Investing in gas distribution through Scotia Gas Networks (SGN)

In addition to its own capital and investment expenditure programme, SSE effectively has a 50% interest in SGN's capital and replacement expenditure, through its 50% equity share in that business. SGN is self-financing and all debt relating to it is separate from SSE's balance sheet. Nevertheless, it is a very substantial business which gives SSE, through its 50% stake, a major interest in gas distribution. In 2011/12, a 50% share of SGN's capital and replacement expenditure was £202.2m, compared with £199.7m in the previous year.

Delivering investment efficiently

Central to SSE's strategy is 'efficient' investment in a balanced range of economically-regulated and market-based energy businesses. This means that investments should be:

- consistent with SSE's financial principles and so should achieve returns which are greater than the cost of capital (with an appropriate risk premium applied to the expected rate of return from individual projects where appropriate), enhance earnings and contribute to dividend growth; and
- governed, developed, approved and executed in an effective manner, consistent with SSE's Large Capital Project Governance Framework which is, in itself, regularly updated.

The premium is applied to reflect any risk associated with asset construction, market dynamics, new technologies or regulatory or legislative change.

There are four main categories in SSE's investment and capital expenditure plans to March 2015:

- economically-regulated expenditure on electricity transmission upgrades;
- economically-regulated electricity distribution expenditure plus essential maintenance of other assets;
- expenditure that is already committed to development of new assets such as wind farms; and
- expenditure that is not yet committed but which could be incurred to support the development of new assets.

Decisions on whether to proceed with individual projects are made:

- in line with SSE's financial principles;
- in the context of SSE's commitment to maintaining a diverse range of assets within its economically-regulated and market-based businesses;
- in the light of developments in public policy and regulation; and
- on the basis of the experience and skills available to SSE.

SSE believes that its pipeline of development opportunities means that it will be able to focus uncommitted spend on projects with the strongest potential to achieve returns well in excess of its cost of capital, enhance earnings and contribute to dividend growth.

In particular, a disciplined programme with the principles, shape and scale described above is designed to allow SSE to maintain the development of a balanced and diverse range of assets to support sustained, above-inflation dividend growth while remaining consistent with the criteria for a single A credit rating without the need to issue new shares. It will deliver:

- further significant enhancements to the asset base in key businesses, including economically-regulated electricity networks;
- a continuing increase in fuel for electricity in the form of renewable sources of energy, supporting a reduction in the CO₂ intensity of electricity generated; and
- additional cashflows and profits to support continuing dividend growth.

During the same period SGN, in which SSE has a 50% stake, will also be making a significant investment in economically-regulated gas distribution networks.

Financial management and balance sheet

Key Performance Indicators	Mar 12	Mar 11	Mar 10
Adjusted net debt and hybrid capital (£bn)	6.76	5.89	5.29
Average debt maturity (years)	9.3	10.6	11.0
Adjusted interest cover ¹ (excluding SGN)	5.9	7.3	6.3
Shares in issue at 31 March (m)	944.7	936.9	923.1
Shares in issue (weighted average) (m)	937.8	927.6	921.9

¹including hybrid coupon

Maintaining a prudent treasury policy

SSE's operations and investments are generally 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 2012, after taking account of interest rate swaps, 77.4% of SSE's borrowings were at fixed rates.

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

The United Kingdom remains SSE's main area of operation, although business activities in the Republic of Ireland are also substantial. 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.

SSE's policy is to hedge all material transactional foreign exchange exposures through the use of forward currency purchases and/or derivative instruments. 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.

Managing net debt and maintaining cash flow

SSE's adjusted net debt and hybrid capital was £6.76bn at 31 March 2012, compared with £5.89bn at 31 March 2011. Fundamentally, this increase reflects:

- the quantum and phasing of capital and investment projects to support sustained real dividend growth; and
- the decision to delay the increase in household energy prices until September 2011, which meant some additional revenue would not be collected until the new financial year.

In addition, significant coal stocks have been acquired in anticipation of the fuel requirements at SSE's coal-fired power stations during 2012/13.

As the table below sets out, adjusted net debt excludes finance leases and includes outstanding liquid funds that relate to wholesale energy transactions. Hybrid capital is accounted for as equity within the Financial Statements but has been included within SSE's 'Adjusted net debt and hybrid capital' to aid comparability.

Adjusted Net Debt and Hybrid Capital	Mar 12	Mar 11
	£m	£m
Adjusted Net Debt and hybrid capital	(6,755.8)	(5,890.6)
Less: hybrid capital	1,161.4	1,161.4
Adjusted Net Debt	(5,594.4)	(4,729.2)
Add: Outstanding Liquid Funds	(119.9)	(28.1)
Add: Finance Leases	(342.1)	(372.2)
Unadjusted Net Debt	(6,056.4)	(5,129.5)

A strong debt structure through medium- and long-term borrowings

SSE's objective is to maintain a balance between continuity of funding and flexibility, with debt maturities set across a broad range of dates. Its average debt maturity as at 31 March 2012 was 9.3 years, compared with 10.6 years at 31 March 2011. The completion of the private placement (see 'Ensuring SSE is well-financed' below) means that SSE's average debt maturity was 9.6 years at 30 April 2012.

SSE's debt structure remains strong, with around £5.1bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans. The table above also includes the issue by SSE, in September 2010, of hybrid capital of £1.16bn. The balance of SSE's adjusted net debt is financed with short-term commercial paper and bank debt. SSE's adjusted net debt includes cash and cash equivalents totalling £189.2m.

Around £100m of medium-to-long-term borrowings will mature during 2012/13.

Ensuring SSE is well-financed

SSE believes that maintaining a strong balance sheet, evidenced by a commitment to the criteria for a single A credit rating, is a key financial principle. Its corporate credit ratings are currently:

- 'A-', with a 'stable' outlook (Standard & Poors); and
- 'A3' with a 'stable' outlook (Moody's).

SSE is committed to maintaining financial diversity and will move quickly to take the right financing options, including issuing new bonds and loans. In line with that it:

- successfully re-opened the European corporate bond market in September 2011 with the issuance of a £300m bond with a 4.25% coupon and a 10-year maturity. As Lloyds Bank Corporate Markets stated, the strength of the order book was testament to SSE's attractions to investors;

- secured in October 2011 a JPY15bn (equivalent to around £125m) seven-year loan with an effective interest rate of 3.52%; and
- undertook in February 2012 a private placement of senior notes with 22 US-based investors for a total consideration of US\$700m (equivalent to around £450m). The senior notes consist of four tranches with a weighted average maturity of 10.3 years and an all-in funding cost of around 4.25% once swapped to Sterling.

Following the issue of hybrid capital in 2010/11, the private placement was a further example of SSE diversifying its funding sources and putting in place funding at attractive rates. The placement was formally completed in April 2012. The net proceeds will be used to refinance short term debt and to support SSE's programme of large capital projects.

With regard to shorter-term funding, SSE's core revolving credit facilities of £900m are, and are expected to remain, undrawn. The facilities are the subject of an agreement with banks which runs to 2015. In addition to these facilities, SSE has a committed bilateral facility of £100m with one other bank.

SSE believes that it has sufficient financial flexibility to pursue the best opportunities to provide the means with which to increase dividends. At the same time, it also believes that history – including shocks and uncertainties seen in the financial markets in recent years – demonstrates how companies with a commitment to the long term must be disciplined when managing their balance sheets and cautious in financing their activities.

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 2011/12 were £322.1m, compared with £342.8m in the previous year.

	Mar 12	Mar 11
	£m	£m
Adjusted net finance costs	322.1	342.8
add/(less):		
Movement on derivatives	89.5	44.4
Exceptional charges	-	8.8
Share of JCE ¹ /Associate interest	(146.5)	(139.9)
Reported net finance costs	<u>265.1</u>	<u>256.1</u>
Adjusted net finance costs	322.1	342.8
Return on pension scheme assets	147.4	141.9
Interest on pension scheme liabilities	(149.8)	(150.2)
Finance lease interest	(38.4)	(39.7)
Notional interest arising on discounted provisions	(7.8)	(4.3)
Hybrid coupon payment	65.5	-
Adjusted interest costs for interest cover calculation	<u>339.0</u>	<u>290.5</u>

¹Jointly Controlled Entities

The charge for hybrid debt is presented within dividends and reflected within adjusted earnings per share*.

The average interest rate for SSE, excluding JCE/Associate interest, during 2011/12 was 5.06%, compared with 5.43% for the previous year. Based on adjusted interest costs, SSE's adjusted interest cover (including the hybrid coupon) was (previous year's comparison in brackets):

- 5.9 times, excluding interest related to SGN (7.3 times); and
- 4.9 times, including interest related to SGN (5.7 times).

Excluding shareholder loans, SGN's net debt at 31 March 2012 was £3.27bn, and within the adjusted net finance costs of £322.1m, the element relating to SGN's net finance costs was

£96.5m (compared with £90.4m in the previous year), after netting loan stock interest payable to SSE. Its contribution to SSE's adjusted profit before tax* was £138.3m, compared with £96.4m in 2010/11.

Contributing to employees' pension schemes

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension scheme liabilities of £731.9m are recognised in the balance sheet at 31 March 2012, before deferred tax. This compares to a liability of £668.6m at 31 March 2011.

During the year to March 2012, employer cash contributions amounted to:

- £47.9m for the Scottish Hydro Electric scheme, including deficit repair contributions of £29.5m; and
- £90.1m for the Southern Electric scheme, including deficit repair contributions of £67.2m.

As part of the electricity Distribution Price Control for 2010-15, it was agreed that allowances equivalent to economically-regulated businesses' share of deficit repair contributions in respect of the Southern Electric and Scottish Hydro Electric schemes would be included in price controlled revenue, with an incentive around ongoing pension costs.

Tax

Being a responsible tax payer

Central to SSE's approach to tax is that it should be regarded as a responsible tax payer. As a consequence, SSE maintains a good relationship with HM Revenue & Customs, based on trust and cooperation.

SSE strives to manage efficiently its total tax liability, and this is achieved through operating within the framework of legislative reliefs. SSE does not take an aggressive stance in its interpretation of tax legislation, or use so-called 'tax havens' as a means of reducing its tax liability. SSE's tax policy is to operate within both the letter and spirit of the law at all times.

SSE's tax paid to the Government in the UK, including Corporation Tax, Employers' National Insurance Contributions and Business Rates, totalled £396.4m during the year to 31 March 2012, compared with £343.8m in the previous year. SSE also pays taxes in the Republic of Ireland, in relation to its operations there, and indirectly contributed £59.5m to UK government tax revenues through its significant investment in joint ventures and associates (as compared with £69.9m in the previous year).

As a member of the Hundred Group of Finance Directors, SSE contributes to its annual Total Tax Contribution survey. SSE ranked 23rd in the 2011 survey, both in terms of tax paid and total tax contribution.

Setting out SSE's tax position

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

	Mar 12 £m	Mar 11 £m
Adjusted current tax charge	213.4	268.2
Add/less		
Share of JCE/Associate tax	(6.6)	3.3
Deferred tax	118.0	83.3
Tax on exceptional items/certain remeasurements	(319.6)	252.4
Reported tax charge	<u>5.2</u>	<u>607.2</u>

The effective adjusted current tax rate, based on adjusted profit before tax*, was 16%, compared with 20.5% in 2010/11, on the same basis. The impact of SSE's higher capital

expenditure programme and the changes introduced in Budget 2007 and subsequently have had, and will continue to have, a positive impact on the effective current tax rate.

The Budgets in June 2010, March 2011 and March 2012 have announced a series of annual reductions in the UK Corporation Tax rate for future years. The deferred tax balance has been remeasured to reflect the latest of these enacted rate reductions (from 26% to 24%) and the effect of this has been disclosed as an exceptional item. The deferred tax balances for future years will continue to be remeasured as each subsequent rate reduction is enacted.

The reported tax charge for 2011/12 is £5.2m, compared with a tax charge of £607.2m in the previous year. This reflects a large exceptional credit in 2011/12 compared to a large exceptional charge in 2010/11.

Further information

Disclaimer

This financial report 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.

Investor Timetable

Remuneration Report 2012 on sse.com/investors	16 May 2012
Annual Report 2012 on sse.com/investors	18 June 2012
Ex-dividend date	25 July 2012
AGM (Bournemouth) and IMS	26 July 2012
Record date	27 July 2012
Final date for Scrip elections	24 August 2012
Payment date	21 September 2012
Interim results (provisional)	14 November 2012

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Analysts' presentation

Start: 0900 (BST)

Location: The Lincoln Centre, 18 Lincoln's Inn Fields, London WC2A 3ED

Webcast facility

You can join the webcast by visiting www.sse.com and following the link on the homepage.

Conference call

UK 020 3450 9987

US +1 646 254 3367

When asked please provide conference number **7060470**.

Online information

News releases and announcements are made available on SSE's website at www.sse.com.

You can also follow the latest news from SSE through Twitter at www.twitter.com/sse.

NETWORKS

Networks Key Performance Indicators	Mar 12	Mar 11
ELECTRICITY TRANSMISSION		
Operating profit* - £m	73.7	47.7
Regulated Asset Value (RAV) - £m	770	560
Capital expenditure - £m	228.7	117.4
ELECTRICITY DISTRIBUTION		
Operating profit* - £m	396.5	418.9
Regulated Asset Value (RAV) - £m	2,840	2,687
Capital expenditure - £m	260.3	211.9
Customer minutes lost (North)	73	78
Customer minutes lost (South)	60	64
Performance-based revenue - £m	11.4	8.5
SCOTIA GAS NETWORKS		
Operating profit* (SSE's share) - £m	234.8	186.8
Regulated Asset Value (SSE's share) - £m	2,270	2,150
Capital and replacement expenditure (SSE's share)- £m	202.2	199.7
Uncontrolled gas escapes attended within one hour %	98.7	97.2
SGN gas mains replaced - km	1,202	1,102
OTHER NETWORKS		
Operating profit* - £m	32.1	37.1
Capital expenditure - £m	48.0	55.0
Lighting Services maintenance contracts (GB and Ire)	52	52
Lighting Services PFI contracts	11	10
Utility Solutions electricity networks in operation	118	74
Utility Solutions new gas connections	13,850	11,120
Telecoms network – km	11,200	11,200

Owning, operating and investing in Networks

In previous years, SSE reported the performance of its electricity networks on a geographical basis (i.e. the north of Scotland and central southern England). In terms of regulation, process, customers and service, it is now more relevant to report performance of electricity networks by activity (i.e. transmission and distribution) rather than geography and so from 2011/12 onwards SSE is adopting this approach.

The performance of the economically-regulated SGN will continue to be reported within Networks. In addition, market-based activities of Lighting Services, Utility Solutions and Telecoms are also network-based and have, therefore, been included within SSE's Networks segment as Other Networks.

Economically-regulated network companies with a growing Regulatory Asset Value

SSE has an ownership interest in five economically-regulated energy network companies:

- Scottish Hydro Electric Transmission (100%);
- Scottish Hydro Electric Power Distribution (100%);
- Southern Electric Power Distribution (100%);
- Scotland Gas Networks (50%); and
- Southern Gas Networks (50%).

SSE's electricity networks transmit and distribute electricity to around 3.7 million businesses, offices and homes via around 130,000km of overhead lines and underground cables and SGN's gas networks distribute gas to around 5.7 million homes, offices and businesses via 75,000km of gas mains.

SSE estimates that the total Regulatory Asset Value (RAV) of its economically-regulated 'natural monopoly' businesses is now £5.88bn, up from £4.2bn five years ago, comprising:

- £770m for electricity transmission;
- £2.84bn for electricity distribution; and
- £2.27bn for gas distribution (i.e. 50% of the business' total RAV of £4.54bn).

SSE is the only energy company in the UK to be involved in electricity transmission, electricity distribution and gas distribution. Through Price Controls, Ofgem sets the index-linked revenue the network companies can earn through charges levied on their users to cover their costs and earn a return on their regulated assets. These lower-risk economically-regulated natural monopoly businesses provide a financial backbone and operational focus for SSE and balance its activities in the competitive Wholesale and Retail markets. They are core to SSE, to its strategy in the short, medium and long term and to its ability to deliver sustained real dividend growth.

Developing market-based networks businesses

In addition to its economically-regulated network companies, SSE owns and operates three other networks businesses, which are market-based:

- Lighting Services, maintaining and replacing street and highway lighting;
- Utility Solutions, designing, building, owning and operating networks for electricity, gas, water and heat; and
- Telecoms, providing network capacity, bandwidth and data centre services.

As with economically-regulated networks, they have made significant progress in the past five years, in terms of assets, contracts and operating profit.

Financial performance in Networks

Operating profit* in Networks increased by 6.7%, from £690.5m to £737.1m, contributing 44.5% of SSE's total operating profit*. This comprised (comparisons with the previous year):

- £73.7m in electricity transmission, compared with £47.7m;
- £396.5m in electricity distribution, compared with £418.9m;
- £234.8m representing SSE's share of the operating profit* for SGN, compared with £186.8m; and
- £32.1m in other network businesses, compared with £37.1m.

Electricity Transmission

Performance in Scottish Hydro Electric Transmission Ltd (SHETL)

In SHETL, operating profit* increased by 54.5% from £47.7m to £73.7m. This reflected the increase in its asset base following on from the ongoing increase in capital invested. During 2011/12, a total of £228.7m was invested by SHETL in its networks, up from £117.4m in the previous year, taking its total Regulated Asset Value from £560m to £770m.

Upgrading Scotland's electricity transmission network

SHETL is responsible for maintaining and investing in the transmission network in its area, which comprises almost 5,300km of high voltage overhead lines and underground cables and which serves around 70% of the land mass of Scotland. As the licensed transmission company for the area, SHETL has to ensure there is sufficient network capacity for those within it seeking to generate electricity from renewable and other sources.

A series of major developments is under way which is transforming the scale and scope of SHETL:

- **Knocknagael Substation:** Ofgem authorised £43.8m of investment in this project (at 2009/10 prices) and all major construction works relating to the substation and related overhead lines and underground cables have been completed. The

successful completion of the project has increased by 125MW the amount of electricity that can be exported from the north of Scotland.

- **Beauly-Blackhillock-Kintore:** Work on replacing the conductors of the 275kV transmission lines between Beauly and Blackhillock and Blackhillock and Kintore, to allow an increase in the capacity of the network to transmit electricity, is well under way and is expected to be finished in 2015. Ofgem has authorised investment of £81m (at 2009/10 prices) for this development.
- **Dounreay-Beauly:** Work on upgrading and reinforcing the transmission network between Dounreay and Beauly is continuing, including the installation of a second set of conductors to create a double circuit line and development of new and upgraded substations. Ofgem has authorised investment of £73.5m (at 2009/10 prices) for this programme, which should be completed in 2013.
- **Beauly-Denny:** Following consultation, Ofgem approved, in September 2011, an asset value adjusting event submitted by SHETL to recover additional forecast construction costs arising from the replacement of its part of the line, from Beauly to Wharry Burn, taking the total to £539m (at 2009/10 prices). Full construction work on the replacement line is now under way, including the erection of the first of the new pylons. The replacement line should be completed in 2014.

A total of £173m was invested in these four projects during 2011/12 and their completion is expected to take SHETL's RAV from £770m as at 31 March 2012 to over £1bn by March 2013 and around £1.6bn in March 2015. In 2012/13 SHETL expects to incur capital expenditure of over £350m.

In addition, in January 2012, SHETL submitted to Scottish Ministers an application to construct a replacement 132kV transmission line between Beauly and Mossford to accommodate a higher capacity. Work on a new substation is getting under way. Based on current estimates, the two parts of the project are likely to require total investment of around £45m.

Achieving a 'fast track' to Price Control agreement

In January 2012 Ofgem announced that it was recommending that SHETL be 'fast tracked' under the RIIO T1 (Revenue = Incentives + Innovation + Outputs) process for the eight-year transmission Price Control period from April 2013. This was on the basis of the business plan submitted by SHETL, *Keeping the lights on and supporting growth*, which set three key objectives for the next decade:

- keep the lights on for customers;
- invest for a greener future; and
- minimise as far as possible the impact on the environment.

Ofgem said the business plan provided good evidence of how significant benefits will be delivered to consumers through 'greater efficiency, enhanced consumer engagement and investment'.

Ofgem adopted the new RIIO framework during 2011, and it is designed to incentivise companies to deliver investment while providing value for money for customers. RIIO T1 is the first Price Control to be conducted under the new process. As Ofgem stated, fast-tracked companies, such as SHETL, can 'benefit from the swiftness of the process and concentrate on delivering efficient network improvements for consumers'.

Following consultation, Ofgem published Final Proposals for RIIO T1 in April 2012 featuring:

- an allowed cost of equity of 7.0%;
- a new index for determining companies' debt costs;
- depreciation based on 20 years for existing assets; and
- depreciation for new assets (except Beauly-Denny) moving to 45 years over the course of two Price Control periods.

SHETL is now developing a full implementation plan for the new Price Control period, which will be shared with stakeholders later this year, much earlier in the process than would have been possible had it not been 'fast tracked'. This should be of benefit to SHETL and its stakeholders.

Keeping the lights on and supporting growth in the long term

The central case of SHETL's business plan is a £1.1bn capital investment programme, with flexibility to increase this by up to a further £4bn if required, to upgrade the transmission network during 2013-21. Projects currently being developed and which could be constructed during the period include:

- **Western Isles:** In October 2010, SHETL concluded that the lack of financial underwriting from electricity generators (attributed to the level of transmission charges) relating to the proposed link from the Western Isles to the mainland meant it would not be able to conclude a contract for the supply of the necessary electricity cable. As a result, it withdrew its request to Ofgem for authorisation to make the investment. Developers of wind farms on the Western Isles are now conveying greater confidence about the deliverability of their projects, which means that the case for the Western Isles link has been renewed and submitted to Ofgem. Detailed work is being undertaken to ensure that the final scheme design for the link meets the needs of the developers and, over the coming months, work will resume on placing the relevant contracts and undertaking environmental and other studies.
- **Caithness to Moray:** SHETL is now planning to develop a subsea electricity cable between Caithness, where consent has been secured for a new substation at Spittal, and Moray, where it is proposed to upgrade the existing substation at Blackhillock, to transmit the large volume of existing and planned electricity from renewable sources in the north of Scotland. The cable will be capable of transmitting around 1,200MW of electricity. This proposal to develop a subsea cable retains the flexibility to accommodate generation developments in the north of Scotland as and when the need to do so arises. An investment case will be submitted to Ofgem shortly.
- **Shetland:** SHETL has now secured consent for converter stations associated with the proposed subsea/onshore underground high voltage direct current (HVDC) transmission link between the Shetland Islands and the Scottish mainland to accommodate renewable energy developments in Shetland. The link would also connect properties in Shetland to the mainland electricity network for the first time and could be installed in the second half of this decade.

Based on current estimates (although these will inevitably be revised) these developments could require investment of around £1.4bn and would form part of the £4bn investment programme that is additional to the £1.1bn central case of SHETL's business plan.

In May 2012, Ofgem set out plans to change the charging arrangements for electricity transmission networks, with greater account being taken of the type of electricity generator seeking to use the networks. This will require the Investment Cost Related Pricing (ICRP) methodology to be improved. Once this is completed, Ofgem will consider the final form of the ICRP and make a final decision on its modification. The impact of the planned changes will have a bearing on the amount of electricity from renewable sources that is developed in Scotland and, therefore, on the way in which the transmission network is upgraded.

Electricity Transmission Priorities for 2012/13 and Beyond

SHETL is SSE's fastest-growing and fastest-changing business, where the core activity for much of the next decade will be construction. Against this background, its priorities for 2012/13 and beyond are to:

- complete successfully the remaining stages of the RIIO T1 price control process;
- meet key milestones in projects under construction, in a way that is consistent with all safety and environmental requirements;
- make progress with projects in development; and
- ensure it has the people, skills, resources, supply chain and stakeholder relationships that will be necessary to support growth on a significant scale.

Electricity Distribution

Performance in Southern Electric Power Distribution and Scottish Hydro Electric Power Distribution

The performance of SSE's two electricity distribution companies during 2011/12 was as follows (comparisons with previous years):

- operating profit* decreased by 5.3% to £396.5m;
- electricity distributed fell by 1.4TWh to 40.7TWh;
- the average number of minutes of lost supply per customer was 73 in the north (78) and 60 in the south (64);
- the number of supply interruptions per 100 customers was 71 in the north (74) and 70 in the south (64); and
- performance-based additional incentive income and allowances (excluding losses) of £11.4m is expected to be earned, compared with the final out-turn of £8.5m in the previous year.

The decrease in operating profit principally reflects the timing of recovery of allowed income.

Performance in respect of both minutes lost and interruptions was ahead of the targets set by Ofgem under its Interruptions Incentive Scheme (IIS), which gives financial benefits to distribution network operators that deliver good performance for customers. The number of minutes lost in the South was the lowest ever. Performance-based income covers a number of issues, including the quality of service provided to customers and innovation.

Volume of electricity distributed

The total volume of electricity distributed by the two distribution companies during 2011/12 was 40.7TWh, compared with 42.1TWh in the previous year. Under the electricity Distribution Price Control for 2010-15, the volume of electricity distributed no longer affects companies' overall allowed revenue (although it does have an impact on the timing of revenue). This has further reduced the level of risk associated with energy networks businesses.

Earning revenue by delivering a good quality of service

As a result of their operational performance during 2011/12 SSE's two electricity distribution companies expect to earn additional incentive income and allowances of £11.4m (2010/11: £8.5m) including additional incentive income of £4.5m (2010/11: £3.4m). This reflects effective investment in the automation of the networks and effective operational responses to electricity supply interruptions.

Responding to the effects of severe weather

In the winter of 2011/12, SSE's electricity networks were subjected to the effects of severe weather on an unusually large number of occasions, including the 3 January storm affecting the north of Scotland. This weather event alone, featuring exceptional low altitude wind speeds of over 90 miles per hour, resulted in 600 separate faults and over 1,000 points of damage on the network and the loss of power to around 40,000 households. The equivalent of three months of fault repair work was carried out in four days (with very high winds also occurring on 4 January) and was marked by the commitment of SSE employees and the patience on the part of affected communities. The efforts of SSE and other service providers were praised by the Scottish Government. The 3 January storm and a number of other weather events were treated as exceptional by Ofgem, meaning that they are excluded from the calculation of performance measures such as customer minutes lost.

Operating electricity networks efficiently

Efficiency is one of SSE's core values and amongst Ofgem's explicit purposes in setting Price Controls is to keep as low as possible the costs of providing secure and reliable networks. SSE has a straightforward operating model, under which the vast majority of activities are in-house. Under this model:

- customer-facing activities, such as restoring power supplies or providing new connections, are managed from a network of 14 depots in communities throughout central, southern England and the north of Scotland; and
- network management activities, such as inspections, maintenance and investment, are carried out in Operational Production Groups.

This model gives SSE a strong oversight of operations and investment, allows flexibility in responding to changed circumstances and supports a culture of efficiency, teamwork and excellence, including innovation.

Investing in electricity networks and securing growth in their RAV

2011/12 was the second year of the electricity Distribution Price Control for 2010-15. The Price Control changed the framework for operating and capital expenditure to remove the perceived bias in favour of the latter and to ensure the delivery of not only the investment itself but of agreed outputs from it. The most successful electricity distribution companies, therefore, will be those that apply efficiency and innovation to maximise outputs from agreed expenditure.

In response to this, SSE has identified a number of solutions and interventions for wider deployment in 2010-15 to ensure its success throughout the Price Control period. This means SSE has robust and cost efficient network investment processes that deliver real value for customers. It has also identified a number of important innovations and new technologies that are delivering cost savings and minimising disruption.

For example, in rural areas, use of the Ordnance Survey's Imagery database of aerial photography has provided a simple and effective way of surveying thousands of kilometres of overhead lines for potential risk of tree damage. In urban areas, SSE has used directional drill technology, which creates minimum disturbance to the highway and thereby reduces disruption to the public and the cost of reinstatement, to install – for example - new 66kW circuits in west London.

The deployment of innovations and technologies such as these, plus good performance in response to Ofgem's enhanced incentive mechanisms in areas such as customer service should enable SSE to continue to achieve the post-tax real return in excess of 5% which it is targeting in electricity distribution.

Against this background, capital expenditure in electricity distribution networks was £260.3m in 2011/12. The need for further significant investment in Great Britain's electricity distribution networks, to maintain and/or replace ageing assets or to provide additional capacity, is likely to mean SSE will invest around £275m in 2012/13, taking the total for the first three years of the 2010-15 Price Control to around £750m. As a result, the RAV of SSE's two electricity distribution networks should increase to over £2.9bn over the course of the year.

Significant developments include a £30m project to install new 132kV plant at Bracknell and Camberley substations and new 132kV under ground cables between the substations. The project will help to meet demand for electricity in a key area between the M3 and M4 motorways. The cabling works should be finished in the autumn of this year and the final substation work should be completed in 2013.

In Scotland, plans have been made to invest in the resilience of the electricity network in Argyll and Bute, which was particularly affected by the storms of 2011/12, including provision of underground cables in Dunoon and of large-scale mobile generation connection points for Bute.

Making electricity networks smart

Although there is no standard definition, the European Technology Platform for the Electricity Networks of the Future defines smart grids as 'electricity networks that can intelligently integrate the behaviour and actions of all users connected to it - generators, consumers and those that do both – in order to efficiently deliver sustainable, economic and secure electricity supplies'.

The next decade promises major technological change for electricity distribution networks as a result of things like micro generation, the growth of electricity as a source of heating and electric vehicles. All of this will change the traditional flows of electricity, which means smarter, more dynamic networks will be required.

SSE, with Smarter Grid Solutions Ltd, an associate company, 'switched on' the UK's first commercial smart grid technology on its power distribution network on Orkney in 2009. This has since allowed 20MW of additional capacity for generating electricity to be connected to the network, at a small fraction of the cost that would have been required had traditional means been adopted.

Two other major 'smart' projects, with total funding of £64m, are being led by SSE's electricity distribution businesses:

- **Northern Isles New Energy Solutions (NINES) in Shetland:** NINES is a pilot project representing the first stage of the Integrated Plan for managing electricity supply and demand on Shetland, which Scottish Hydro Electric Power Distribution is required by Ofgem to present in 2013. It features the use of heat and electricity storage to manage intelligently the impact of movements in demand on electricity generation in Shetland, which could allow more renewable energy to be connected to the network. It also features new active network management solutions. In September 2011, Ofgem announced that the NINES should be funded as part of the Integrated Plan, with 85% of its expenditure included in SHEPD's RAV and the remaining 15% included in SHEPD's allowed revenue. This confirmed that NINES is not just a 'smart' programme but a comprehensive and sustainable solution to the energy challenges on Shetland which is designed to meet the needs and aspirations of the community.
- **New Thames Valley Vision (NTVV) in and around Bracknell:** NTVV aims to demonstrate that applying new technologies to Bracknell's network will provide a lower cost alternative to redeveloping the substation to meet increasing electricity demand, with the potential to reduce significantly costs to customers. NTVV involves monitoring and predicting electricity demand and usage patterns and using a range of innovative technologies, including network automation, energy storage and automated demand response, to manage the network flows predicted by the modelling. In November 2011, Ofgem announced that NTVV should secure funding totalling £30m under its Low Carbon Networks Fund and, as a result, NTVV will lead to the creation of one of the UK's first 'intelligent' distribution networks.

Supporting deployment of electric vehicles

Electric vehicles (EVs) will be an essential part of the move towards a low-carbon transport infrastructure. Current predictions suggest that EVs could account for as many as 10% of new car sales by 2020. The challenge for electricity distribution companies is to prepare their networks for the likely upswing in demand arising from EVs and SSE was a full participant in two EV projects, both supported by the Technology Strategy Board - the MINI E and the Ford Transit Connect consortia.

These have helped to demonstrate that up to one in four homes will be able to have an EV without it having a significant impact on the electricity network. Nevertheless, other issues – such as the need to schedule re-charging effectively and to develop new control systems – require significant attention and SSE is carrying out further work to understand the requirements of so-called "smart charging" to maximise use of the existing infrastructure.

In March 2012, SSE opened in Glasgow the UK's first dedicated free EV charging, hiring and parking facility. The facility features six charging car park spaces and electric car hire from Europcar and Peugeot as well as an electric car available for test drives.

Electricity Distribution priorities in 2012/13 and beyond

During 2012/13 and beyond SSE's priorities in Electricity Distribution are to:

- comply fully with all safety standards and environmental requirements;

- ensure that the networks are managed as efficiently as possible, delivering required outputs while maintaining tight controls over operational expenditure;
- put responsiveness at the heart of day-to-day operations, so that the number and duration of power cuts experienced by customers is kept to a minimum;
- ensure there is adequate capacity to meet changing demands on the electricity system;
- deliver excellent service to customers, which responds effectively to their needs during supply interruptions and in 'business-as-usual' situations; and
- make progress on the deployment of innovative investment in smart grids.

With such significant changes required over the next few years, not least in adapting the networks to accommodate changes in production and consumption, the scope for additional incremental growth in electricity distribution networks is clear.

Gas Distribution

Performance in SGN

SSE receives 50% of the distributable earnings from Scotia Gas Networks (SGN), in line with its equity holding, and also provides it with corporate and management services. In SGN in 2011/12 (comparisons with the previous year):

- SSE's share of operating profit* was £234.8m, compared with £186.8m;
- gas transported fell by 22.8TWh to 143.4TWh; and
- 98.7% of uncontrolled gas escapes were attended within one hour of notification, compared with 97.2% in 2010/11 and the standard of 97%.

The increase in operating profit* for SGN is primarily due to three things:

- the impact of the price changes agreed as part of the five-year gas Distribution Price Control to March 2013;
- underlying operational efficiencies achieved during the year; and
- income from 2010/11 not recovered during that financial year but subsequently received.

Only 3.5% of SGN's transportation income is volume-related; the remaining 96.5% is related to the maximum capacity requirements of its customers. A small part of SGN's operating profit is derived from the non-regulated activities of its contracting, connections and commercial services operations.

Operating gas networks efficiently

When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of £30m per annum. In following years, services were brought within SGN, and SGN's remaining service contracts with National Grid totalled £7m per annum by the end of 2010/11.

These Managed Services Agreement contracts covered transmission services, control and IT services and emergency call handling, and the process of bringing them within SGN is continuing. In June 2011, SGN stopped using National Grid's Gas Transportation Management System and replaced it with its new Distribution Network Control System and in September 2011 it replaced a National Grid system with a new application called Demand Management System. This means that SGN's remaining contracts with National Grid now total £4.5m per annum.

Investing in gas networks and securing growth in their RAV

The five-year gas Distribution Price Control, which began in April 2008, provides the opportunity for SGN to increase significantly investment in its gas distribution networks, thereby reinforcing their safety and reliability and securing another significant increase in their RAV. By the end of 2012/13, SGN estimates that its total RAV will be around £4.8bn.

During 2011/12, SGN invested £404.3m in capital expenditure and mains and services replacement projects, compared with £399.3m in the previous year, including:

- The £21m replacement of the under-sea gas main between the south coast of England and the Isle of Wight was completed during the year. The project involved connecting Lepe and Gurnard through the longest directional drill ever undertaken (2.9km). Tunnels were bored from each direction, meeting around 40 metres below the seabed, to take the two 12 inch diameter pipes.
- The majority of the mains replacement expenditure was incurred 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. During 2011/12, SGN replaced 1,202km of its metallic gas mains with modern polyethylene pipes.
- SGN is also committed to making new gas connections to existing homes that are not on mains gas as affordable as possible, and is running a new Assisted Connections scheme, under which 19,456 properties were connected to its networks during 2011/12. A further 19,500 properties are expected to be connected in 2012/13.

Investment will continue to be a top priority for SGN and, in line with that, it expects to invest around £400m in capital expenditure and mains and service replacement projects during 2012/13.

Earning financial rewards for corporate responsibility

In July 2011, SGN was awarded £1.3m under Ofgem's Discretionary Reward Scheme which rewards companies for developing and adopting best practice in serving the interests of customers, society and the environment. This was the third successive year in which SGN secured the highest award under the scheme, and it recognised SGN's work on its environmental impact, fuel poverty and safety. The Scheme, which is judged by a panel of industry experts, was established as part of Ofgem's gas Distribution Price Control 2008-13.

Making gas networks more sustainable

In March 2011, the UK government launched the Renewable Heat Incentive 'to revolutionise the way heat is generated and used in buildings'. It will support emerging technologies and is designed to reduce dependence on heating from fossil fuels.

SGN has long recognised that renewable heat is an untapped resource. Working with a water company and a gas supplier, it began the delivery and supply of biomethane to 200 homes in Oxfordshire. Under the scheme, the first of its kind in Britain, sludge is subjected to the process of anaerobic digestion to create biogas which, after the removal of impurities, is fed into the gas distribution network. It has since begun participation in the first commercial biomass upgrading system in England, near Poundbury in the Duchy of Cornwall. Biogas produced from green waste and chicken manure will be upgraded to natural gas quality and fed into SGN's gas network to supply green gas to almost 4,000 homes.

It is estimated that biomethane could account for up to 15% of domestic gas needs in the UK in 2020. SGN is now developing this technology so that larger volumes of biomethane at other sites can be commissioned into the network and is carrying out feasibility studies on a further six proposals for biomethane network entry points from anaerobic digestion and landfill gas projects in Scotland and southern England.

Preparing for the new gas Distribution Price Control

As with electricity transmission, a new eight-year Price Control will be introduced for gas distribution from 1 April 2013 – RII0-GD1. SGN has undertaken extensive consultations with stakeholders to help determine what should be included in its business plan for the new Price Control.

In October 2011, SGN completed a public consultation on its proposed business plan for RII0-GD1 and submitted it to Ofgem in November 2011. The plan set out four key themes and related measures of progress:

- acting safely, through reducing risk and protecting the public and employees;
- providing excellent service through maintaining gas supplies, providing timely information and listening to customers;
- being good neighbours by reducing environmental impact and removing assets that affect local communities; and
- being a business for the future by helping to mitigate and adapt to climate change and keeping costs down.

In February 2012, Ofgem set out its initial assessment of gas distribution networks' business plans. Overall, it decided not to retain SGN (or any other company) within the 'fast track' process because of the number of issues that would have had to be resolved in a compressed timetable. SGN submitted a revised business plan in April 2012 which it is hoped Ofgem will adopt as the basis for its Initial Proposals document on the gas distribution Price Control in July 2012.

Gas Distribution priorities in 2012/13 and beyond

During 2012/13, SGN's priorities are to:

- deliver a safe and secure gas supply to customers;
- deliver to time and budget the 2012/13 mains replacement and capital works programmes;
- continue to work with stakeholders to secure an acceptable outcome to the new gas Distribution Price Control; and
- support sustainable developments in gas distribution.

Other Networks

Performance in Other Networks

SSE's 'Other Networks' businesses – Lighting Services, Utility Solutions and Telecoms – are relatively small when compared with its energy networks, and they operate in tough and competitive markets. As a result of difficult economic circumstances, their contribution to SSE's operating profit* fell, from £37.1m in 2010/11 to £32.1m, in 2011/12.

Maintaining leadership in lighting services provision

SSE remains the UK's and Ireland's leading street-lighting contractor. It has:

- 24 contracts with local authorities in England, Wales and Scotland to maintain over 630,000 lighting units;
- 28 contracts with local authorities in the Republic of Ireland to maintain over 240,000 lighting units, through Airtricity Utility Solutions; and
- 11 contracts with 12 local authorities, under the Private Finance Initiative, to replace and maintain over 610,000 lighting units.

The PFI contracts include the 25-year contract awarded by Knowsley Metropolitan Borough Council for the maintenance of over 24,000 lighting columns, traffic bollards and traffic signs and for the replacement of more than 70% of these during the initial four-year investment period which began in August 2011. It includes the deployment of SSE's Mayflower technology which offers customers variable light control, monitoring, fault detection and energy consumption measurement – all undertaken from a central location.

Lighting Services fits well within SSE's business model and, as in electricity distribution, future success will be based on effective and efficient customer service and successful deployment of new technology.

Providing comprehensive Utility Solutions

SSE provides a comprehensive range of 'utility solutions'. It designs, builds, owns, operates and maintains cable and pipe networks for delivering electricity, gas, water, heat and telecommunications to existing and new commercial and residential developments in

England, Wales and Scotland. It is, therefore, able to provide a one-stop solution for multi-utility infrastructure requirements to customers in the development and construction sectors.

- **Electricity Networks:** SSE now owns and operates 118 embedded energised electricity networks outside the areas served by its economically-regulated subsidiaries Scottish Hydro Electric Power Distribution and Southern Electric Power Distribution. A further 43 are under construction and contracts have been signed for the development of an additional 5, taking the total to 166 – up from 117 at the end of 2010/11. In total, SSE has 825MW of network capacity, including 476MW of existing demand and 349MW of connections to be completed.
- **Gas Pipelines:** SSE is also a licensed gas transporter, installing, owning and operating gas mains and services on new housing and commercial developments throughout the UK. The total number of new premises connected to its gas networks has continued to grow, and during 2011/12 it connected a further 13,853 premises, taking the total number of connections to over 92,000. Contracts have been signed for a further 60,000 connections to be completed.
- **Water:** Through SSE Water (SSEW) SSE is able to install, own, operate and supply water and sewerage services alongside its existing electricity and gas services. An 'inset' appointment is the route by which one company replaces another as the appointed water and/or sewerage company for a specified area. SSEW now has 15 such appointments and provides, or has secured contracts to provide, water and sewerage services to over 21,000 properties in England and Wales.
- **Heat:** SSE uses a range of sustainable technical solutions, including Combined Heat and Power (CHP) generation, biomass boilers and ground- and air-source heat pumps and combines these with community heating schemes where appropriate. There are currently seven heat networks in operation and five further schemes where SSE is the preferred bidder.

Of the four areas that Utility Solutions operates in, Heat is the least developed but has significant potential as a result of the planning requirements placed on developers and the introduction of the Renewable Heat Incentive. That, allied to continuing focus on safety, customer service and value across all activities and an ability to offer a true multi-utility solution to customers, means that Utility Solutions should continue to increase its already prominent market presence.

Operating a national telecoms network

SSE's Telecoms business operates in two different markets. It owns and operates the UK's fourth largest fibre and microwave network offering carrier standard connectivity to external customers and providing SSE's internal managed voice and data services. The origins of this business lie in the installation, a decade ago, of fibre on SSE's electricity network, and the telecoms network now comprises:

- fibre optic cabling which SSE owns (5,000km);
- leased lit fibre (2,600km); and
- microwave radio (3,600km).

To complement its core telecoms network business, SSE's Fareham-based data centre provides capacity for more than 1,200 racks for the co-location of IT services within the 80,000 square feet secure site and 10MW of power in a resilient and energy efficient environment.

Despite gaining some large, high-profile technology companies as clients, the year was characterised by a challenging environment for sales in respect of the network, which made tight control on operating costs especially important. To support the business in the future, there will be a focus on development of its network and products in what remains a very fast-developing sector.

Other Networks priorities in 2012/13 and beyond

Lighting Services, Utility Solutions and Telecoms have specific priorities for 2012/13, but across all of them there is a continuing need for:

- efficiency and customer service;
- effective product development; and
- technological change and innovation.

Conclusion

Through efficiency, responsiveness and innovation, SSE aims to expand significantly its Networks businesses in the coming years and they will play a significant part in helping it to meet its financial objective of sustained real dividend growth.

RETAIL

Retail Key Performance Indicators	Mar 12	Mar 11
ENERGY SUPPLY		
Operating profit* - £m	271.7	347.7
Electricity customer accounts (GB domestic) - m	5.04	5.16
Gas customer accounts (GB domestic) - m	3.48	3.57
Energy customers (GB business sites) - m	0.41	0.43
All-Island Energy Market customers (Ire) - m	0.62	0.49
Total energy customer accounts (GB, Ire) - m	9.55	9.65
Electricity supplied household average (GB) - kWh	4,104	4,408
Gas supplied household average (GB) - kWh	451	563
Household/small business aged debt (GB, Ire) - £m	88.3	89.2
Customer complaints to third parties (GB)*	896	1,161
* Energy Ombudsman, Consumer Focus and Consumer Direct		
ENERGY-RELATED SERVICES		
Operating profit* - £m	49.9	52.8
Home Services customer accounts (GB) - m	0.41	0.42
Meters read - m	15.0	13.8
SSE Contracting Order Book - £m	78	67

Improving transparency in competitive customer-facing businesses

In previous years, SSE reported performance relating to its energy supply activities as part of a Generation and Supply segment and SSE continues to believe that its involvement in the Retail activity of energy supply and the Wholesale activities of energy production and portfolio management means it has a well-balanced portfolio of customers, assets and contracts for purchasing gas and power purchase agreements.

In October 2009, Ofgem introduced the requirement to report details of SSE's Generation and Supply results in a Consolidated Segmental Statement (CSS). Ofgem commissioned an independent review of suppliers' segmental statements by BDO LLP and in January 2012 announced that while BDO had recommended several changes to the way suppliers prepare their statements to improve transparency and cross-company comparability the fact it 'found suppliers' financial information to be fair and appropriate and should also give consumers a degree of reassurance.'

Therefore, in relation to Generation and Supply, SSE was already publishing information to help to improve the transparency of its financial reporting. Following changes to SSE's management structure in 2011 and in the interests of further transparency, it has concluded that this should be extended to its financial statements.

The second biggest energy supplier across the Great Britain and Ireland markets

SSE is the second biggest energy retailer across the competitive markets in Great Britain and Ireland. It supplies electricity and gas to more than 9.5 million household and business accounts under brands such as SSE, Scottish Hydro, Southern Electric, SWALEC and Atlantic in the Great Britain market and Airtricity in the markets on the island of Ireland.

The key responsibilities of the Energy Supply business are to:

- ensure it secures enough electricity and gas to meet customers' needs;
- arrange for electricity and gas to be distributed to customers' premises through the relevant networks;
- provide customers with necessary associated services such as metering and billing; and
- meet obligations in respect of energy efficiency and any related social or environmental schemes promoted by government.

It must do so while being mindful of the fact that its core products – electricity and gas – are something which people need to buy rather than choose to buy, which means there is legitimate and significant political and regulatory interest in energy supply markets. In Great Britain, for example, energy supply has been the subject of a Retail Market Review announced by Ofgem in November 2010, which is supposed to make energy retail markets work more effectively in the interests of customers.

A significant provider of energy-related services

SSE provides other energy-related goods and services to customers, covering three principal areas:

- retailing of ‘home services’ such as gas boiler, central heating and wiring maintenance and installation, telephone line rental, calls and broadband services and microgeneration;
- supplying, installing, maintaining and reading meters in the household, commercial, industrial and generation sectors in Great Britain; and
- domestic, commercial and industrial mechanical and electrical contracting and electrical and instrumentation engineering.

SSE’s contracting business is the second largest mechanical and electrical contracting business in the UK. Its metering business became national in Great Britain in 2010 after it completed a programme of in-sourcing of activities. ‘Home services’ were supplied to over 400,000 customer accounts as at 31 March 2012.

SSE’s activities in home services, metering and electrical and mechanical contracting are all customer-facing and have, therefore, been included in the Retail segment.

Financial performance in Retail

Operating profit* in Retail fell by 19.7%, from £400.5m to £321.6m, contributing 19% of SSE’s total operating profit*. This comprised (comparisons with the previous year):

- £271.7m in Energy Supply, compared with £347.7m; and
- £49.9m in Energy-Related Services, compared with £52.8m.

Energy Supply

Performance in Energy Supply

SSE’s Energy Supply business buys the electricity and gas it needs through SSE’s Energy Portfolio Management and Generation divisions. The associated cost to the Energy Supply business comprises:

- the weighted average cost of electricity, made up of fuel used in generation plus associated costs of CO₂ emissions, power purchase agreements and direct bilateral electricity contracts; and
- the weighted average cost of gas, made up of gas purchase contracts and direct bilateral gas contracts and gas storage.

It therefore carries risks associated with energy procurement. In addition the Energy Supply business has to meet costs associated with the transmission and distribution of energy, customer service and government-sponsored social and environmental obligations.

Operating profit* in Energy Supply in 2011/12 fell by 21.9% to £271.7m, and comprised 16.4% of SSE’s total operating profit. Within this, SSE’s operating profit from supplying energy to a household account in Great Britain in 2011/12 was an average of around £30. Operating profit in Energy Supply reflects the higher wholesale gas costs and the delay to September 2011 in implementing an increase in household energy prices and falling energy consumption. There was, however:

- a reduction in overheads associated with the doorstep sales operation as a result of its closure in July 2011; and

- success in managing, with customers, the level of aged debt.

Expected profitability in Energy Supply

Electricity and gas are things which people need to buy rather than choose to buy (unless they are used inefficiently), so SSE recognises that it would not be acceptable for it to achieve an excessive level of profitability in Energy Supply. At the same time, a reasonable and sustainable level of profitability is necessary to ensure that the risks associated with energy procurement can be remunerated in a way that will sustain investment and to ensure that investment can also be made in the services and systems that customers will need in the future.

SSE expects that its profit margin (i.e. adjusted operating profit* as a percentage of revenue) in Energy Supply will average around 5% over the medium term (i.e. three to five years). In 2011/12, it was 3.5%. On this basis, SSE hopes to demonstrate that the prices it charges for, and any profit it makes in, supplying electricity and gas are fair. It also hopes to give further momentum to its efforts to build trust in energy supply.

Building trust in energy supply

In October 2011, SSE published a document, *Building Trust: SSE's proposals to build customers' trust in energy supply* in Great Britain. It set out 10 measures to:

- restore simplicity, including reducing the number of tariffs from over 60 to four core products;
- enhance transparency, including improving wholesale electricity market liquidity;
- improve customer service, including retrospective introduction of a Sales Guarantee; and
- ensure fairness for all customers, including ensuring all customers have the opportunity to access all tariffs.

In line with the fairness principle, SSE has made a clear commitment never to engage in any form of unfair pricing. As the Institute for Public Policy Research stated in February 2012, 'customers are being overcharged to subsidise cheap offers for customers who switch suppliers in the more competitive end of the market'. An effect of this practice is to make entry in to the energy supply market in Great Britain more difficult for new suppliers, and that is another reason why the practice should be stamped out.

In April 2012, SSE confirmed that the 10 measures had been completed, including two that had been successfully piloted and would go forward to full implementation. It also set out a number of other measures to maintain the momentum, including steps to simplify energy bills, tackle estimated bills and to enable prepayment meter customers get on to the best tariff.

As part of its Retail Market Review, Ofgem has completed consultations on possible interventions in areas such as pricing structures, tariff comparability and customer communications. Ofgem has said it would prefer to implement reform wherever appropriate with the co-operation of energy supply companies but will consider a referral to the Competition Commission if necessary.

SSE accepts the challenge posed by Ofgem but believes it is moving faster, and further, to meet customers' needs in a way that a regulator-determined approach would not be able to achieve. Indeed, the quick way in which SSE was able, in April 2012, to enter into an agreement with the UK government on measures to help improve the quality and relevance of the information available to customers demonstrates that speed of response and innovation are most likely to sustain and build customers' trust in energy supply.

Energy supply markets in Ireland are at a different stage of development; indeed, since 2009, Ireland has experienced the EU's highest levels of customers switching between suppliers. Nevertheless, after a period of rapid growth in customer numbers, SSE is committed to ensuring that the principles of *Building Trust* are also applied on the island of Ireland, and its Customer Charter for household customers in the Republic of Ireland reflects that commitment.

SSE's approach to retaining and gaining customers

Long-term success in Energy Supply depends on the supplier's ability to retain and gain customers. SSE aims to do this by:

- offering consistently competitive prices over the medium term;
- providing a straightforward range of products that are easy to assess; and
- delivering the highest possible quality of service.

In summary, its proposition to customers is based on fair pricing, simple products and excellent service. At the same time, SSE believes that, because the products it supplies are fundamental to the functioning of modern life and so are not discretionary, it has a responsibility to earn and retain the trust of customers.

Supplying energy to customers in GB and Ireland

During 2011/12, SSE's energy customer accounts in Great Britain and Ireland fell slightly, to 9.55 million from 9.65 million in March 2011. Customer accounts at March 2012 comprised:

- 8.52 million household electricity and gas accounts in GB;
- 407,000 business electricity and gas sites in GB; and
- 621,000 electricity and gas customer accounts in Northern Ireland and the Republic of Ireland (91% household and 9% business).

The reduction in customer account numbers in GB was, therefore, offset somewhat by success in the Irish markets, where there was a net customer gain of 130,000. In contrast, there was a reduction of 230,000 in customer numbers in Great Britain, reflecting the highly competitive market conditions. Of this net reduction, most accounts were lost in the six months between July and December 2011. This was the period following SSE's decision to stop selling energy on the doorstep in Great Britain and the announcement of increases in household gas and electricity prices.

Customer account numbers do not tell the whole story, however. Within the overall total, 2.5 million customer accounts in Great Britain are for loyalty products such as:

- energyplus Argos, which rewards customers with money-off discount vouchers;
- energyplus Pulse, under which customers are able to support the British Heart Foundation (which received £133,000 from SSE in respect of energyplus Pulse customers during 2011/12, taking the total since the product was launched to £1.5m); and
- M&S Energy, available to customers through Marks & Spencer's stores and website.

In May 2012 SSE has announced its intention to acquire Phoenix Supply Limited, a regulated supplier of natural gas to 130,000 customers in Northern Ireland. The acquisition also includes a small number of customers in ROI's deregulated commercial supply market. The acquisition is subject to approval by the Irish Competition Authority and SSE expects to complete the purchase during the summer.

Selling energy in the right way

In July 2011, SSE became the first of the leading suppliers in the Great Britain market to stop commission-based doorstep selling. The decision was taken because confidence in the way energy was being sold on the doorstep and in the way in which salespeople were being remunerated had become low.

This was followed in December 2011 by SSE's decision to implement its Sales Guarantee for household energy customers and to apply the guarantee to any household energy sales made by it since October 2009, when Ofgem placed new obligations on energy suppliers to make sure sales activities are conducted in a fair and professional manner.

Under the guarantee, devised as part of SSE's *Building Trust* initiative, any customer who shows that they switched their energy supply to SSE after being given inaccurate information

or being misled will have any resulting financial loss made good. Since it was launched, SSE has contacted customers about the guarantee and so far settled over 3,000 claims. It expects that the retrospective implementation of the guarantee could cost up to £5m. The application of the guarantee is being independently assured and extended to all energy products.

In May 2012, SSE was fined £1.25m after being found guilty, at Guildford Crown Court, on two counts (out of seven) relating to the use of direct sales aids in February 2009. SSE recognises that a company of its standing and with its values should not have found itself in this position and various steps – of which the Sales Guarantee is one - have been taken to ensure that it does not do so again.

Meanwhile, SSE is continuing to co-operate with Ofgem's investigation into whether it complied with the new licence conditions to govern sales processes introduced in 2009.

SSE aims to gain customers through venue, telephone, online and direct mail sales and through customer advice activities; through extending its range of affinity partnerships, of which M&S Energy is one example; and through a series of commercially-focused sponsorships.

It is also planning to launch later this year pilot networks of appointment-only and salary-based 'smart energy advisers', starting in Wales and Scotland and trained to an externally-accredited standard. The advisers will draw on SSE's experience in the Energy Demand Research Project carried out in North Leigh, Oxfordshire, between 2007 and 2010, during which a locally-based energy adviser employed by SSE engaged with local people to secure a 10% reduction in household energy consumption. According to the Independent Project Final Analysis, published in June 2011, the adviser was 'able to work very well within the community and was very well received by them'.

Customers' use of energy is continuing to decline

SSE household customers have continued to reduce their use of energy, and on an actual basis in 2011/12 SSE household customers used, on average:

- 451 therms of gas, compared with 563 therms in the previous year; and
- 4,104kWh of electricity, compared with 4,408kWh in the previous year.

On a weather-corrected basis, average household consumption of gas by SSE's customers has fallen by 21.5% in the five years since 2007 and consumption of electricity has fallen by 16.7%. The decline in energy consumption is expected to continue for the next few years.

Falling consumption presents short term issues in relation to the revenue that companies are able to earn from supplying energy and in relation to the operation and development of plant for generating electricity. Nevertheless, as a result of the underlying fall in energy consumption, households are less exposed to the impact of high unit prices than they otherwise would be and the overall sustainability of supplies of gas and electricity is improved. These are very positive trends, which SSE welcomes.

Helping customers use less energy in the future

As an energy supplier, SSE has obligations under the Carbon Emissions Reduction Target (CERT) 2008-12 scheme to deliver energy efficiency measures to households throughout Great Britain that deliver savings in CO₂ emissions, and in 2011/12 it funded the installation of cavity wall insulation in over 125,000 homes and loft insulation in over 190,000 homes (excluding DIY insulation), an increase of over 60% on last year.

In August 2011, Ofgem published its Annual Report on suppliers' progress towards CERT targets for 2008-12. It reported that SSE had achieved 64% of its obligation by the end of the third year of CERT; this increases to 71% when the innovation features of CERT are taken into account. The delivery of CERT and, in particular, of the requirement to ensure that 15% of the CO₂ savings are achieved in a subset of low income households considered to be at high risk of fuel poverty (the Super Priority Group) has proved to be very challenging, not

least because of difficulties associated with identifying, and then collecting the information required to verify, a customer as being within the Super Priority Group.

Complementing CERT, the Community Energy Savings Programme (CESP) is an obligation placed on energy suppliers and electricity generators to make savings in customers' homes by helping to install energy efficiency measures. The programme is designed to ensure that suppliers work in the lower income areas and to incentivise a 'whole house' approach to energy savings. While delivering CESP is challenging, SSE now has 33 CESP agreements in place for locations throughout England, Scotland and Wales.

CERT and CESP will be superseded by the Green Deal and Energy Company Obligation (ECO) when they are introduced following the passage of the Energy Act 2011:

- the Green Deal is a new financing mechanism for customers seeking to install energy saving measures, featuring a 'Golden Rule' under which the expected financial savings arising from the measures must be equal to or greater than the costs attached to the energy bill; and
- the ECO will replace the obligations arising from CERT and CESP, with suppliers expected to focus assistance on the poorest and most vulnerable households and the hardest-to-treat properties, which may not be able to take advantage of the Green Deal.

In April 2012, SSE was one of 22 organisations to sign an agreement with the UK government to work to become one of the first Green Deal providers, offering energy efficiency packages to consumers when the scheme launches later this year. The UK government has emphasised the importance of a 'good customer experience from day one' of the Green Deal, a point which SSE strongly endorses.

Energy efficiency is also a key issue in Ireland and 2013 will see the introduction there of an energy company-administered Pay As You Save programme.

Helping vulnerable customers

In March 2012 Professor John Hills published the final report following his review of the fuel poverty definition and target commissioned by the Secretary of State for Energy and Climate Change. Under the existing definition, a household is classed as being in 'fuel poverty' if it would need to spend more than 10% of its income on fuel to keep its home warm enough.

Hills has proposed an alternative measurement framework focused directly on the overlap of high energy costs and low income. Hills believes that the new framework will show that interventions targeted at the core of the problem – especially energy efficiency policies focused on low income households – can make a substantial difference. Following Hills' final report, the UK government has committed to the adoption of a revised approach to measuring fuel poverty by the end of the year.

SSE agrees with Hills' assessment of the importance of energy efficiency and the successful deployment of measures under schemes like CERT and CESP is an important priority for it. In addition, SSE fulfils three other key responsibilities in order to help those of its customers who struggle to pay for their basic energy needs:

- giving financial assistance with energy bills, helping over 400,000 customers with a total of £46m in 2011/12;
- providing tailor-made payment arrangements, helping over 300,000 customers who may be experiencing hardship and having difficulty in paying their energy bills; and
- contacting more than 60,000 potentially vulnerable customers, helping them with practical advice and support.

As in Great Britain, greater energy efficiency is seen as the most sustainable solution to issues relating to energy affordability in Ireland.

Retail energy bills in Great Britain

SSE increased its prices for household gas supply by 18% and household electricity supply by 11% (average) on 14 September 2011. That was the first increase in household electricity prices for three years. SSE was able to cut the unit price of gas for household customers by 4.5% on 26 March 2012.

There are three upward pressures on household energy bills:

- the cost of using energy networks to distribute electricity and gas to customers' homes;
- the cost of mandatory environmental and social schemes that energy suppliers are required to fund; and
- the wholesale cost of energy.

The decline in actual average consumption of electricity and gas by SSE's household customers in Great Britain in 2011/12, compared with 2010/11, means that - despite the price increase on 14 September - a typical household customer of SSE paid £1,118 for electricity and gas in the year to 31 March 2012 (excluding VAT), down from £1,137 in the previous year. This illustrates the distinction between the price of a unit of energy and the amount customers pay for heating and powering their homes.

According to the UK government's statement of Energy Trends in March 2012, for the period July to December 2011, prices (including tax) paid by medium domestic gas and electricity customers in the UK were the lowest and fourth lowest in the EU15 respectively.

A typical SSE dual fuel bill is made up of:

- distribution costs – 23%;
- metering and customer service costs – 8%;
- mandatory social and environmental costs – 9%;
- VAT – 5%; and
- Energy costs – 50%.

This leaves SSE with a profit of around 5%. As recently as 2008, energy costs accounted for 55% of a typical dual fuel bill. The fall to 50% in 2012 shows the impact of distribution, environmental and social costs on household energy bills. The bills issued by SSE now contain this breakdown.

SSE will not implement an increase in the price of household electricity or gas before October 2012 at the earliest. Beyond that, energy prices for household customers will ultimately depend on what happens in wholesale electricity and gas markets, with public policy and regulatory decisions on energy production, distribution and consumption also having a significant impact.

As part of its *Building Trust* initiative, SSE publishes an online 'tracker' showing the relationship between the different components of a typical dual fuel energy bill. The tracker shows the changing components of bills with the aim of explaining the rationale for pricing decisions.

How people pay their energy bills

A total of 61% of SSE's domestic electricity and gas accounts across Great Britain and Ireland are paid by direct debit or standing order. A further 12% are paid through pay-as-you-go (or pre-payment) meters in Great Britain and the balance are on credit terms and settled by cheque or other such payment methods.

Keeping customers' energy debt under control

As at 31 March 2012, the total aged debt (i.e. debt that is overdue by more than six months) of SSE's domestic and small business electricity and gas customers in Great Britain and Ireland was £88.3m, compared with £89.2m in March 2011. A bad debt-related charge to

profits of £40.5m has been made. This compares with a charge of £47.4m in the previous year.

The general economic climate means there are significant debt management challenges, with the volume of work in this area for SSE's Customer Service division again increasing. SSE has office- and field-based employees who work with customers to resolve debt issues. They aim to help customers by identifying as early as is practical when their payments are in arrears and contacting them as soon as possible to discuss the options available to them. This makes the situation easier from both SSE's point of view and that of the customer and the benefit can be seen in the fact that debt which is less than three months old was 16.5% lower on 31 March 2012 than the year before and debt overdue by four-to-six months was 6.3% lower.

Providing sector-leading service to customers

SSE continues to be independently and consistently recognised as the customer service benchmark for the leading energy suppliers in Great Britain. To provide customers with the best possible value for money, SSE believes that it needs to provide excellent service, simple products and fair prices.

SSE's position as the customer service benchmark for the rest of the energy supply industry in Great Britain is illustrated by:

- the UK Customer Satisfaction Index, published in July 2011, in which SSE achieved the top ranking in the utility sector for the fourth consecutive year;
- the uSwitch.com Energy Customer Satisfaction Awards, announced in November 2011, in which SSE won the Overall Customer Satisfaction category for the eighth time in a row. Altogether, SSE won eight of the 11 categories;
- the J.D. Power and Associates 2011 UK Electricity and Gas Supplier Customer Satisfaction Study, in which SSE brands topped both the electricity and gas supplier rankings; and
- the energy complaints league table, published by Consumer Focus in March 2012, in which SSE achieved a five star rating with the lowest number of customer complaints to Ombudsman Services: Energy, Consumer Direct and contacts with Consumer Focus' Extra Help Unit. SSE is the only company to achieve a five star rating and has topped the league table since it began in April 2010.

During 2011/12, there were 896 SSE-related complaints to the following third party organisations: the Ombudsman Services: Energy, Consumer Focus and Consumer Direct. This was a reduction from the 1,161 complaints in the previous year and the 1,231 complaints in 2009/10.

Although SSE maintained its best-in-sector position in customer service during 2011/12, it was a year in which the profile of the energy supply sector remained very high. In total, SSE's energy supply customers in Great Britain made almost 16 million calls (excluding calls handled by automated services) to its teams in Basingstoke, Cardiff, Cumbernauld, Havant and Perth during the year. These conversations allow SSE to assess, consider and respond to customers' concerns and, over time, adapt the services and products it provides accordingly.

The same applies to markets in Ireland and SSE is planning further investment in customer services and training to deliver sector leadership there also.

Making services available digitally

Web and email are now firmly established as the second most common means of communication with the company used by SSE's customers. Around 26% of SSE's transactions with customers now take place using digital channels.

Moreover, SSE's customers in the Great Britain and Ireland markets now have 1.7 million digitally billed accounts, up from 1.3 million in the year before. Such customers can view their

account and payment history, submit meter readings and receive an up-to-date balance on their account, make secure payments on their account and other such services.

The popularity of e-services such as paperless billing is likely to continue to increase rapidly over the next few years. Enabling customers to carry out more transactions using digital channels if they so choose is now one of SSE's top customer service priorities and significant investment is being made in this and in services to customers generally. In this context, the development of mobile apps and social media such as Twitter and Facebook mean the ways in which customers engage with SSE is undergoing further change and responding to this is a key priority for 2012/13 and beyond.

At the same time, the charges SSE makes for energy will always be cost-reflective. This means that any differences between prices available online and prices available through other channels will reflect only the different cost of the transactions. Among leading energy suppliers, SSE has had the lowest differential between its online and standard credit prices.

In line with its *Building Trust* commitments, SSE has gone one step further and in October 2011 removed all differentials between its tariffs online and offline. This means that a customer of SSE will have the same price for their energy, regardless of the sign-up method used. SSE will continue to offer a 1% discount to all customers who choose paperless billing, which reflects the lower cost of providing this option.

SSE believes that its approach helps make tariffs simpler and energy prices across all of its customers fairer. It continues to believe the much larger differentials maintained by other suppliers should be the subject of the most detailed investigation by Ofgem.

Developing new energy products and services

The competitive energy supply market in Great Britain spurred companies to develop and deploy an ever-increasing number of features and options around the core commodities of electricity and gas. This led critics to say that customers had become 'bamboozled' by the complexities that resulted from this.

As part of its *Building Trust* initiative, SSE responded to this by introducing, in February 2012, a dramatically-simplified range of energy tariffs which meet the needs of the vast majority of customers featuring:

- four core products – two with a variable price and two with a fixed price;
- five simple questions to enable customers to find the best deal;
- a new price comparison metric to enable customers to see the relative cost of each tariff; and
- the same availability online, face-to-face or over the telephone.

This fulfils two key principles: simplicity for the customer who is concerned only or mainly about price; and choice for the customer who is more concerned about features and products.

To achieve this simplification, SSE removed the 'no standing charge' option from all of its products, with all new customers being placed on a tariff consisting of:

- a standing charge which, covers a proportion of the fixed costs; and
- a single unit price for all units consumed.

In response to SSE's tariff simplification, uSwitch.com said: 'Yet again SSE is setting the pace for the rest of the industry, this time unveiling its plans to simplify its products and prices while Ofgem is still consulting on its own proposals.'

Preparing for the roll-out of smart meters

Energy supply in Great Britain is expected to be transformed by the installation of around 53 million smart energy meters in around 30 million homes and businesses. They will enable the quantity and value of electricity and gas used by the customer to be continuously monitored

and allow information about its use and cost to be available to the customer and exchanged with the supplier, through two-way electronic communications.

SSE supports the two-phase approach to the smart meter roll-out which has been adopted, featuring:

- the foundation stage to enable the energy industry to build and test all the systems needed to start the roll-out, ensure positive customer engagement and deliver energy savings and to enable the UK government to establish the Data Communications Company, on which a consultation was launched in February 2012, to manage smart meter communications; and
- the roll-out stage, between 2014 and 2019, during which the meters themselves will be installed in most households. This has to be a positive experience for customers, as there is evidence from elsewhere that customers can be hostile to smart meter installation programmes.

SSE sees its role in the smart meter roll-out as a service provider, operating within the framework set by the UK government for issues like technical standards, data access and security. In line with this, and its measured and realistic approach to the roll-out, SSE's priority is to make substantive progress on the necessary IT systems to support the wider roll-out, without making commitments that may prove to be mis-placed as the roll-out plan gets under way. This means that, under its own programme, it had installed just 2,500 smart meters in customers' homes by the end of March 2012, as opposed to the hundreds of thousands installed by one other supplier, many of which do not conform to the technical specification issued by the UK government in March 2012.

Fundamentally, SSE believes that the smart meter roll-out is something which should be started well and completed successfully, rather than started too quickly and burdened by problems before completion.

In Ireland, installation of smart meters will be the responsibility of network companies.

Delivering zero carbon homes

Smart meters are one example of change in the energy sector designed to help the way in which electricity and gas are used to become more sustainable. The way in which people live is also changing and, in line with that, SSE completed a development of 10 zero carbon homes on a brownfield site in Slough in 2010. They feature triple glazing, mechanical ventilation systems, solar PV tiles, solar thermal panels and an energy centre with a biomass boiler and a ground-source heat pump and conform to the highest specification for sustainable building, Code 6 in the Code for Sustainable Homes.

The homes have been occupied throughout the period since, allowing information to be gathered about how householders adapt and respond to zero carbon living. The main findings so far are that:

- residents like zero carbon homes which, despite the extensive renewable and energy efficiency measures, feel very normal;
- due to enhanced insulation and triple glazing, residents hear very little external noise;
- the homes have used less electricity and less hot water than expected but more space heating than expected but net energy costs were less than half that of a traditionally-built home; and
- the integration of four different renewable heating technologies into one energy centre has required time to commission and optimise.

Final conclusions from the zero carbon homes will be prepared when the initial trial period is completed, which is expected to be in late 2012. Those conclusions will help inform future developments in the decarbonisation of the energy sector.

Energy Supply priorities in 2012/13 and beyond

During 2012/13, and beyond, SSE's priorities in Energy Supply are to:

- deliver fair prices, simple products and excellent service to customers;
- continue to build customers' trust in energy supply;
- deliver energy efficiency programmes;
- make substantive preparations for the roll-out of smart meters and related developments; and
- maintain progress in providing additional services through digital channels.

Energy-related Services

Providing energy-related products and services

In addition to electricity and gas, SSE also provides energy-related products and services to customers, covering three principal areas:

- retailing of 'home services' such as gas boiler, central heating and wiring maintenance and installation, telephone line rental, calls and broadband services and microgeneration;
- supplying, installing, maintaining and reading meters in the household, commercial, industrial and generation sectors in Great Britain; and
- domestic, commercial and industrial mechanical and electrical contracting and electrical and instrumentation engineering.

Home Services

SSE provides home services to 412,000 accounts. In addition, micro renewables is a very small market, but it has grown quickly in response to Feed-in Tariffs with solar PV being the most popular product. At 31 March 2012, SSE had 38,000 registered FiT customers, equating to a market share of around 15%. At the same time, customer numbers are limited by the fact that SSE's home services products and services have only been available in some regions.

SSE believes that extending the availability of its home services, especially in the context of the forthcoming launch of the Green Deal, will be necessary to integrate these products and services more closely with its wider proposition for electricity and gas customers and it intends to do this over the next three years. It is also intended to extend SSE's home services offering in Ireland.

Maintaining a national Metering business

SSE's Metering business provides services to most electricity suppliers with customers in central southern England and the north of Scotland. It undertakes meter reading operations and meter operator work in all other parts of Great Britain. 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. This national metering business was created following the completion of a programme of in-sourcing in 2010.

During 2011/12, SSE collected (previous year in brackets):

- 9.1 million electricity readings (8.4 million); and
- 5.9 million gas readings (5.4 million).

Longer-term, SSE's Great Britain-wide metering team will be able to support the transition to smart meters which will take place in the coming decade and will help SSE deploy other energy-related services and products during that time (see 'Preparing for the roll-out of smart meters' above).

A leading mechanical and electrical contracting business

SSE Contracting has two main areas of activity:

- industrial, commercial and domestic mechanical and electrical contracting; and

- electrical and instrumentation engineering.

It is one of the largest mechanical and electrical contracting businesses in the UK. It employs around 4,000 people and operates from regional offices throughout Great Britain.

SSE Contracting continued to make solid progress during 2011/12. Its order book ended the financial year at £78m, compared with £67m in 2010/11 (on the revised basis adopted on 1 April 2011). The order book features a number of important new contracts with customers as diverse as Tesco and National Air Traffic Services.

A key focus for SSE Contracting is on post-sales control, particularly in terms of costs, and maintaining strong customer relationships, with careful analysis of the markets and areas of work it should prioritise. The structure of the business has also been kept under review and some rationalisation of depots has been undertaken.

Energy-related Services during 2012/13 and beyond

Home Services, Metering and Contracting have specific priorities for 2012/13 and beyond, but across all of them there is a need to:

- maintain the right portfolio of products and services;
- deliver high standards of customer service; and
- anticipate the changing requirements of customers.

Conclusion

Through focusing on fair prices, simple products and excellent service SSE believes that it can achieve long-term success in its Retail businesses which, in turn, will contribute to the achievement of its key financial goal of sustained real growth in the dividend.

WHOLESALE

Wholesale Key Performance Indicators	Mar 12	Mar 11
Energy Portfolio Management (EPM) and Generation		
EPM and Generation operating profit* - £m	541.5	543.4
EPM and Generation capital expenditure - £m	982.0	943.6
EPM		
Total wholesale electricity auctioned (N2EX) - TWh	25.66	1.75
GENERATION		
Gas- and oil-fired generation capacity - MW	4,470	4,470
Coal-fired generation capacity (inc biomass co-firing) - MW	4,370	4,370
Renewable generation capacity (inc pumped storage) - MW	3,020	2,450
Total electricity generation capacity - MW	11,860	11,290
Gas power station availability - %	94	88
Coal power station availability - %	89	84
Hydro storage availability - %	60	61
Onshore wind farm availability %	97	97
Gas- and oil-fired (inc CHP) output- TWh	21.6	29.3
Coal-fired (inc biomass co-firing) output- TWh	16.8	13.6
Total output from thermal power stations - TWh	38.4	42.9
Conventional hydro output – GWh	4,262	2,558
Wind energy output – GWh	3,199	1,653
Dedicated biomass output – GWh	156	200
Total output of renewable energy – GWh	7,617	4,411
Total output from pumped storage - GWh	372	370

Note 1: Capacity is wholly-owned and share of joint ventures

Note 2: Output is electricity from power stations in which SSE has an ownership interest (output based on SSE's contractual share)

GAS PRODUCTION AND GAS STORAGE

Gas production operating profit* - £m	42.6	4.6
Gas production – m therms	176.7	27.6
Gas storage operating profit* - £m	23.8	23.5
Gas storage customer nominations met - %	100	100
Gas storage net capacity - mcm	490	440
Gas production and storage capital investment - £m	57.1	52.6

Sourcing and producing energy

In previous years, SSE reported performance in Energy Portfolio Management (EPM) and Electricity Generation as part of a Generation and Supply segment. Following changes in SSE's management structure in 2011 and in order to report the results of the Generation and Supply business in a more meaningful and consistent manner, these activities have been separated into different segments.

This means that the results from the Energy Supply business are being reported separately within the Retail segment, and the combined results of SSE's wholesale energy procurement and optimisation activities and its electricity generation operations are being reported together as EPM and Electricity Generation.

The aggregation of these activities reflects the way they are managed and their relationship to the Energy Supply business, with EPM acting as the bridge that delivers energy to Retail customers from SSE's electricity generation, gas production and energy contracts portfolio.

EPM is responsible for the scheduling of generation plant through capacity contracts with the asset owners, the procurement of fuel for the plants and the optimisation and trading of electricity, gas and other commodities. The Generation business is responsible for asset management, maintenance and making available plant for use by EPM. Neither activity is reported as a discrete profit centre or activity. In combination, these activities are carried out to provide the lowest cost input to the Energy Supply business for provision of energy to customers.

Under the new basis of reporting, performance in Gas Production and in Gas Storage will be reported separately, within the Wholesale segment.

SSE continues to believe that its involvement in the Wholesale activities of energy production and portfolio management, and the Retail activity of energy supply means it has a well-balanced portfolio of customers, assets, contracts for purchasing gas and power purchase agreements.

In undertaking these activities, SSE publicly discloses planned or unplanned outages affecting its wholly-owned power plant for units of more than 100MW in capacity (or more than 100MW in aggregate for wind capacity), including the reason for the outage and its expected duration. This information is in line with the expected requirements of the EU Regulation on Energy Market Integrity and Transparency (REMIT) as it affects wholesale energy markets.

Financial performance in Wholesale

Operating profit* in Wholesale increased by 6.4%, from £571.5m to £607.9m, contributing 37% of SSE's total operating profit*. This comprised (comparisons with the previous year):

- £541.5m in EPM and Electricity Generation, compared with £543.4m;
- £42.6m in Gas Production, compared with £4.6m; and
- £23.8m in Gas Storage, compared with £23.5m.

Energy Portfolio Management and Electricity Generation

Financial performance in Energy Portfolio Management and Electricity Generation

SSE's Energy Portfolio Management (EPM) and Electricity Generation businesses have six main responsibilities, for which they are remunerated:

- energy contract management;
- sourcing energy through participation in wholesale markets for electricity, gas, coal, oil, biomass and CO₂ emission permits;
- management of existing power generating assets and making available those assets for use;
- producing renewable energy;
- securing Renewable Obligation Certificates and Levy Exemption Certificates; and
- services to the electricity balancing market under the Balancing and Settlement Code.

Operating profit* in EPM and Electricity Generation reduced by 0.3%, from £543.4m to £541.5m. It contributed 33% of SSE's total operating profit* in 2011/12. The reasons behind this performance are set out under 'Factors affecting adjusted profit before tax* in 2011/12' above.

Working to reduce volatility for energy customers

SSE's activities in EPM and Electricity Generation are guided by two long-term priorities:

- competitive and sustainable energy procurement; and
- flexible and 'greener' electricity production.

In delivering on these priorities SSE is committed to the delivery of a diverse portfolio of robust assets, from which revenue can be generated on a reliable, long-term basis and which support future dividend growth.

The wholesale price of energy can fluctuate greatly, according to variables such as physical supply, customers' demand, the weather, the availability of delivery infrastructure and geopolitical issues. EPM and Generation act in unison, maintaining a diverse and well-balanced portfolio of contracts and assets, both long and short term, to ensure that customers benefit from lower exposure to wholesale price volatility and therefore price stability. In doing so, SSE provides:

- lower risk from wholesale energy price volatility through reduced exposure to any single commodity;
- greater ability to manage wholesale energy price volatility and to protect customers from it; and
- more scope to deliver the investment needed in Generation because the risks associated with large-scale and long-term investments are balanced by having electricity and gas customers.

Generating and buying electricity in Great Britain

As at 31 March 2012, SSE's generation capacity, including its share of joint ventures and associates, was around 11,860MW, comprising:

- 11,360MW in Great Britain;
- 80MW in Northern Ireland; and
- 420MW in the Republic of Ireland.

During 2011/12, in Great Britain, SSE (previous year's numbers in brackets):

- generated 38.4TWh, based on contracted output of electricity from all thermal power stations in which it has an ownership interest in GB (42.9TWh); and
- generated 6.4TWh based on contracted output from renewable sources of energy in which it has an ownership interest in GB, including pumped storage (3.7TWh).

During the same period, also in Great Britain, it:

- supplied 25.2TWh of electricity to its industrial and commercial customers in GB; and
- supplied 26.7TWh to its small business and household customers in GB.

This means that, during the year, SSE:

- generated the equivalent of 86% of the electricity needed to supply all of its customers; and
- generated the equivalent of 168% of the electricity needed to supply its household and small business customers.

Any net balances were traded in the wholesale electricity market, thereby contributing to its liquidity.

Increasing wholesale market transparency

In response to customers' wish for greater transparency and concerns regarding the lack of liquidity in the short-term wholesale market for electricity, SSE introduced a new approach in October 2011 under which it started to phase in the auction of all of its electricity supply and purchase all of its electricity demand in the day ahead market. This move was broadly welcomed by stakeholders, with Ofgem saying it would 'create greater liquidity and more efficient price discovery on the day-ahead market'.

Moving to this approach effectively means that SSE is delivering a new level of transparency, significantly improving liquidity, increasing the depth and credibility of the market, and assisting in the creation of a robust and tangible pricing index.

By the end of 2011/12, SSE had consistently placed 100% of its flexible thermal electricity generation and about 60% of its power demand via Nasdaq OMX Group Inc. and Nord Pool

Spot AS's N2EX daily auction. In the financial year 2011/12 SSE traded over 25TWh in the day ahead auction market and, since starting the initiative, daily market volumes have increased by over 300%. While it is SSE's aim to trade 100% of its power in the day ahead auction (subject to costs and market conditions), delays by other utilities in trading larger volumes has slowed the process.

Overall the move by SSE has been successful in transforming the market and has significantly improved liquidity, depth and credibility. It has contributed to the creation of a more robust and tangible pricing index for electricity contracts and, with greater participation, will make prices more transparent, robust and further increase liquidity.

In April 2012, in line with its *Building Trust* agenda, SSE announced a series of trading commitments for smaller suppliers of electricity to help them secure contracts for wholesale electricity of the right size and shape to enable them to manage their risk profile.

Key trends in EPM and Electricity Generation

Whether at global, European or GB and Irish levels, the energy sector is experiencing a period of profound change and challenge, with a number of external trends influencing SSE decisions including:

- slow economic growth implying lower electricity demand;
- UK climate change legislation requiring a 34% reduction in greenhouse gas emissions, particularly CO₂, by 2020 (compared with 1990 levels);
- EU 2020 targets requiring 15% of the UK's energy requirements to come from renewable sources (for Ireland, it is 16%);
- projected global growth in coal (25%) and gas (65%) demand by 2035 (IEA), impacting fuel supply security;
- continuing integration of UK energy prices into the wider global market;
- tightening generation capacity in GB as older plant closes, including coal, nuclear and gas plant;
- increasing system variability due to higher penetrations of variable energy sources;
- uncertainties surrounding electricity market reform and a regulatory framework trending towards increased central planning; and
- increasing market integration between GB and Ireland.

In assessing and responding to these various trends, SSE is committed to the delivery of a diverse portfolio of robust assets, from which revenue can be generated on a reliable, long-term basis and which supports future dividend growth.

The main public policy driver is European and GB-led decarbonisation policy. In line with the energy 'trilemma', this must be carefully balanced by the need for supply security, both in terms of fuel security and capacity availability and the need for energy affordability and competitiveness. To achieve this tripartite objective, SSE recognises the need for a diverse, sustainable and complementary generation and fuel portfolio. It is, therefore, focused on maintaining a range of options that will meet policy goals, while being consistent with its financial goal of sustained real dividend growth. Retaining options is important but must also be balanced by a focus on selected areas of competitive advantage to SSE.

Managing an energy portfolio

SSE typically needs around 10 million therms of gas per day to supply its customers and to fuel its power stations, and around 150GWh of electricity per day to supply its customers. It is the role of Energy Portfolio Management to acquire the necessary energy to meet this demand. In focusing on the competitive and sustainable procurement of energy, it seeks to meet the needs of Generation and of Retail customers and to maintain a diverse portfolio of energy options to ensure the effective spread of risk.

Managing energy procurement risk is a key challenge as it is heavily influenced to varying degrees by a multitude of national and international factors including: demand growth/decline, the global economy, fuel supply disruptions, international affairs such as Libya, nuclear availability, CCGT demand, shale gas, and Liquefied Natural Gas.

In managing this risk, Energy Portfolio Management has three primary routes for energy procurement:

- assets: upstream gas exploration and production, coal production, renewables, forests and agriculture;
- contracts: gas producer contracts, LNG capacity, power purchase agreements, solid fuel contracts; and
- wholesale trading: where energy contracts are transparently traded on international exchanges.

By optimising this diverse portfolio, SSE ensures that its customers are protected from the considerable volatility that exists in global markets, while ensuring adequate returns to support its commitment to sustained real dividend growth.

Meeting longer-term energy requirements

Fuel supply contracts play a key part in helping SSE to meet its customers' needs and contribute to the long-term stability of its energy portfolio. Long-term fuel supply contracts also support a stable and confident market, which supports investment in new gas-fired generation. Over the past year SSE has secured two significant long-term fuel supply contracts including:

- a 10-year gas supply agreement of 790 million cubic metres (mcm) (292 Mth) per annum with Shell Energy Europe ('Shell'), commencing in 2015. The gas will be supplied as a firm delivery of 800,000 th/day, at a price linked to prevailing prices in the natural gas market; and
- a 10-year contract with Statoil for the annual supply of 500mcm (185 Mth) of natural gas to be delivered to SSE's Peterhead power station via the St Fergus gas terminal. Delivery of gas is due to begin in the final quarter of 2012 with the price of the gas also linked to prevailing prices in the natural gas market. The contract also contains provisions to allow the supply of gas to be diverted to help meet SSE's other requirements if Peterhead is undergoing maintenance or repair work.

The structure of these agreements fits well with the gas purchasing profile SSE needs to support its business contracts and generation requirements. They provide an excellent opportunity to cover a portion of future gas needs with an attractive pricing structure and minimal risk.

SSE's contracts with Shell and Statoil add to a number of arrangements agreed in recent years, including the 15-year tolling agreement with Marchwood Power Ltd which commenced in 2009, and the 2008 extension of the contract for electricity output from Seabank Power Ltd.

Furthermore, SSE's investment in renewable energy sources across the UK and Ireland provides long term energy supply with no fuel purchasing requirement and a hedge against the volatility in fossil fuel markets. During 2011/12 the energy produced by SSE's renewables portfolio was equivalent to 260m therms of gas. Renewables, coupled with existing and future investments in exploration and production assets, are an increasingly important source of energy for SSE.

In recent years LNG has come more to fore in the UK representing around one quarter of gas entering the National Transmission System in 2011. As a further diversification to its long-term energy contracts, SSE is proactively investigating options for booking LNG regasification capacity.

Principles for management of SSE's Generation portfolio

During 2011 SSE defined its long-term priorities in Generation as being flexibility in operations and a 'greening' of production. The establishment of these priorities clearly summarises SSE's ambitions and is underpinned by six core principles that direct the operation of, and investment in, its Generation portfolio:

- **compliance:** with all safety standards and environmental requirements;
- **capacity:** to meet the electricity needs of domestic and small business customers;
- **diversity:** to avoid over-dependency on particular fuels or technologies;
- **availability:** to respond to customer demand and market conditions;
- **flexibility:** to ensure that changes in demand for electricity can be addressed; and
- **sustainability:** to deliver an overall 50% cut in the CO₂ intensity of electricity produced.

Playing to its strengths is an important focus for SSE as it ensures capital and management resources are employed in areas and at stages where it best retains competitive advantage, maximises shareholder value and supports continued dividend growth.

A decision to exit nuclear power development

In its Annual Report 2011, SSE said that: 'the cost, development issues and timetable and operational efficacy of nuclear power stations all require the greatest possible scrutiny before a commitment to invest in new nuclear power stations can be made'.

It was against this background that SSE announced in September 2011 its intention to dispose of its 25% stake in NuGeneration Ltd, the joint venture company established to develop proposals for a new nuclear power station in West Cumbria. In focusing on its strengths, SSE concluded that, for the time being, its resources are better deployed on business activities and technologies where it has the greatest knowledge and experience.

In February 2012, the sale - to NNB Development Company S.A. - was concluded for an upfront cash consideration of £5.75m, with a further contingent payment of £1.25m dependent on progress with the development of the West Cumbria site.

While SSE may become involved in nuclear again at a future date, either as an investor or as a purchaser of nuclear-generated electricity, its Generation investment plans for now are focused on a diverse range of options including renewable energy, gas-fired generation, plant with carbon capture and storage and developments with solid fuel.

Maintaining a diverse Generation portfolio

The way in which energy is converted to electricity is changing, primarily driven by policy drivers directing decarbonisation. There is no 'one size fits all' solution to the achievement of this objective; rather it will require a broad portfolio of solutions, including conventional and renewable generation and, where feasible, carbon abatement technologies. With its focus on diversity and sustainability, SSE continues to operate and develop a variety of options that play to its strengths and capabilities.

The practical application of its generation principles means SSE's portfolio comprised at 31 March 2012:

- 4,470MW of gas- and oil-fired capacity;
- 4,370MW of coal-fired capacity (with biomass co-firing capability); and
- 3,020MW of renewable (hydro including pumped storage, wind and dedicated biomass) capacity.

With this portfolio SSE has the greatest diversity in fuels for generating electricity among UK generators, which enables it to:

- avoid dependency on a single technology or commodity;
- have a balanced portfolio with significant optionality in the management of its power stations; and
- manage effectively the risks inevitably associated with primary fuel procurement.

Management of primary fuel procurement risks is also assisted by the fact that SSE is the largest generator of electricity from renewable sources across the UK and Ireland.

SSE's 31 March 2012 portfolio of 11,860MW of capacity for generating electricity compares

with 11,290MW the year before. During 2011/12, SSE:

- added 495MW of new onshore wind farm capacity as a result of its investment programme;
- commissioned over 180MW of new offshore wind farm capacity at Walney and Greater Gabbard (this excludes capacity in disputed turbines at Greater Gabbard); and
- sold 96.8MW of onshore wind farm capacity in April 2011 the majority of which had no SSE power purchase contracts and took a small windfarm at Spurness off-line for re-powering.

Maximising the capability of SSE's Generation portfolio

In order to deliver the long-term value and reliability of its Generation portfolio and to better inform its decision-making process, SSE has developed its purpose-built Engineering Centre of Excellence. Its objectives are to:

- support safe operation of power generating plant;
- help deliver increased availability and performance of key plant; and
- mitigate project risk with optimum design solutions and technology choice.

A primary output of the centre, through its Equipment Performance Centre (EPC), is the bespoke asset management model which analyses almost 500 million data points every hour, allowing for the early identification and resolution of potential plant safety and availability risks. The EPC has enabled a number of early interventions which previously may have led to significant forced outages. The first wind farms were connected to the EPC during 2011 and predictive monitoring trials are currently in progress, specifically looking at the operating performance of each SSE wind turbine.

With ever-increasing knowledge as to the performance and capability of its portfolio, SSE can ensure the right long-term decisions are made to deliver an efficient, flexible, low carbon generation portfolio which plays to the company's strengths and experience.

Improving delivery of Large Capital Projects

It is through maintaining a breadth of opportunities that SSE can take forward the best investments and achieve the strongest possible returns to support dividend growth. SSE is focused on the safe, sustainable and timely execution of its major project portfolio, delivering business revenues and shareholder value.

To meet this objective SSE has developed a Large Capital Project Governance Framework, which ensures that all of its major investment projects are governed, developed, approved and executed in a consistent and effective manner. Through the rigorous implementation of this framework, SSE is demonstrating industry-leading performance and delivering on its business goals as planned.

A further dimension of the Large Capital Project framework is designed to inform and optimise the stage at which SSE enters the project development cycle, which can range from asset purchases, to new build, to long-term electricity contracts. This supports SSE in identifying the point of entry where it can best maximise value and competitive advantage.

How SSE's gas-fired power stations performed

SSE owns 4,470MW of gas- and oil-fired electricity generation capacity, including its share of joint ventures.

During 2011/12, SSE's principal wholly-owned gas-fired power stations (Keadby, Medway and Peterhead) achieved 94% of their maximum availability to generate electricity, excluding planned outages, compared with 88% availability in the previous year. In addition to SSE's ongoing focus on high operational performance, availability was increased by the return to service of Keadby in early May 2011 following the successful repair of a generator fault.

In addition to its wholly owned gas generation, SSE has joint venture interests in:

- Marchwood, the 840MW CCGT owned by Marchwood Power Ltd, a 50:50 joint venture between SSE and ESB International. During 2011/12, the plant achieved 94% of its maximum availability to operate during the year, compared with 93% the previous year; and
- Seabank, the 1,140 MW CCGT, owned by Seabank Power Limited, a 50:50 joint venture between SSE and Cheung Kong Infrastructure Holdings Limited. During 2011/12, the plant achieved 86% of its maximum availability to operate during the year, down from 96% the previous year.

All of the electricity output at both plants is sold under contract to SSE.

The amount of electricity generated by SSE at gas-fired power stations in which it has an ownership or contractual interest, including CHP, was 21.6TWh in the year to 31 March 2012 (including 12.5TWh from wholly-owned stations), compared with 29.3TWh in the previous year (including 13.3TWh from wholly-owned stations).

This reduction in output was driven by very high wholesale gas prices in the course of the year which had a significant negative impact on spark spreads, which averaged less than £1/MWh over the year. Spark spread is the difference between the cost of gas and the price of electricity produced from it. Because it was very low over the period, the stations were operated less frequently. This was consistent with the Department of Energy and Climate Change's *Energy Trends*, published in March 2012, which indicated a 17.4% reduction in gas used for electricity generation.

However, a record year for SSE's renewable generation, alongside increased output from its coal-fired power stations, mitigated the impact of spark spreads by displacing higher-cost CCGTs and highlighted the significant benefits to customers of SSE's diverse generation portfolio.

Developing flexibility in gas-fired generation

With more penetration of renewable generation in the GB system, the stations at Peterhead, Keadby and Medway have, increasingly, been required to operate on a more flexible 'two shift' basis. This requirement will grow in the medium-term. To increase flexibility, SSE is applying modifications to support more frequent 'two shifting'.

Against this background, and following the sustained period of low spark spreads, SSE has decided to undertake a comprehensive programme of upgrade work to support more flexible operations at its Keadby and Medway power stations from 2013 onwards. To allow this work to be carried out, it suspended electricity generation at the stations at the end of March 2012 (see also exceptional items in the Finance section). The work that will be carried out follows a similar and successful programme undertaken at Peterhead power station in 2011.

Investment options for gas-fired power stations

Irrespective of current market circumstances, gas will play an increasingly important role in electricity generation, providing vital flexibility to support the increasing amount of generation from on- and offshore wind farms required to deliver renewable energy and climate change targets.

As stated in the EU Energy Roadmap 2050 'gas will be critical for the transformation of the energy system' and, in particular, the power sector. Many factors support this, including its relatively low capital costs, flexibility, short construction time, high thermal efficiency and its status as the cleanest of the fossil fuel technologies.

Recognising this future role for gas in a diversified generation portfolio, SSE continues to develop a range of CCGT options for both the medium and long-term.

SSE's most advanced CCGT option, Abernedd in South Wales, secured its construction and operation consents in February 2011. SSE is pursuing a single CCGT unit of up to 470MW, which it considers the most economic option in the context of the site and the medium-term

outlook for gas-fired generation. While an invitation to tender was issued in late 2011, an investment decision will not be taken until the second half of 2012 at the earliest and will depend, amongst other things, on the emerging shape of the electricity market following the UK government's proposed electricity market reforms. This means that the power station, if built, will not be operational before 2015.

Furthermore, SSE has a number of high potential CCGT development options located at existing generation sites including Keadby, Ferrybridge and Fiddler's Ferry, plus Seabank, where SSE has recently acquired adjacent land for possible further development. These locations offer many attractive characteristics, including established grid and gas connections, availability of cooling water and land area. These and other potential sites across GB and Ireland mean SSE has a wide range of CCGT development options for independent or co-development.

Additional factors when considering the development and operation of CCGTs include fuel procurement, technical requirements for plant flexibility and future carbon abatement. In assessing these options, SSE is continuing its policy of rigorous analysis to ensure the right investment decisions are made and then effectively delivered. It is against this backdrop that:

- Barking Power Ltd, in which SSE has a 30% interest, is mothballing capacity at its 1,000 MW power station; and
- Derwent Cogeneration Limited, in which SSE has a 49.5% share, is planning to cease operation at its CHP plant during 2013. The plant provides heat to the nearby Celanese Acetate's Spondon factory in Derbyshire.

While SSE agrees with the important role of gas-fired generation in both the company's and the overall UK portfolio, it believes the right market signals must be apparent if the necessary investment decisions are to be taken, particularly the introduction of a well functioning capacity mechanism under electricity market reform proposals.

How SSE's coal-fired power stations performed

During 2011/12, SSE's 4,370MW of coal-fired power stations, located at Fiddler's Ferry, Ferrybridge and Uskmouth, generated 16.8TWh of electricity, compared with 13.6TWh in the previous year.

This increase in output took place against the backdrop of global and national energy market volatility and demonstrated the considerable value of SSE's coal-fired stations as part of a diverse portfolio through their operational flexibility, availability and reduced reliance on imported gas.

The stations achieved 89% of their maximum availability to generate electricity, excluding planned outages, compared with 84% in the previous year. Availability was primarily impacted by a number of emergent issues identified during scheduled outages at Ferrybridge and Fiddlers Ferry but all units were available during the 2011/12 winter period.

SSE Mineral Solutions owns and operates an ash separation plant at Fiddler's Ferry, where fresh and stored ash produced by the power station can be processed into marketable minerals and materials such as cement substitutes. While SSE fundamentally believes in the inherent value of the asset, overall market demand for its products is such that the business is trading at an ongoing loss. However, as coal-fired stations close, this situation may change as the value of ash as a cement substitute increases. Accordingly, SSE announced in April 2012 the mothballing of the plant until conditions improve sufficiently to support the business. This will have no impact on the continued operation of Fiddler's Ferry power station.

Looking to the future of coal-fired power stations

As exemplified in 2011/12, coal-fired power stations will continue to have a significant part to play in maintaining secure supplies of electricity and ensuring customers benefit from the most cost-effective portfolio of fuels. Additional value also accrues to SSE's coal-fired power sites as they benefit from key infrastructure including access to water, transport links, and electricity network connections.

All of the capacity at Fiddler's Ferry and Uskmouth and half of the capacity at Ferrybridge (over 3,300MW in total) complies with the EU Industrial Emissions Directive and can operate for 17,500 hours between 2016 and 2023.

However, consistent with the UK's climate change abatement policies, as set out in the White Paper *Planning our Electric Future*, it is SSE's view that no new coal-fired power generation plant should be built in the UK without CO₂ abatement and that no coal-fired plant without such abatement should remain operational beyond 2030.

SSE's desire to deliver the full current and future value potential of these sites, while meeting CO₂ abatement targets, means operational and investment decisions in its coal fired power plants will be influenced by four main factors:

- the need to maintain and improve the day-to-day performance of the stations while they are operational;
- the prospects for the development of other solid fuels;
- the UK Government's final determination on proposed levels of banded support under the Renewables Obligation between 2013 and 2017; and
- the continuing UK government commitment to the development of Carbon Capture and Storage (CCS) technology.

Generating electricity from 'multi-fuel'

The potential of the sites of SSE's coal-fired power stations was demonstrated in April 2012 when SSE and Wheelabrator Technologies Ltd entered into a 50:50 joint venture to develop a new £300m multi-fuel generation facility at Ferrybridge. The joint venture – Multifuel Energy Ltd (MFE) – expects to begin full construction of a 68MW multi-fuel facility later this year and to complete it in 2015. When operational, the electricity generated by the plant will be sold to SSE.

MFE has entered into a long-term fuel procurement contract with 3SE (SSE's joint venture with Shanks Plc), which will provide processed waste-derived fuels using waste taken from nearby Barnsley, Rotherham and Doncaster Councils. To support this contract, 3SE intends to develop a new Mechanical Biological Treatment and Anaerobic Digestion facility. Subject to planning permission, this is expected to be operational by 2015.

Multi-fuel technology is a tried and tested way of generating clean, base-load power. This new multi-fuel plant will provide additional diversity to SSE's generation portfolio and make a useful contribution to ensuring there are reliable energy supplies in the future. The transactions that make up this project represent a strong partnership between major players in the multifuel sector, who are committed to making a significant level of investment in this technology.

Between them, the companies involved have extensive experience in sourcing and processing waste, constructing and commissioning multi-fuel technologies, and operating generation plant. This partnership creates a valuable platform to develop multi-fuel technology in future.

Maintaining additional options for coal-fired power stations

In addition to multifuel, SSE's investment strategy for Fiddler's Ferry, Ferrybridge and Uskmouth is as follows:

- following completion of a front end engineering design (FEED) study, it is investing in NOx emissions reduction technology for one unit of 500MW at Fiddler's Ferry to establish the feasibility of the various options for operating the unit up to and beyond 2023;
- it is continuing to invest in the operation and maintenance of the three stations with a total of £60.1m invested in the stations during 2011/12;
- it is investigating the potential to increase co-firing with biomass at Fiddler's Ferry, subject to the RO banding review and the impact on future operation arising from the

- Industrial Emissions Directive; and
- it is operating Europe's largest post-combustion CO₂ capture trial at Ferrybridge, in collaboration with Doosan Babcock and Vattenfall, following its completion during 2011/12 (see 'Making progress on Carbon Capture and Storage' below).

Making progress on Carbon Capture and Storage (CCS)

EU energy policy is primarily driven by the decarbonisation agenda and will broadly require a halving of CO₂ emissions by the electricity sector every decade between now and 2050. Ensuring that this transition is achieved, while retaining supply security and affordability, will require the continued involvement of carbon-based fuels including coal and gas.

In the near term, coal-fired power stations still have a crucial role to play in maintaining secure supplies of electricity as they provide capacity availability, flexibility and diversity. However, in the medium term, the use of coal to generate electricity will depend on the extent to which CCS technology can be applied to abate CO₂ emissions.

In the longer-term, CCS technology will need to be applied as widely as possible if targets for reducing CO₂ emissions are to be met and has become a key consideration when planning the development of gas fired generation. Consequently, the development of viable carbon capture technology is central to the UK's climate change and energy security objectives and this is reflected in the UK government's welcome inclusion of gas-fired generation plant in its CCS demonstration programme.

Against this background, SSE has two CCS projects under way:

- Coal at Ferrybridge:** This project, Europe's largest post-combustion CO₂ capture trial, came into full operation in early 2012. The project is a collaboration between SSE, Doosan Power Systems and Vattenfall, and is the first of its size to be integrated into a working power plant in the UK. The plant bridges the gap between pilot-scale trials and the commercial-scale demonstration projects envisaged by the UK government. It captures 100 tonnes of CO₂ per day from the equivalent of 5MW of coal-fired power generating capacity. The significance of the project lies in its scale and its ability to demonstrate the operational characteristics of capture plant on an actual power station; and
- Gas at Peterhead:** In April 2012, the UK government announced a new competition for funding of commercial-scale CCS projects in the UK. SSE is working with Shell UK to develop a gas CCS project at SSE's gas-fired power station in Peterhead. The project aims to design and develop a full chain, post-combustion CCS facility which will be capable of capturing CO₂ from one 385MW combined cycle gas turbine unit. It is planned that the CO₂ will then be transported to the Shell-operated Goldeneye gas field in the North Sea using, as far as possible, existing infrastructure. With works already undertaken, the Peterhead project should be in a position to begin a full FEED study in the second half of 2012, positioning it as a leading contender for the new CCS competition. The correct funding package will be necessary for the project to go ahead, and it is also being considered by the European Commission to receive funding under the EU's NER (New Entrant Reserve) scheme to support CCS and renewable energy projects across the EU.

Generating electricity from alternative sources like biomass

In October 2011, the UK government released proposals for the level of banded support under the Renewables Obligation between 2013 and 2017. This included proposals for:

- dedicated biomass (1.5 ROCs);
- biomass conversion (1.0 ROCs);
- co-firing biomass (0.5 ROCs); and
- enhanced co-firing, where biomass is used to generate at least 15% of gross output (1.0 ROCs).

The outcome of this consultation will have a significant influence on SSE's plans for developments in biomass, particularly enhanced co-firing, at its coal-fired power stations.

Under the proposals, qualifying output from dedicated regular biomass plants will continue to attract 1.5 ROCs per MWh. SSE's plant at Slough has a current generating capacity of 80MW and remains the UK's largest dedicated biomass energy facility. During 2011/12, it produced 156GWh of electricity from renewable sources, compared with 200GWh during the previous year.

Participating in the EU Emissions Trading Scheme

Phase II of the EU Emissions Trading Scheme (EU ETS) began on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE has an allocation of 18.9 million tonnes of CO₂ emissions allowances per calendar year. During 2011/12, the price of allowances ranged from around €6/tonne to around €17/tonne.

SSE's emissions allowances requirement for 2011/12, beyond those apportioned from the EU ETS allocation, was 5.3 million tonnes. This compares with 6.5 million tonnes in the previous year. With high gas prices and low spark spreads for gas generation, SSE used the portfolio diversity provided by its coal plants to ensure least cost power generation for its customers. However, increased CO₂ emissions from coal generation were offset by reduced emissions from gas-fired stations generation and record volumes of renewable output.

Assuming current market conditions persist SSE expects a similar output from its coal plant during 2012/13, after which point it anticipates a substantial reduction in coal related emissions as gas plants such as Keadby and Medway return to service, additional renewables are commissioned and coal plants use up their allocated running hours under the EU's Industrial Emissions Directive. This means SSE remains on track to half its CO₂ emissions by 2020.

From 2013, all of the CO₂ emissions permits for electricity producers will be auctioned. Moreover, the UK government's introduction of the carbon price floor provides a clear market signal for investment in low carbon and carbon sequestration investments. Proposals for the introduction of a 'floor' for the price of allowances in the electricity sector will result in an effective carbon price of £16/tonne in 2013, rising to around £30/tonne in 2020 (in 2009 prices). This further signals the importance of carbon capture and storage for coal and gas generation in ensuring the achievement of long-term carbon abatement targets.

Tackling emissions of CO₂ in thermal generation

SSE's priorities in Generation are to be a greener and more flexible non-nuclear electricity generator. Greener means effectively halving its carbon footprint every decade between now and 2050. As a non-nuclear generator, this goal will be achieved through a stable, managed transition utilising a diverse range of solutions including:

- expanding biomass co-firing at coal-fired stations;
- demonstrating carbon capture technology for both coal and gas;
- increasing significantly the output of renewable electricity; and
- ensuring industry-leading operational efficiency of its generation portfolio.

In 2011/12, emissions of CO₂ from power stations in which SSE has an ownership or contractual interest totalled 24.9 million tonnes, compared with 25.3 million tonnes in the previous year. SSE's CO₂ emissions data is externally verified by a UK Accreditation Service (UKAS) accredited organisation.

SSE's first target is to reduce the amount of CO₂ per kilowatt-hour of electricity generated at plant in which it has an ownership or contractual interest by 50% between 2006, the first full year after it acquired coal-fired power stations, when it was just over 600g/kWh, and 2020. On this basis, its CO₂ intensity in 2011/12 was 531g/kWh, compared with 504g/kWh in the previous year, primarily reflecting increased output from coal-fired power stations.

More broadly, SSE has formed a partnership with other European energy companies calling for the EU to adopt a greenhouse gas emissions reduction target of 25% (up from 20% at present) as part of a long-term move away from fossil fuel-based electricity generation and full decarbonisation by 2050. As the 2020 deadline nears, SSE considers it critical that the

institutions of Europe provide investors with certainty regarding targets and the policy framework beyond the current 2020 cliff edge.

Fulfilling the potential of renewable sources of energy

The way energy is transformed into electricity is evolving. While decarbonisation, supply security and affordability are of equal importance, the primary European and UK energy policy intervention is on decarbonisation. The targets that underpin this include the binding EU carbon abatement target of a 20% reduction in CO₂ emissions by 2020, compared with 1990 levels, coupled with more challenging targets over and above this that have been adopted by both the UK and Ireland. These targets accompany the UK's and Ireland's 15% and 16% renewable energy targets respectively.

While achievement of the renewable energy targets is spread across electricity, heating and transport, it is the electricity sector that has proven itself most adept at responding to the policy. This has been evidenced most recently by DECC's Energy Trends 2011 which saw renewables' share of generation output in the UK increase to a record 9.5%, coupled with a one-third increase in capacity for renewable energy over the year.

In its *Renewable Energy Roadmap*, the UK government made clear its commitment to increasing the deployment of renewable energy across the UK, stating that 'renewables will make the UK more energy secure, will help protect consumers from fossil fuel price fluctuations, is driving investment in new jobs and businesses in the renewable energy sector, as well as keep us on track to meet our carbon reduction objectives for the coming decades'.

With this clear vision, public policy is strongly aligned with the renewable energy targets, providing financial support via the Renewables Obligation in the UK and the Renewable Energy Feed in Tariff in the Republic of Ireland. Furthermore, the UK government's current work on electricity market reform is explicitly intended to make sure that low carbon technologies, such as energy from renewable sources, become a more attractive choice for investors. The effect of appropriate policy supports should not be undervalued, and the viability of the renewables industry remains dependent on their continued existence.

With the exception of hydro, SSE believes that the UK's revised ROC levels are appropriate to changing market conditions, once they are complemented by an effective carbon floor price and cost reductions in the supply chain for renewable energy. It is also of the view that, given hydro's flexibility, storage capacity and investment economics, a ROC of around 1.0/MWh is required to sustain investment in this important source of renewable energy.

With this continued strong political support for increased renewable penetration in the portfolio mix, SSE does not perceive any weakening of public policy commitment to renewable energy in either the UK or Ireland. Nevertheless, it remains one of SSE's priorities to avoid dependency on a single generation technology or related financial support.

Increasing energy from renewable sources

In January 2012 SSE announced that ongoing progress in the construction of its large capital projects meant that its onshore wind farm capacity had exceeded its conventional hydro electric capacity for the first time. It now has over 1,300MW of onshore wind farm capacity for the first time. That total compares with just 40MW of wind power just six years ago.

Good progress made on SSE's land mark projects, including Clyde, Griffin and Gordonbush in Scotland and Slieve Kirk in Northern Ireland, means that 495MW of onshore wind farm capacity became operational during 2011/12. Progress at Greater Gabbard and Walney has taken SSE's net offshore wind farm capacity to 187MW.

At 31 March 2012, SSE had 3,020MW of renewable energy capacity in the UK and Ireland, including its share of joint ventures, comprising:

- 1,150MW conventional hydro;
- 1,303MW onshore wind;
- 187MW offshore wind;

- 80MW dedicated biomass; and
- 300MW pumped storage.

Of this, output from over 1,500MW qualifies for ROCs, the key financial support scheme for renewable energy in the UK, with:

- 1 ROCs/MWh for qualifying hydro and onshore wind;
- 1.5 ROCs/MWh for qualifying dedicated biomass; and
- 2.0 ROCs/MWh for qualifying offshore wind.

In advance of planned revisions to ROC banding, most of SSE's existing construction sites will be accredited before the April 2013 value revision and, as such, will be eligible for the existing 20 year support level.

Following a very successful year of constructing renewable energy projects, SSE remains on course to own around 3,500MW of renewable energy capacity that is in operation or under construction in the UK and Ireland by the end of 2012/13. This will mean SSE is making solid progress in line with its 'green' priority and is supporting the achievement of CO₂ abatement targets, maximising the potential of indigenous and free renewable resources, and reducing consumer exposure to the price volatility of internationally traded fossil fuels.

Producing electricity from renewable sources

Total electricity output from all of SSE's renewable resources, including conventional hydro electric schemes, onshore wind farms, offshore wind farms and dedicated biomass plant was 7,617GWh during 2011/12, compared with 4,411GWh in 2010/11. This 73% increase is a reflection of additional generation capacity coming in to operation and the wet and windy weather conditions experienced during the period. In energy terms, it is equivalent to 260 million therms of gas.

Producing electricity from hydro electric schemes

SSE owns and operates more than 50 hydro electric power stations in Highland, Perth and Kinross and Argyll and Bute, with just over 1,150MW of capacity. A further 300MW comes from its pumped storage facility at Foyers, on Loch Ness.

Over the last 30 years, electricity output from conventional hydro electric schemes has ranged from a high of 3,896GWh to a low of 2,429GWh. However, 2011/12 was an exceptional year, delivering a new record hydro electricity output of 4,262GWh. This success is a result of SSE's continued investment in refurbishment of its hydro schemes in the north of Scotland, coupled with a particularly high amount of rainfall and snowmelt in each hydro catchment.

During 2011/12 (previous year's comparison in brackets):

- total output from all of SSE's conventional hydro electric schemes was 4,262GWh (2,558GWh); and, within this,
- total output from SSE's hydro electric capacity qualifying for ROCs – just over 500MW – was 1,954GWh (1,193GWh).

As at 31 March 2012, the total amount of water held in SSE's reservoirs which could be used to generate electricity was 60% of the maximum, compared with 61% in the previous year.

Restoring generation at the Glendoe hydro electric scheme

Work on the restoration of electricity generation at the 100MW Glendoe hydro electric scheme is continuing to progress well, although it is a very substantial project which has required considerably more investment than originally expected. The restoration works arose due to a rock fall which blocked the tunnel carrying water from the reservoir to the power station, stopping operation. The process of re-filling the reservoir is expected to begin shortly, with electricity generation resuming in the middle of the calendar year.

Meanwhile, SSE is continuing to pursue its legal and insurance options following the loss of electricity generation in August 2009. The net cost to SSE of the restoration work will not be

known until the works and the insurance and legal processes are complete. The actual and projected rate of return on the total net investment at Glendoe, including the original construction cost of £160m, will depend on this and on the prices achieved for the electricity produced. These prices should, in turn, reflect the strategic nature of the asset and its ability to respond rapidly to help meet changes in electricity demand.

Developing new hydro electric schemes

Through the combination of investment and ideal weather conditions, hydro-sourced generation has demonstrated its continuing success as a valued source of renewable energy. Investment in such schemes should continue to be attractive as they provide firm capacity and fast-response flexibility, complementing variable output from the growing number of wind farms - characteristics that the market should value more in the future.

With its considerable operational experience in this technology, SSE is advancing a number of development opportunities:

- **Kildermorie:** SSE has consent to develop a new 7.5MW hydro electric power station near Ardross in Ross-shire. It will consist of a new dam and storage reservoir, a buried pipeline and a semi-buried powerhouse with associated tailrace. Construction is scheduled to commence later in 2012, but is subject to the outcome of the current ROC banding review;
- **Sloy:** SSE has consent to develop a 60MW pumped storage scheme as part of its 152MW Sloy power station, near Loch Lomond. This means that, in addition to electricity produced from water collected and held in the Loch Sloy reservoir, Sloy will be able to generate an additional 100GWh of electricity in a typical year using water pumped from Loch Lomond to the reservoir. A final decision on this circa £40m investment will be made following review of technical and engineering assessments, which are now nearing completion and following consideration of decisions relating to electricity market reform;
- **Coire glas:** In February 2012, SSE submitted an application to the Scottish Government for consent to construct a new pumped storage scheme of up to 600MW capacity to the north-west of Loch Lochy in the Great Glen. This scheme has the potential to produce 1,000GWh of electricity in a typical year and would be the largest hydro project to be built in Scotland, and the first brand new pumped storage scheme to be developed in Great Britain in almost 40 years. The scheme would require the construction of a new dam and upper reservoir at Loch a' Choire Ghlais (the upper reservoir). A powerhouse complex would be constructed underground, together with a series of tunnels to provide access and convey water between the lower reservoir (Loch Lochy) and the upper reservoir. Once completed, the scheme would have minimal visual impact in the Great Glen.
- **Balmacaan:** SSE is also proposing to develop a 300MW-600MW pumped storage scheme at Loch Ness. While independent of Coire glas, the two projects are managed by a single development team. Balmacaan has recently completed its pre-planning consultation on its environmental impact assessment and is expected to be submitted for planning during 2012.

Construction of Coire glas and/or Balmacaan would not begin before 2014 at the earliest and, subject to planning consent among other factors, SSE will have the option to build neither, one or both of the schemes.

Furthermore, progressing these schemes and other similar developments will be dependent upon a satisfactory public policy and regulatory framework, including the ROC banding review and the transmission charging regime changes envisaged by Ofgem's Project TransmiT.

Adding to onshore wind farm capacity and production

At 31 March 2012, SSE owned 1,303MW of onshore wind farm capacity and output during 2011/12 was as follows (previous year's comparison in brackets):

- 1,418GWh in the UK (739GWh); and
- 1,353GWh in the Republic of Ireland (914GWh).

Total electricity output from onshore wind-based generation increased from 1,653GWh in 2010/11 to 2,771GWh in 2011/12. The key drivers of this increase were the completion of an additional 495MW of new generation and the significantly windier weather relative to 2010/11. Windier conditions also saw load factors rise above 30%, compared with 24% in 2010/11.

On average, the turbines at SSE's onshore wind farms in the UK and Ireland achieved 97% of their maximum availability to generate electricity which has been consistent over the past three years.

Delivering new onshore wind farms

In meeting its commitment to high quality project delivery, SSE has made significant progress in 2011/12 with the completion of its wind farms at Griffin (156MW) in Perthshire and Gordonbush (70MW) in Sutherland. Their total capital cost was £340m and they are expected to produce around 640GWh of electricity in a typical year.

At Clyde, 100 turbines with a capacity of 230MW are producing electricity. The remaining 52 turbines, which will bring the project to its 350MW total, are expected to be completed around the end of summer 2012. The project is expected to cost around £500m and produce over 1,000GWh of electricity in a typical year.

Also during 2011/12, SSE constructed and commissioned the 27MW Slieve Kirk wind farm in Northern Ireland and the 12MW Rathcahill wind farm located in the Republic of Ireland.

Developing new onshore wind farms

At 31 March 2012, SSE's onshore wind farm portfolio comprised around (net):

- 1,303MW in operation;
- 380MW in construction or pre-construction; and
- Over 550MW with consent for development.

As the current tranche of onshore wind farms reaches completion during 2012/13, SSE is focusing on the alignment of its development pipeline in to strategic areas. These areas facilitate the continued efficient allocation of resources and economies of scale. The following fully consented projects in the UK and Ireland are components of these areas:

- **Strathy North** (75MW) – located near Strathy village, Sutherland, this project received consent from Scottish Ministers in November 2011. The wind farm, which is near Gordonbush, will comprise 33 turbines over an area of around 950 hectares within Strathy North Forest, which is a commercial conifer plantation. The project is anticipated to enter construction in the next 18 months.
- **Keadby** (68MW) – is a fully consented project acquired from RES in May 2011. Adjacent to SSE's Keadby gas-fired power station, preparatory works began for the wind farm in February 2012, with construction expected to start later this year.
- **Calliachar** (32MW) - This fully consented site, adjacent to SSE's Griffin project in Perthshire, was acquired by SSE in 2010. SSE subsequently sought consent to increase the tip height of the turbines from 100m to 109.8m. In January 2012, consent was received from Perth and Kinross Council Development Control Committee subject to conditions. Work is ongoing to satisfy the conditions and construction is getting under way.
- **Glenconway** (18MW) – As part of the Slieve Kirk strategic area located in County Derry, Northern Ireland, Glenconway will add a further 18MW to the existing 27MW completed during 2011/12. The project began construction in early May and is expected to be completed during 2013.

In total, onshore wind farm projects in or near construction will add more than 150MW to the existing portfolio in 2012/13. In addition, SSE has over 550MW of fully consented projects across GB and Ireland, including its 110MW share of the 170MW Galway Wind Park.

The amount with consent for development also includes SSE's share of the capacity

contained in the proposal by Viking Energy, the joint venture between Viking Energy Ltd (which is 90% owned by the Shetland Charitable Trust) and SSE to develop a wind farm with a capacity expected to be around 370MW (SSE's share being 185MW) on Shetland's Central Mainland. This project has recently received consent from Scottish Government Ministers, with a reduction in the number of turbines to 103. The Viking Energy Partnership will now prepare reports for its shareholders so they can consider the funding of the next steps in the project.

This provides a portfolio of options whereby SSE may select developments that deliver the best value and continue to support dividend growth.

In addition to its consented portfolio, SSE continues to assess high potential developments and has submitted for approval by the relevant planning authorities in the UK and Ireland proposals for onshore wind farms with a total capacity of over 500MW including Clyde Extension (171MW) and Dalnessie (70MW).

Progress on all of SSE's renewable projects is dependent on a continued favourable planning, policy and regulatory environment. The projects themselves would be developed over the next few years.

Maximising electricity output from wind farms

With its onshore and offshore wind farms producing 3,199GWh of electricity in 2011/12, SSE is the largest operator and developer of wind power across GB and Ireland. From its Centre of Engineering Excellence in Renewable Energy in Glasgow, SSE's highly skilled team of professionals ensure that maximum value is derived from its wind assets. Ensuring maximum value is founded in four critical factors, rigorously assessed through the development stages:

- site selection;
- wind analysis carried out by a specialist team;
- site optimisation to maximise output, including turbine layout; and
- turbine selection to match turbine characteristics with wind conditions and ensure reliability.

Carefully assessing each of these criteria ensures delivery of high quality projects, adding to business value and supporting sustained real dividend growth.

Developing options in Scandinavia

Further afield SSE is actively pursuing a 295MW development pipeline in Sweden, of which 80MW has consent for development, and the Nordconnect interconnector. In an early stage of development, Nordconnect is a partnership between SSE, Energi, E-CO, Lyse, and Vattenfall AB to plan, build and operate an HVDC interconnector between Norway and the UK. These projects align strategically to maximise the potential of the European energy market while providing diversity to the portfolio of future SSE renewable development options.

Managing constraint on the electricity system

Constraint occurs when there are limitations in electricity transmission capacity or for reasons of system frequency voltage control or stability. Transmission systems generally experience periods of constraint, and it is this that provides a market signal for additional investment in the grid infrastructure.

During 2011/12, across GB, 6TWh of generation was constrained at a value of around £300m. Of this SSE wind generation was 80GWh or 1.3% of the total constraint over the whole system.

With additional volumes of variable renewable generation on the system, instances of constraint will occur from time to time at different locations. In Great Britain and Ireland an emergent issue centres on equitable compensation for constrained wind.

At times of constraint, generators in Great Britain are required to bid in their constrained generation capacity to National Grid. It has been SSE's policy to bid fair and reasonable

prices at all times for its renewable generation and it believes that this is the equitable approach for all renewable generators and in the best interest of customers.

In Ireland's SEM market, compensation rules for wind generation recognise both the degree of controllability of an individual wind farm and the export capacity guaranteed in its connection agreement with the System Operator. In times of constraint, controllable wind farms are compensated for their lost output at market prices, while Government support payments (REFIT in RoI and ROCs in NI) are paid on the basis of metered output. SSE works with the System Operator to ensure that its wind farms demonstrate the level of response required to be recognised as 'controllable'.

To minimise the impact of constraints, appropriate investment is needed in transmission infrastructure, an issue which is particularly acute in Ireland. At the same time, market arrangements in both GB and Ireland must provide equitable payment for constrained generation.

Creating local value from onshore renewable development

A leading differentiator and a source of pride for SSE is the economic benefit its onshore renewable investments bring to local communities. In particular this year SSE:

- confirmed its ongoing commitment to the Highland region in Scotland with the announcement of 50 new roles created at its regional headquarters in Inverness. The new roles are being created primarily to support SSE's renewable ambitions in the north of Scotland. The local economic and employment value associated with the establishment of a corporate presence in Inverness helps to highlight the benefit of renewable development. SSE believes the new regional headquarters will support its endeavours in working with communities and stakeholders.
- established its Scotland Sustainable Energy Fund, an onshore wind community investment plan. The fund will be worth a potential £90 million over 25 years if SSE is able to realise its ambitions for new onshore wind farms in Scotland. The fund will be available for organisations promoting skills development, community energy schemes and improving the built and natural environment. The fund is in addition to the £150m SSE has already committed to support community projects in Scotland over the 25-year projected lifetime of the company's existing and planned wind farms.

Building new offshore wind farms

Due to the significantly larger scale and cost of both consenting and constructing offshore wind farms compared with onshore, SSE recognises the inherent risks are best managed through partnership arrangements across a portfolio of projects. To this end SSE is building:

- Greater Gabbard, a 500MW development being built by Greater Gabbard Offshore Winds Limited ('GGOWL'), in which SSE has a 50% stake; and
- Walney, a 367MW development being built by Walney (UK) Offshore Windfarms Ltd, in which SSE has a 25.1% stake.

Total electricity output from SSE's offshore wind farms was 428GWh in 2011/12. This was the result of significant progress in the period to 31 March at:

- Greater Gabbard where all 140 turbines were in place, of which 62 had been commissioned and not the subject of any claim and were successfully generating electricity. In addition, 46 of the 52 disputed turbines had also exported power; and
- Walney where all of the phase one turbines have been successfully commissioned and all 51 turbines in the second phase are producing power, of which 28 are fully commissioned.

Progress has continued at Greater Gabbard since the year end and currently 81 turbines which are not the subject of dispute have been commissioned. At Walney, an additional 19 turbines have also been commissioned.

Managing the issues at Greater Gabbard

Significant construction progress was made at Greater Gabbard during the financial year, with all 140 monopile foundations and turbines installed and to date, a total of 127 have produced power. Meanwhile, the third and final electricity export cable has been installed and is undergoing commissioning. All of this means that construction works should be completed, as planned, before the end of this year.

GGOWL remains in a contractual dispute with Fluor Limited, the principal contractor for the wind farm. The dispute relates to the quality of lower foundations (monopiles) and upper foundations (transition pieces) used in the early stages of the development and supporting 52 of the 140 turbines. The contractual dispute centres on:

- the claim by Fluor Limited of around £300m relating to time and costs Fluor Limited alleges it incurred in carrying out additional testing and repairs of some of the welds on these foundations; and
- GGOWL's need for assurance as to the structural integrity of these foundations, which resulted in GGOWL initiating its own programme of offshore testing to determine whether they meet the required contractual standards and will provide a full operating life of at least 25 years.

In relation to the claim by Fluor, GGOWL has submitted what it believes is a very robust defence. A formal arbitration process is beginning and will resolve the dispute in due course.

In relation to the second aspect of the dispute, in October 2011, on the basis of the available evidence, including from its own programme of testing, and independent advice, GGOWL notified Fluor Limited that all 52 of the relevant foundations are defective and do not meet the standard required by the contract between the two companies.

Of these 52 foundations, Fluor Limited previously corrected defects that had been identified in a number of the monopiles before they were installed, and GGOWL believes that these repaired monopiles are sound. The balance of the monopiles and all 52 of the transition pieces are believed to be defective.

GGOWL believes that the onus is currently on Fluor Limited to determine how it proposes to meet its contractual obligation to ensure that the transition pieces and monopiles comply with the contract and that Fluor Limited will be liable for all associated costs. In relation to this, GGOWL has initiated a formal contractual claim against Fluor Limited, which is currently the subject of a formal arbitration process.

Making progress at Walney

The first phase of Walney is operational and commissioning of the second and final phase of the wind farm, with 51 turbines with a total installed capacity of 183.6MW, is now well under way. All of the turbines have now been installed, and all have now exported electricity.

The progress at Walney has set the benchmark for future offshore development, where DONG Energy has constructed the second phase of Walney in the fastest ever time for an offshore wind project. A new record was set for the sector following the installation of all turbines and cables in just five months and 13 days. This marks an important step in the drive toward further industrialising the sector. As a result of this progress it is expected that the full 102 turbine, 367MW wind farm will be completed in the next few months.

Developing more new offshore wind farms

Undoubtedly, offshore wind will play an ever-increasing role in the delivery of low carbon energy for the UK. Already the GB offshore wind market is the largest in the world, with 1.5GW in operation, 2.6GW under construction and a total of 11-18GWs planned by 2020.

SSE has gained valuable experience of offshore wind farm development and construction through the Greater Gabbard and Walney projects, and it is this experience that enables it to exercise informed and disciplined judgement when prioritising projects in its development pipeline. In the near term, the main focus for SSE is the successful and timely completion and

commissioning of these projects. The next two offshore wind farm projects then taking priority are:

- the 500MW Galloper wind farm, close to the existing Greater Gabbard development, a 50:50 partnership with RWE npower renewables; and
- the 1,000MW Beatrice wind farm in the Moray Firth, a 75:25 partnership with Repsol Nuevas Energias UK (25%) (formerly SeaEnergy Renewables).

Through 2011/12, significant progress was made in the planning phases of these projects, with Galloper receiving confirmation from the Infrastructure Planning Commission that it has accepted the Development Consent Order application. At Beatrice, an application for consent to develop the Beatrice offshore wind farm in the Outer Moray Firth has been submitted to the Scottish Government. The application is the first of the Scottish Territorial Waters sites to be submitted for consideration. The proposed wind farm builds on the success of the Beatrice Demonstrator Project and would have a maximum of 142 to 277 turbines, depending on turbine size.

Beyond this, SSE has secured from The Crown Estate rights for the potential development of up to 4.8GW (net) additional offshore wind farm assets later in the decade. Decisions regarding the build out of this pipeline will be reflective of SSE's disciplined approach and focus on taking forward only the best investments and achieve the strongest possible returns to support dividend growth.

Building a supply chain for offshore wind

In order to meet the full potential of the UK's offshore wind resource it is essential to exert downward pressure on the cost of energy through the evolution of a sustainable supply chain. This will include the development of larger and simpler turbines and the effective industrialisation of the sector.

SSE has recently invested in a broad range of new initiatives to increase the effectiveness, and decrease the cost, of offshore wind deployment, including:

- taking a leading role in forming the 'G9' group of the world's largest renewable energy developers, which have come together to place health and safety at the forefront of all offshore wind activity and developments;
- consent from North Ayrshire Council to construct an offshore test facility at Hunterston in North Ayrshire. The facility will be Scotland's first offshore wind turbine test site and will be an extension of SSE's Centre of Engineering Excellence for Renewable Energy. In partnership with leading turbine suppliers, up to three prototype turbines will be tested at the site for a period of five years;
- identification of Dundee as a key strategic location for the development of a comprehensive supply chain to support Scotland's emerging offshore wind industry. Joining forces with Forth Ports, Scottish Enterprise and Dundee City Council, SSE has taken a proactive approach to the development of the offshore wind supply chain;
- formation of strategic alliances with companies such as Siemens and Mitsubishi to collaborate on offshore wind development;
- ongoing participation in the Carbon Trust's Offshore Wind Accelerator;
- acquisition of Wind Towers Ltd, a joint venture between SSE and Marsh Wind Technology Ltd in May 2011. In addition to producing wind turbine towers for onshore wind farms, this site is constructing new facilities to allow the production of turbine towers for offshore wind and therefore maximising the potential of its modern facilities in the expanding market for offshore wind turbine towers.

In seeking to reduce supply chain cost, SSE is giving practical leadership in the delivery of the UK government's ambitious 2020 target to lower the levelised cost of energy from offshore wind to £100/MWh and believes this target can, and indeed should, be achieved.

Establishing an intermediate holding company for offshore renewable energy

SSE has advised external stakeholders that it intends to reorganise all of its offshore wind farm equity interests, including assets in operation, under construction or in development, into

a newly-incorporated holding company. It will be wholly-owned by SSE for the foreseeable future, and its establishment will give SSE a company through which to finance offshore renewable energy developments and the flexibility to introduce other sources of funding should this support the development and construction of offshore wind farms. The incorporation of the new company should be completed shortly.

Developing marine sources of electricity

While offshore wind is a rapidly evolving technology at deployment stage, marine-based wave and tidal energy is at an earlier stage of technology development. As a longer term prospect, the UK's substantial marine energy resource, coupled with a considerable commitment to technology testing facilities, means this sector could start to make a significant energy contribution around the end of this decade and beyond.

SSE has a two-pronged approach to the development of this sector and to fulfilling the potential of marine energy resources:

Technology development:

- Aquamarine Power is a wave energy developer, in which SSE has invested £24.7m over the past three years. At the beginning of 2012, 11% of SSE's shareholding was acquired by the Environmental Energies Fund (EEF) (see Investing in New Ventures). EEF is now one of Aquamarine Power's largest shareholders, along with SSE, multinational power and automation company ABB and Scottish Enterprise. The investment is a further step toward taking Aquamarine Power to commercialisation in 2014.
- In November 2011, Aquamarine installed its next-generation Oyster 800 wave energy device to its foundations on the seabed at Orkney. Final commissioning is under way and the device is expected to be fully operational this summer. In February 2012, consent was granted to install two further Oyster devices in the same location. With a maximum generating capacity of 2.4MW, the three Oyster devices will demonstrate the feasibility of installing multiple Oysters in small arrays and ultimately in larger wave farms.

Sites development:

- SSE and its JV Partners, including Aquamarine, Open Hydro and most recently, Alstom, have exclusive rights from The Crown Estate to develop 600MW of wave and tidal energy at sites in the Pentland Firth and Orkney Waters. This includes the 200MW Costa Head Wave Project, a new joint venture between SSE and Alstom agreed in January 2012. SSE also retains exclusive rights to develop a further 200MW of tidal energy. SSE is continuing to work closely with The Crown Estate and other stakeholders in advance of submitting consent applications for these projects, the first of which is expected in 2013.

Investing in new ventures in energy

SSE Ventures (SSEV) was set up in 2007 to develop and grow a portfolio of investments in small and medium-sized enterprises offering renewable, sustainable and energy efficiency-enhancing products and services.

In January 2012 it completed a deal with Scottish Equity Partners (SEP) that involves SEP's new Environmental Energies Fund (EEF) acquiring a portfolio of cleantech investments owned by SSEV. As part of the deal, SSEV has become a major partner in the new £95m green energy fund.

The new Fund has acquired nine investments from the SSEV portfolio, all of which are market leaders from across the clean energy spectrum. The fund will have substantial fresh capital available for investment in the portfolio and also has agreement to add up to five further SSE investments to the portfolio in future.

By moving investments into the EEF, cleantech companies can now also benefit from the track record and expertise of SEP, draw upon the financial resources of the new partners and ultimately deliver a better return on SSE's initial investment.

EPM and Generation priorities in 2012/13 and beyond

Over the coming year EPM will maintain its focus on value for money while further diversifying its range of energy options, including:

- continuing to improve wholesale market liquidity including forward markets;
- optimising SSE's energy portfolio, including upstream assets, fuel supply, purchase of storage services, and generation; and
- investigating additional long-term and geographically diverse fuel supply contracts across the fuel portfolio.

In Generation, SSE's 2012/13 priorities remain consistent with its established principles to:

- comply fully with all safety standards and environmental requirements;
- ensure power stations are available to respond to customer demand and market conditions; and
- operate power stations efficiently to achieve the optimum conversion of primary fuel into electricity.

SSE's Generation investment programme is designed to abate the environmental impact of existing assets and extend their working lives, and to deliver new assets, principally in renewable energy but also through trialling other forms of decarbonised generation, including carbon capture and storage. All of this is aimed at maintaining, for the long term, a diverse, well balanced portfolio that will deliver a decarbonised, secure and affordable energy supply.

During 2012/13, SSE expects to invest around £750m in maintaining and upgrading existing generation assets and in developing new assets. Investment priorities for the coming year are to:

- invest in power stations to increase flexibility;
- complete asset maintenance and refurbishment programmes on time and on budget;
- meet key milestones in new asset development and construction, particularly on and offshore wind and multifuel; and
- make progress in developing the diverse range of investment options it has created for the second half of this decade.

SSE will also actively seek to maintain optionality and diversity in the future development of its generation portfolio, so that it remains on course to reduce by 50% the CO₂ intensity of electricity produced at power stations in which it has an ownership or contractual interest, over the period from 2006 to 2020.

The future development of its portfolio will depend to a significant extent on the outcome of the UK government's consultation on electricity market reform. SSE believes a workable package of reforms can still emerge from this process, based around carbon price support, a mechanism to reward all electricity capacity that is available to generate electricity, and continuing support for the production of electricity from renewable sources. It retains concerns, however, about the proposed 'Contract for Difference' model and is continuing to work with the UK government and other stakeholders to ensure that the shortcomings associated with this proposal are addressed. The UK government is expected to introduce legislation later this year, after further consultations.

Gas Production

Producing upstream supplies of gas

A key milestone for SSE in 2011 was its acquisition from Hess Limited of North Sea natural gas and infrastructure assets. This acquisition was a measured entry by SSE in to non-operated upstream assets. Following on from the significant learning and experience gained, it is SSE's intention to increase its presence in the upstream fuel sector if assets can be acquired for a fair price. In doing so, SSE aims to diversify further its sources of primary fuel and provide a hedge for its gas-fired generation and gas supply activities.

Overall, Gas Production delivered an operating profit* of £42.6m in 2011/12 compared with £4.6m for the short period after the assets were acquired in 2010/11. Total output during the year was 176.7 million therms, compared with 27.6 million therms in the period from acquisition in February 2011 to March 2011.

Gas Production priorities in 2012/13 and beyond

In seeking to pursue further opportunities to secure upstream gas assets SSE will:

- focus on mature, producing, gas-weighted assets; and
- consider opportunities that include operatorship.

As well as pursuing such opportunities directly, SSE will work with Faroe Petroleum plc, in which it has a 5% holding. Future investment decisions will, however, continue to be considered in a careful, measured way, consistent with its financial principles and, therefore, only where fair value can be secured.

Gas Storage

Providing capacity to store gas

In 2011 the UK's gross imports of natural gas were greater than gross production for the first time since 1967 and over the coming decade UK gas imports are projected to increase significantly. This presents both a supply security and price risk associated with the potential for: operational failures in pipelines delivering gas to the UK, political disputes in gas-producing regions, increased demand from emerging economies and periods of unexpected low temperatures.

The two leading solutions to abating this risk are gas storage and liquefied natural gas (LNG), both of which are required to accommodate future growth in gas demand.

SSE has an ownership interest in two major gas storage facilities in East Yorkshire:

- **Hornsea** is the UK's largest onshore gas storage facility in which around 325 million cubic metres (mcm) of gas can be stored in a total of nine caverns. Hornsea accounts for around 7% of the total gas storage capacity in the UK and 15% of deliverability. It can be injected with gas at a rate of 2mcm per day and delivered to the National Transmission System at a rate of 18mcm per day, equivalent to the demand of four million homes. During 2011/12, Hornsea was 100% available to customers, except in instances of planned maintenance. This enabled storage customers to manage their gas market risks and respond to gas trading opportunities.
- **Aldbrough** is one of the UK's newest onshore gas storage facilities, which SSE (66.6% share) is developing with Statoil (UK) Ltd. Aldbrough will ultimately have the capacity to store around 330mcm of gas in nine underground caverns (of which SSE will own two-thirds). It will have the capacity to deliver gas to the National Transmission System at a rate of up to 40mcm per day, equivalent to the average daily consumption of eight million homes, and the ability to have up to 30mcm of gas per day injected. In parallel with completion of the project, the Aldbrough site has been in commercial operation since July 2009. During 2011/12 it performed well, with the surface plant delivering 94% availability.

Gas Storage profitability

During 2011/12, Gas Storage delivered an operating profit* of £23.8m, compared with £23.5m in the previous year. Profitability has been aided by the increased capacity available for storage as a result of the progress of the Aldbrough development, however, this was offset by weaker prices for Standard Bundled Units arising from the very mild winter and a reduction in the differentials between forward summer and winter gas prices and reflecting the increased availability of LNG. While LNG has had a negative financial impact on gas storage in the near term, the diversity offered by both options will be important for risk abatement for the reasons set out above.

Completing the new gas storage facility at Aldbrough

To form caverns such as those at Aldbrough and Hornsea, salt deposits around 2km underground are leached out by seawater which, in turn, is replaced (dewatered) by gas under pressure. At Aldbrough, six of nine caverns are already storing gas at a capacity of 170mcm. Leaching at the remaining three caverns is completed and completion of dewatering through the injection of gas is expected shortly. They are expected to be fully operational by the summer of this calendar year. SSE's forecast total investment for the development remains around £290m.

SSE and Statoil (UK) Ltd have consent to increase the storage capacity at the Aldbrough site beyond that currently under development, but concluded during 2010 that an investment decision on the development should be deferred while the UK government develops its policy on gas security.

Gas Storage priorities in 2012/13 and beyond

Gas storage priorities for the coming financial year include:

- completion of construction work at Aldbrough; and
- ensuring safe and effective operation of capacity at Hornsea and Aldbrough.

Conclusion

With a focus on flexibility and sustainability in its Wholesale businesses, SSE believes that its activities in Energy Portfolio Management, Generation, Gas Production and Gas Storage will support the achievement of its first financial goal of sustained real growth in the dividend payable to shareholders.

Consolidated Income Statement
for the year ended 31 March 2012

		2012			2011		
	Note	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 6) £m	Total £m	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 6) £m	Total £m
Revenue	4,5	31,723.9	-	31,723.9	28,334.2	-	28,334.2
Cost of sales		(29,464.4)	(903.3)	(30,367.7)	(26,094.1)	948.8	(25,145.3)
Gross profit		2,259.5	(903.3)	1,356.2	2,240.1	948.8	3,188.9
Operating costs		(888.0)	(82.0)	(970.0)	(902.0)	-	(902.0)
Other operating income		8.0	-	8.0	16.0	-	16.0
Operating profit before jointly controlled entities and associates		1,379.5	(985.3)	394.2	1,354.1	948.8	2,302.9
Jointly controlled entities and associates:							
Share of operating profit		278.3	-	278.3	298.8	(103.2)	195.6
Share of interest		(146.5)	-	(146.5)	(139.9)	-	(139.9)
Share of movement on derivatives		-	14.2	14.2	-	5.9	5.9
Share of tax		(44.9)	38.3	(6.6)	(58.2)	61.5	3.3
Share of profit on jointly controlled entities and associates		86.9	52.5	139.4	100.7	(35.8)	64.9
Operating profit	4,5	1,466.4	(932.8)	533.6	1,454.8	913.0	2,367.8
Finance income	7	250.1	-	250.1	250.2	-	250.2
Finance costs	7	(425.7)	(89.5)	(515.2)	(453.1)	(53.2)	(506.3)
Profit before taxation		1,290.8	(1,022.3)	268.5	1,251.9	859.8	2,111.7
Taxation	8	(324.8)	319.6	(5.2)	(354.8)	(252.4)	(607.2)
Profit for the year		966.0	(702.7)	263.3	897.1	607.4	1,504.5
Attributable to:							
Ordinary shareholders of the parent		900.5	(702.7)	197.8	897.1	607.4	1,504.5
Other equity holders		65.5	-	65.5	-	-	-
Basic earnings per share	10			21.1p			162.2p
Diluted earnings per share	10			21.1p			162.0p
Dividends paid in the year	9			£716.9m			£659.8m

The accompanying notes are an integral part of the financial information in this announcement.

Consolidated Statement of Comprehensive Income
For the year ended 31 March 2012

	2012 £m	2011 £m
Profit for the year	263.3	1,504.5
Other comprehensive income:		
(Losses)/gains on effective portion of cash flow hedges	(15.3)	32.3
Transferred to assets and liabilities on cash flow hedges	0.2	(7.0)
Taxation on cashflow hedges	4.0	(5.9)
	(11.1)	19.4
Exchange difference on translation of foreign operations	(65.3)	(78.3)
Gains on net investment hedge	29.8	4.3
Taxation on net investment hedge	(7.7)	(1.2)
	(43.2)	(75.2)
Actuarial losses on retirement benefit schemes	(161.1)	(8.8)
Taxation on actuarial losses on defined benefit pension schemes	30.3	(7.9)
	(130.8)	(16.7)
Jointly controlled entities and associates:		
Share of (loss) on effective portion of cash flow hedges	(20.8)	(4.1)
Share of taxation on cashflow hedges	3.7	(0.3)
	(17.1)	(4.4)
Share of actuarial gains/(losses) on retirement benefit schemes	5.6	(11.6)
Share of taxation of actuarial losses on retirement benefit schemes	(3.9)	1.8
	1.7	(9.8)
Net share from jointly controlled entities and associates	(15.4)	(14.2)
Other comprehensive income, net of taxation	(200.5)	(86.7)
Total comprehensive income for the period	62.8	1,417.8
Attributable to:		
Ordinary shareholders of the parent	(2.7)	1,417.8
Other equity holders	65.5	-
	62.8	1,417.8

Consolidated Balance Sheet
as at 31 March 2012

	2012	2011
Note	£m	£m
Assets		
Property, plant and equipment	9,153.1	8,513.1
Biological assets	3.4	4.4
Intangible assets:		
Goodwill	627.5	685.3
Other intangible assets	218.8	287.8
Equity investments in associates and jointly controlled entities	911.7	760.8
Loans to associates and jointly controlled entities	1,191.9	1,124.6
Other investments	36.1	39.6
Deferred tax assets	222.1	161.7
Derivative financial assets	348.0	990.1
Non-current assets	12,712.6	12,567.4
Other intangible assets	365.7	325.6
Inventories	323.7	217.5
Trade and other receivables	5,174.6	5,068.1
Cash and cash equivalents	189.2	476.9
Derivative financial assets	851.2	2,525.5
Current assets held for sale	68.0	269.4
Current assets	6,972.4	8,883.0
Total assets	19,685.0	21,450.4
Liabilities		
Loans and other borrowings	708.6	446.5
Trade and other payables	5,182.7	5,078.0
Current tax liabilities	231.8	268.2
Provisions	55.3	9.9
Derivative financial liabilities	817.6	2,307.5
Current liabilities	6,996.0	8,110.1
Loans and other borrowings	5,537.0	5,159.9
Deferred tax liabilities	921.8	1,068.3
Trade and other payables	332.7	304.2
Provisions	182.3	169.2
Retirement benefit obligations	731.9	668.6
Derivative financial liabilities	399.2	769.3
Non-current liabilities	8,104.9	8,139.5
Total liabilities	15,100.9	16,249.6
Net assets	4,584.1	5,200.8
Equity:		
Share capital	472.3	468.4
Share premium	862.0	859.8
Capital redemption reserve	22.0	22.0
Hedge reserve	(29.4)	(1.2)
Translation reserve	(5.0)	38.2
Retained earnings	2,100.8	2,652.2
Total equity attributable to ordinary shareholders of the parent	3,422.7	4,039.4
Hybrid capital	1,161.4	1,161.4
Total equity attributable to equity holders of the parent	4,584.1	5,200.8

Statement of Changes in Equity as at 31 March 2012

Consolidated

Reconciliation of movement in reserves	Share capital £m	Share premium account £m	Capital redemption reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Hybrid Capital £m	Total £m
At 1 April 2011	468.4	859.8	22.0	(1.2)	38.2	2,652.2	1,161.4	5,200.8
Profit for the year	-	-	-	-	-	197.8	65.5	263.3
Effective portion of changes in fair value of cash flow hedges (net of tax)	-	-	-	(11.3)	-	-	-	(11.3)
Transferred to balance sheet on cash flow hedges (net of tax)	-	-	-	0.2	-	-	-	0.2
Effective net investment hedge (net of tax)	-	-	-	-	22.1	-	-	22.1
Exchange differences on translation of foreign operation	-	-	-	-	(65.3)	-	-	(65.3)
Actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	(130.8)	-	(130.8)
Jointly controlled entities and associates:								
Share of change in fair value of effective cash flow hedges	-	-	-	(17.1)	-	-	-	(17.1)
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	1.7	-	1.7
Total comprehensive income for the year	-	-	-	(28.2)	(43.2)	68.7	65.5	62.8
Dividends to shareholders	-	-	-	-	-	(716.9)	-	(716.9)
Scrip dividend related share issue	3.6	(3.6)	-	-	-	88.2	-	88.2
Issue of hybrid capital	-	-	-	-	-	-	(65.5)	(65.5)
Issue of shares	0.3	5.8	-	-	-	-	-	6.1
Credit in respect of employee share awards	-	-	-	-	-	13.5	-	13.5
Investment in own shares	-	-	-	-	-	(4.9)	-	(4.9)
At 31 March 2012	472.3	862.0	22.0	(29.4)	(5.0)	2,100.8	1,161.4	4,584.1

Consolidated

Reconciliation of movement in reserves	Share capital £m	Share premium account £m	Capital redemption reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Non-controlling interest £m	Hybrid Capital £m	Total £m
At 1 April 2010	461.5	857.5	22.0	(16.2)	113.4	1,686.6	(3.8)	-	3,121.0
Profit for the year	-	-	-	-	-	1,504.5	-	-	1,504.5
Effective portion of changes in fair value of cash flow hedges (net of tax)	-	-	-	26.4	-	-	-	-	26.4
Transferred to balance sheet on cash flow hedges (net of tax)	-	-	-	(7.0)	-	-	-	-	(7.0)
Effective net investment hedge (net of tax)	-	-	-	-	3.1	-	-	-	3.1
Exchange differences on translation of foreign operation	-	-	-	-	(78.3)	-	-	-	(78.3)
Actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	(16.7)	-	-	(16.7)
Jointly controlled entities and associates:									
Share of change in fair value of effective cash flow hedges	-	-	-	(4.4)	-	-	-	-	(4.4)
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	(9.8)	-	-	(9.8)
Total comprehensive income for the year	-	-	-	15.0	(75.2)	1,478.0	-	-	1,417.8
Dividends to shareholders	-	-	-	-	-	(659.8)	-	-	(659.8)
Scrip dividend related share issue	6.4	(6.4)	-	-	-	146.1	-	-	146.1
Issue of hybrid capital	-	-	-	-	-	-	-	1,161.4	1,161.4
Issue of shares	0.5	8.7	-	-	-	-	-	-	9.2
Credit in respect of employee share awards	-	-	-	-	-	9.9	-	-	9.9
Transactions with shareholders	-	-	-	-	-	-	3.8	-	3.8
Investment in own shares	-	-	-	-	-	(9.2)	-	-	(9.2)
Current and deferred tax recognised in equity in respect of employee share awards	-	-	-	-	-	0.6	-	-	0.6
At 31 March 2011	468.4	859.8	22.0	(1.2)	38.2	2,652.2	-	1,161.4	5,200.8

The capital redemption reserve comprises the value of shares redeemed or purchased from distributable profits.

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 comprised 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.

Consolidated Cash Flow Statement
for the year ended 31 March 2012

	2012	2011
	£m	Restated £m
Cash flows from operating activities		
Profit for the year after tax	263.3	1,504.5
Taxation	5.2	607.2
Movement on financing and operating derivatives	523.2	(1,417.4)
Finance costs	425.7	453.1
Finance income	(250.1)	(250.2)
Share of jointly controlled entities and associates	(139.4)	(64.9)
Pension service charges less contributions paid	(100.2)	(68.8)
Exceptional impairment of assets	478.6	521.8
Other exceptional items	73.0	-
Depreciation and impairment of assets	561.8	496.7
Amortisation and impairment of intangible assets	13.5	21.5
Impairment of inventories	1.1	6.6
Release of provisions	(7.3)	(6.0)
Release of deferred income	(14.7)	(19.6)
(Increase) / decrease in inventories	(107.3)	48.4
(Increase) in receivables	(133.7)	(95.4)
Increase in payables	342.9	635.2
Increase in provisions	5.9	1.9
Charge in respect of employee share awards (before tax)	13.5	9.9
(Gain) on disposal of property, plant and equipment	(4.6)	(5.8)
Loss on disposal of fixed asset investment	2.1	-
(Gain) on disposal of business and subsidiaries	(5.5)	(10.2)
Cash generated from operations	1,947.0	2,368.5
Dividends received from jointly controlled entities	111.4	81.7
Interest income	108.3	109.7
Interest costs	(242.2)	(316.0)
Income taxes paid	(211.4)	(172.6)
Payment for consortium relief	(4.9)	(21.2)
Net cash from operating activities	1,708.2	2,050.1
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,501.2)	(1,079.0)
Purchase of other intangible assets	(400.9)	(297.3)
Deferred income received	0.5	-
Proceeds from sale of property, plant and equipment	22.2	7.9
Proceeds from sale of fixed asset investment	23.5	-
Proceeds from sale of business and subsidiaries	185.5	31.9
Loans to jointly controlled entities and associates	(138.6)	(204.4)
Purchase of businesses and subsidiaries	(3.6)	(241.3)
Cash included in disposals	-	(5.5)
Cash included in assets held for sale	(3.9)	(23.0)
Investment in jointly controlled entities and associates	(138.8)	(221.6)
Loans and equity repaid by jointly controlled entities	25.9	13.3
Increase in other investments	(2.1)	(30.4)
Net cash from investing activities	(1,931.5)	(2,049.4)
Cash flows from financing activities		
Proceeds from issue of share capital	6.1	9.2
Dividends paid to Company's equity holders	(628.7)	(513.7)
Hybrid capital dividend payment	(65.5)	-
Issue of hybrid capital	-	1,161.4
Employee share awards share purchase	(4.9)	(9.2)
New borrowings	1,024.1	765.1
Repayment of borrowings	(393.0)	(1,187.1)
Net cash from financing activities	(61.9)	225.7
Net increase / (decrease) in cash and cash equivalents	(285.2)	226.4
Cash and cash equivalents at the start of year	471.6	252.5
Net (decrease)/increase in cash and cash equivalents	(285.2)	226.4
Effect of foreign exchange rate changes	(0.9)	(7.3)
Cash and cash equivalents at the end of year	185.5	471.6
Cash and cash equivalents as above	185.5	471.6
Bank overdraft (i)	3.7	5.3
Cash and cash equivalents per balance sheet	189.2	476.9

(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.

Notes to the Preliminary Statement

For the year ended 31 March 2012

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 2012 or 2011 but is derived from those accounts. Statutory accounts for 2011 have been delivered to the Registrar of Companies, and those for 2012 will be delivered in due course. The auditors have reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for 2012. This preliminary announcement was authorised by the Board on 15 May 2012.

2. Basis of preparation

The financial information set out in this announcement has been extracted from the consolidated financial statements of SSE plc for the year ended 31 March 2012. These consolidated financial statements were prepared under the historical cost convention excepting certain assets and liabilities stated at fair value and in accordance with International Financial Reporting Standards and their interpretations as adopted by the European Union (adopted IFRS). This consolidated financial information has been prepared on the basis of accounting policies consistent with those applied in the consolidated financial statements for the year ended 31 March 2011. The Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future. The financial information has therefore been prepared on a going concern basis. 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 SSE 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. Change of Reportable Segments

Following changes to the structure of the Group's internal organisation, and subsequent changes to the way in which financial and management information is presented to both the Main Board and Management Board in the current year, the composition of the Group's Reportable Segments has changed.

The activities included in the new Reportable Segments are explained in more detail in Note 5. The main changes to the segments have been:

Power Systems, previously split on a geographical basis, is now presented as Electricity Distribution and Electricity Transmission. The Electricity Connections activity is now included in Electricity Distribution.

Generation and Supply, previously a single reportable segment, will now be reported as two new main segments, (i) Energy Supply and (ii) Energy Portfolio Management and Electricity Generation, reflecting the new management structure and basis of management reporting. Other activities previously included in this segment, such as other energy-related services provided to end-user customers, are disclosed in Energy-related Services.

The Other businesses segment, previously disclosed as an aggregation of less significant activities are now disclosed in the segment which corresponds to the Group's new management structure. These new segments include Other Networks, Gas Storage and Gas Production.

Notes to the Preliminary Statement

For the year ended 31 March 2012

4. Change of Reportable Segments (continued)

The impact of the change in the segments on the prior year can be summarised as follows:

(a) Revenue

The Revenue by segment disclosure note for the year to March 2011 was as follows:

	External revenue £m	Intra-segment revenue £m	Total revenue £m
Power Systems			
Scotland	245.7	111.0	356.7
England	303.1	214.1	517.2
	548.8	325.1	873.9
Generation and Supply			
Retail	8,044.4	-	8,044.4
Wholesale and Trading	18,882.8	17.1	18,899.9
Other	207.1	15.8	222.9
	27,134.3	32.9	27,167.2
Other businesses	651.1	568.8	1,219.9
	28,334.2	926.8	29,261.0

Following the change in the composition of segments, this has been restated as follows:

	External revenue £m	Intra-segment revenue £m	Total revenue £m
Networks			
Electricity Distribution	559.8	325.0	884.8
Electricity Transmission	94.1	0.1	94.2
Other Networks	148.9	40.7	189.6
	802.8	365.8	1,168.6
Retail			
Energy Supply	8,008.1	15.8	8,023.9
Energy-related Services	429.7	164.6	594.3
	8,437.8	180.4	8,618.2
Wholesale			
Energy Portfolio Management and Electricity Generation	19,014.1	4,547.1	23,561.2
Gas Storage	30.5	42.2	72.7
Gas Production	0.2	15.6	15.8
	19,044.8	4,604.9	23,649.7
Corporate unallocated	48.8	305.7	354.5
Total	28,334.2	5,456.8	33,791.0

The increase in intra-segment revenue relates to electricity and gas provided to Energy Supply from the Energy Portfolio Management and Electricity Generation segment (£4,530.0m).

Notes to the Preliminary Statement

For the year ended 31 March 2012

4. Change of Reportable Segments (continued)

(b) Operating profit by segment

The Operating Profit by segment disclosure note for the year to March 2011 was as follows:

	Adjusted operating profit reported to the Board)	JCE / Associate share of interest and tax	2011		Total
			Before exceptional items and certain re- measurements	Exceptional items and certain re- measurements	
	£m	£m	£m	£m	£m
Power Systems					
Scotland	168.1	-	168.1	-	168.1
England	287.4	-	287.4	-	287.4
	455.5	-	455.5	-	455.5
Scotia Gas Networks	186.8	(150.7)	36.1	38.4	74.5
Energy Systems	642.3	(150.7)	491.6	38.4	530.0
Generation and Supply	882.8	(47.1)	835.7	874.6	1,710.3
Other businesses	136.8	(0.3)	136.5	-	136.5
	1,661.9	(198.1)	1,463.8	913.0	2,376.8
Unallocated expenses	(9.0)	-	(9.0)	-	(9.0)
	1,652.9	(198.1)	1,454.8	913.0	2,367.8

Following the change in the composition of segments, this has been restated as follows:

	Adjusted operating profit reported to the Board	JCE / Associate share of interest and tax	2011		Total
			Before exceptional items and certain re- measurements	Exceptional items and certain re- measurements	
	£m	£m	£m	£m	£m
Networks					
Electricity Distribution	418.9	-	418.9	-	418.9
Electricity Transmission	47.7	-	47.7	-	47.7
Gas Distribution	186.8	(150.7)	36.1	38.4	74.5
Other Networks	37.1	-	37.1	-	37.1
	690.5	(150.7)	539.8	38.4	578.2
Retail					
Energy Supply	347.7	-	347.7	-	347.7
Energy-related Services	52.8	(0.3)	52.5	-	52.5
	400.5	(0.3)	400.2	-	400.2
Wholesale					
Electricity Generation and Energy Portfolio Management	543.4	(47.1)	496.3	874.6	1,370.9
Gas Storage	23.5	-	23.5	-	23.5
Gas Production	4.6	-	4.6	-	4.6
	571.5	(47.1)	524.4	874.6	1,399.0
Corporate Unallocated	(9.6)	-	(9.6)	-	(9.6)
Total	1,652.9	(198.1)	1,454.8	913.0	2,367.8

Notes to the Preliminary Statement

For the year ended 31 March 2012

5. Segmental information

The Group's operating segments are those used internally by the Main Board to run the business, allocate resources and make strategic decisions. The Group's main businesses and operating segments are the **Networks** business comprising Electricity Distribution, Electricity Transmission, Gas Distribution and Other Networks; the **Retail** business comprising Energy Supply and Energy-related Services, and; **Wholesale** comprising Energy Portfolio Management and Electricity Generation, Gas Storage and Gas Production.

The types of products and services from which each reportable segment derives its revenues are:

Business Area	Reported Segments	Description
Networks	Electricity Distribution	The economically regulated lower voltage distribution of electricity to customer premises in the North of Scotland and the South of England
	Electricity Transmission	The economically regulated high voltage transmission of electricity from generating plant to the distribution network in the North of Scotland
	Gas Distribution	SSE's share of Scotia Gas Networks, which operates two economically regulated gas distribution networks in Scotland and the South of England
	Other Networks	Operation of other networks and services including telecoms capacity and bandwidth, out-of-area local networks in the UK and street-lighting services in the UK and Ireland
Retail	Energy Supply	The supply of electricity and gas to residential and business customers in the UK and Ireland
	Energy-related Services	The provision of energy-related goods and services to customers in the UK including electrical contracting, meter reading and installation, telecommunication and broadband services, boiler maintenance and installation and the sale of electrical appliances
Wholesale	Energy Portfolio Management and Electricity Generation	The generation of power from renewable and thermal plant in the UK, Ireland and Europe and the optimisation of SSE's power and gas contracts and requirements
	Gas Storage	The operation of gas storage facilities in the UK
	Gas Production	The production and processing of gas and oil from North Sea fields

The measure of profit used by the Board is adjusted operating profit which is before exceptional items, remeasurements arising from IAS 39 and after the removal of taxation and interest on profits from jointly controlled entities and associates.

Analysis of revenue, operating profit, assets and other items by segment is provided below. All revenue and profit before taxation arise from operations within Great Britain, Ireland and mainland Europe.

a) Revenue by segment

	External revenue 2012 £m	Intra-segment revenue (i) 2012 £m	Total revenue 2012 £m
Networks			
Electricity Distribution	542.1	336.9	879.0
Electricity Transmission	117.7	0.1	117.8
Other Networks	249.0	49.4	298.4
	908.8	386.4	1,295.2
Retail			
Energy Supply	7,787.3	23.1	7,810.4
Energy-related Services	280.4	184.8	465.2
	8,067.7	207.9	8,275.6
Wholesale			
Energy Portfolio Management and Electricity Generation	22,664.2	4,447.5	27,111.7
Gas Storage	30.3	51.9	82.2
Gas Production	3.0	99.3	102.3
	22,697.5	4,598.7	27,296.2
Corporate Unallocated	49.9	264.3	314.2
Total	31,723.9	5,457.3	37,181.2

The comparative information for the previous financial year is shown in Note 4.

(i) Significant intra-segment revenue is derived from use of system income received by the Electricity Distribution business from Energy Supply; Other Networks provide Telecoms infrastructure and other charges to other Group companies; Energy Supply provides internal heat and light power supplies to other Group companies; Energy-related Services provides Contracting, Metering and other services to other Group companies; Energy Portfolio Management and Electricity Generation provides power and gas to the Energy Supply segment; Gas Storage provide the use of Gas Storage facilities to Energy Portfolio Management; Gas Production sells gas from producing North Sea fields to the Energy Portfolio Management and Electricity Generation segment and Corporate unallocated provides corporate and infrastructure services to the operating businesses. All are provided at arm's length basis.

Notes to the Preliminary Statement

For the year ended 31 March 2012

a) Revenue by segment (continued)

Revenue within Energy Portfolio Management and Electricity Generation includes revenues from generation plant output and the gross value of all wholesale power and gas sales including settled physical and financial trades. These are entered into to optimise the performance of the generation plants and to support the Energy Supply segment. Purchase trades are included in cost of sales.

Revenue from the Group's investment in Scotia Gas Networks (SSE share being: 2012 – £454.3m; 2011 – £392.5m) is not recorded in the revenue line in the income statement.

b) Operating profit by segment

	Adjusted operating profit reported to the Board	JCE / Associate share of interest and tax (i)	2012		Total
			Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements	
	£m	£m	£m	£m	£m
Networks					
Electricity Distribution	396.5	-	396.5	-	396.5
Electricity Transmission	73.7	-	73.7	-	73.7
Gas Distribution	234.8	(164.5)	70.3	48.5	118.8
Other Networks	32.1	-	32.1	-	32.1
	737.1	(164.5)	572.6	48.5	621.1
Retail					
Energy Supply	271.7	-	271.7	(20.0)	251.7
Energy-related Services	49.9	(0.2)	49.7	(40.0)	9.7
	321.6	(0.2)	321.4	(60.0)	261.4
Wholesale					
Electricity Generation and Energy Portfolio Management	541.5	(26.7)	514.8	(869.3)	(354.5)
Gas Storage	23.8	-	23.8	(30.0)	(6.2)
Gas Production	42.6	-	42.6	(22.0)	20.6
	607.9	(26.7)	581.2	(921.3)	(340.1)
Corporate Unallocated	(8.8)	-	(8.8)	-	(8.8)
Total	1,657.8	(191.4)	1,466.4	(932.8)	533.6

The comparative information for the previous financial year is shown in Note 4.

(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 Limited interest includes loan stock interest payable to the consortium shareholders (included in Gas Distribution). The Group has accounted for its 50% share of this, £33.4m (2011 - £33.4m), as finance income (note 7).

The Group's share of operating profit from jointly controlled entities and associates has been recognised in the Energy Portfolio Management and Electricity Generation segment other than that for Scotia Gas Networks Limited, which is recorded in Gas Distribution, and PriDE (South East Regional Prime), which is recognised in Energy Services (£0.2m before tax; 2011 – £0.3m before tax).

6. Exceptional items and certain re-measurements

i) Exceptional items

In the year to 31 March 2012, the following exceptional items were recorded:

Impairment of Generation-related assets arising from changing market conditions. Exceptional charges have been recognised in relation to the impairment of goodwill (£19.3m), property, plant and equipment (£275.1m), current receivables (£5.0m), held for sale assets (£9.9m) and intangible assets (£87.3m) in relation to Generation-related assets.

These were recognised as a result of the long-term view of spark spreads at Medway and Keadby, leading to a change the way in which the plants are operationally configured. In addition, further impairment charges in respect of the station running hours at Ferrybridge and in respect of the future prospects for the European wind portfolio were recognised. Carbon dioxide emissions allowances intangible assets purchased to cover the emissions liabilities at the Group's thermal plants have been impaired based on current market prices.

Impairment of Other assets. Exceptional charges have been recognised in relation to goodwill (£30.0m), property, plant and equipment (£30.0m) and intangible assets (£22.0m). These were recognised following the goodwill impairment review of the Gas Storage CGU and as a result from changing operational conditions and updated development expectations associated with legacy Metering assets and North Sea exploration assets.

Notes to the Preliminary Statement for the year ended 31 March 2012

6. Exceptional items and certain re-measurements (continued)

i) Exceptional items (continued)

Provisions for onerous contracts, restructuring and other-liabilities. Exceptional charges have been recognised in relation to commodity contracts associated with thermal Generation assets (£37.4m). In addition, costs associated with Retail restructuring and other charges and the impairment of other financial assets (£35.6m) have been recognised as exceptional in the year.

Changes in UK corporation tax rates. The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate would reduce from 28% to 24% over a period of four years from 2011. The first changes from 28% to 27% and, after the March 2011 Budget, accelerated to 26% had been substantively enacted and applied by 1 April 2011. The March 2012 Budget confirmed a further acceleration of the reduction in rate to 24% effective from 1 April 2012, this being substantively enacted on 26 March 2012, with a revised rate of 22% expected to be enacted by 2014.

These changes will reduce the Group's future current tax charge accordingly. As the rate change to 24% has been substantively enacted it has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2012 by £45.7m (2011 - £49.4m). It has not yet been possible to quantify the full anticipated effect of the announced further 2% rate reduction due to legislation not being enacted, although this will further reduce the Group's future current tax charge and reduce the Group's deferred tax liabilities/assets accordingly.

In addition, in the previous year, the March 2011 Budget increased the rate of supplementary corporation tax (SCT) from 20% to 32%. This had been substantively enacted on 29 March 2011. This had the effect of increasing the Group's deferred tax liabilities and assets in relation to the Group's Exploration and Production (E&P) business to which this supplementary tax applies. The impact on the Group's net deferred tax liabilities was an increase of £31.7m.

In the year to 31 March 2011 the following exceptional items were recorded:

Impairment of thermal and renewable generation portfolio assets arising from changing market conditions. Exceptional charges have been recognised in relation to the impairment of goodwill (£42.5m), property, plant and equipment (£442.7m), development intangible assets (£39.7m) and financial assets (£7.6m). In addition, related net credits of £10.6m have been recognised, including £8.8m relating to finance costs.

These were recognised as a consequence of changing regulatory and economic conditions, in particular, (i) the impact of the Industrial Emissions Directive on station running hours and useful economic lives at certain plants including the Fiddler's Ferry and Ferrybridge power stations; (ii) the consequential impact on the ash remediation plant at Fiddler's Ferry, (iii) changes in the economic prospects of certain older, less flexible thermal plants, and, (iv) the decision to concentrate continental Europe wind generation activities on the Sweden and Netherlands markets.

Impairment of Investments in Associates. Exceptional impairment charges have been recognised in relation to the Group's investments in Barking Power Limited and Derwent Cogeneration Limited following the expiry of long-term power purchase agreements at both stations. In addition, certain other investments have been impaired. The combined impairment charges are £76.3m net of deferred tax.

ii) Certain re-measurements

Certain re-measurements arising from 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 12.

iii) Taxation

The Group has separately recognised the tax effect of the exceptional items and certain re-measurements summarised above.

Notes to the Preliminary Statement
for the year ended 31 March 2012

6. Exceptional items and certain re-measurements (continued)

These transactions can be summarised thus:

	2012 £m	2011 £m
Exceptional items		
Impairments and other charges:		
Impairment of Generation assets arising from changing market conditions	(396.6)	(521.8)
Impairment of Other Assets	(82.0)	-
Provisions for onerous contracts, restructuring and other liabilities	(73.0)	-
Impairment of Investments in Associates (share of results, net of tax)	-	(76.3)
Share of effect of change in UK corporation tax on deferred tax liabilities and assets of associate and joint venture investments	42.0	36.3
	<u>(509.6)</u>	<u>(561.8)</u>
Certain re-measurements		
Movement on operating derivatives (note 12)	(433.7)	1,461.8
Movement on financing derivatives (note 12)	(89.5)	(44.4)
Share of movements on derivatives in jointly controlled entities (net of tax)	10.5	4.2
	<u>(512.7)</u>	<u>1,421.6</u>
Exceptional items before taxation	(1,022.3)	859.8
Exceptional items		
Effect of change in UK corporation tax rate on deferred tax liabilities and assets	45.7	49.4
Effect of change in UK supplementary corporation tax rate	-	(31.7)
Taxation on other exceptional items	137.4	126.1
	<u>183.1</u>	<u>143.8</u>
Taxation on certain re-measurements	136.5	(396.2)
Taxation	319.6	(252.4)
	<u>(702.7)</u>	<u>607.4</u>

7. Net finance costs

Recognised in income statement

	Before exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments (note 6) £m	2012 £m	Before exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments (note 6) £m	2011 £m
Finance income:						
Return on pension scheme assets	147.4	-	147.4	141.9	-	141.9
Interest income from short term deposits	2.0	-	2.0	2.7	-	2.7
Other interest receivable:						
Scotia Gas Networks loan stock	33.4	-	33.4	33.4	-	33.4
Other jointly controlled entities and associates	23.8	-	23.8	23.1	-	23.1
Other receivable	43.5	-	43.5	49.1	-	49.1
	<u>100.7</u>	<u>-</u>	<u>100.7</u>	<u>105.6</u>	<u>-</u>	<u>105.6</u>
Foreign exchange translation of monetary assets and liabilities	-	-	-	-	-	-
Total finance income	250.1	-	250.1	250.2	-	250.2
Finance costs:						
Bank loans and overdrafts	(25.0)	-	(25.0)	(58.1)	-	(58.1)
Other loans and charges	(280.3)	-	(280.3)	(247.1)	(8.8)	(255.9)
Interest on pension scheme liabilities	(149.8)	-	(149.8)	(150.2)	-	(150.2)
Notional interest arising on discounted provisions	(7.8)	-	(7.8)	(4.3)	-	(4.3)
Finance lease charges	(38.4)	-	(38.4)	(39.7)	-	(39.7)
Foreign exchange translation of monetary assets and liabilities	(0.3)	-	(0.3)	(13.2)	-	(13.2)
Less: interest capitalised	75.9	-	75.9	59.5	-	59.5
Total finance costs	(425.7)	-	(425.7)	(453.1)	(8.8)	(461.9)
Changes in fair value of financing derivative assets or liabilities at fair value through profit or loss	-	(89.5)	(89.5)	-	(44.4)	(44.4)
Net finance costs	(175.6)	(89.5)	(265.1)	(202.9)	(53.2)	(256.1)
Finance income	250.1	-	250.1	250.2	-	250.2
Finance costs	(425.7)	(89.5)	(515.2)	(453.1)	(53.2)	(506.3)
Net finance costs	(175.6)	(89.5)	(265.1)	(202.9)	(53.2)	(256.1)

Notes to the Preliminary Statement
for the year ended 31 March 2012

7. Net finance costs (continued)

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

	2012 £m	2011 £m
Net finance costs	(265.1)	(256.1)
(add)/less:		
Share of interest from jointly controlled entities and associates:		
Scotia Gas Networks loan stock	(33.4)	(33.4)
Other jointly controlled entities and associates	(113.1)	(106.5)
	(146.5)	(139.9)
Exceptional charges	-	8.8
Movement on financing derivatives	89.5	44.4
Adjusted finance income and costs	(322.1)	(342.8)
(add)/less:		
Return on pension scheme assets	(147.4)	(141.9)
Interest on pension scheme liabilities	149.8	150.2
Notional interest arising on discounted provisions	7.8	4.3
Finance lease charges	38.4	39.7
Hybrid coupon payment	(65.5)	-
Adjusted finance income and costs and hybrid coupon payments for interest cover calculations	(339.0)	(290.5)

8. Taxation

Analysis of charge recognised in the income statement:

	Before Exceptional items and certain re- measure ments £m	Exceptional items and certain re- measure ments (note 6) £m	2012 £m	Before Exceptional items and certain re- measure ments £m	Exceptional items and certain re- measure ments (note 6) £m	2011 £m
Current tax						
UK corporation tax	224.2	(16.9)	207.3	270.2	-	270.2
Adjustments in respect of previous years	(22.3)	-	(22.3)	(25.0)	-	(25.0)
Total current tax	201.9	(16.9)	185.0	245.2	-	245.2
Deferred tax						
Current year	93.3	(257.0)	(163.7)	60.8	234.7	295.5
Effect of change in tax rates	-	(45.7)	(45.7)	-	17.7	17.7
Adjustments in respect of previous years	29.6	-	29.6	48.8	-	48.8
Total deferred tax	122.9	(302.7)	(179.8)	109.6	252.4	362.0
Total taxation charge	324.8	(319.6)	5.2	354.8	252.4	607.2

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

	2012 £m	2012 %	2011 £m	2011 %
Group profit before tax	268.5		2,111.7	
Less: share of results of associates and jointly controlled entities	(139.4)		(64.9)	
Profit before tax	129.1		2,046.8	
Tax on profit on ordinary activities at standard UK corporation tax rate of 26% (2011 – 28%)	33.6	26.0	573.1	28.0
Tax effect of:				
Change in rate of UK corporation tax	(45.7)	(35.4)	(49.4)	(2.4)
Change in rate of UK supplementary corporation tax	-	-	31.7	1.5
Expenses not deductible for tax purposes	16.8	13.0	27.6	1.3
Impact of supplementary corporation tax	22.7	17.6	2.2	0.1
Non taxable income	-	-	(4.3)	(0.2)
Impact of foreign tax rates and foreign dividends	(3.8)	(2.9)	6.4	0.3
Hybrid capital coupon payments	(16.6)	(12.9)	-	-
Adjustments to tax charge in respect of previous years	7.3	5.7	23.8	1.2
Consortium relief not paid for	(8.6)	(6.7)	(9.0)	(0.4)
Other items	(0.5)	(0.4)	5.1	0.3
Group tax charge and effective rate	5.2	4.0	607.2	29.7

Notes to the Preliminary Statement for the year ended 31 March 2012

8. Taxation (continued)

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

	2012 £m	2012 %	2011 £m	2011 %
Total taxation charge	5.2	4.0	607.2	29.7
Effect of adjusting items (see below)	-	(3.6)	-	16.6
Total taxation charge on adjusted basis	5.2	0.4	607.2	46.3
add/(less):				
Share of current tax from jointly controlled entities and associates	11.5	0.9	23.0	1.8
Exceptional items	183.1	13.7	143.8	11.0
Tax on movement on derivatives	136.5	10.2	(396.2)	(30.2)
Deferred tax (excluding share of jointly controlled entities)	(122.9)	(9.2)	(109.6)	(8.4)
Adjusted current tax charge and effective rate	213.4	16.0	268.2	20.5

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

	2012 £m	2011 £m
Profit before tax	268.5	2,111.7
add/(less):		
Exceptional items and certain re-measurements	1,022.3	(859.8)
Share of tax from jointly controlled entities and associates	44.9	58.2
Adjusted profit before tax	1,335.7	1,310.1

9. Dividends

	Year ended 31 March 2012			Year ended 31 March 2011		
	Total £m	Settled via scrip £m	Pence per ordinary share	Total £m	Settled via scrip £m	Pence per ordinary share
Interim – year ended 31 March 2012	224.8	76.3	24.0	-	-	-
Final – year ended 31 March 2011	492.1	11.9	52.6	-	-	-
Interim – year ended 31 March 2011	-	-	-	208.3	61.7	22.4
Final – year ended 31 March 2010	-	-	-	451.5	84.4	49.0
	<u>716.9</u>	<u>88.2</u>		<u>659.8</u>	<u>146.1</u>	

The final dividend of 52.6p per ordinary share declared in the financial year ended 31 March 2011 (2010 – 49.0p) was approved at the Annual General Meeting on 21 July 2011 and was paid to shareholders on 23 September 2011. Shareholders were able to elect to receive ordinary shares credited as fully paid instead of the cash dividend under the terms of the Company's scrip dividend scheme.

An interim dividend of 24.0p per ordinary share (2011 – 22.4p) was declared and paid on 23 March 2012 to those shareholders on the SSE plc share register on 27 January 2012. Shareholders were able to elect to receive ordinary shares credited as fully paid instead of the interim cash dividend under the terms of the Company's scrip dividend scheme.

The proposed final dividend of 56.1p per ordinary share is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

Notes to the Preliminary Statement
for the year ended 31 March 2012

10. Earnings per share

Basic earnings per share

The calculation of basic earnings per share at 31 March 2012 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 2012. All earnings are from continuing operations.

Adjusted earnings per share

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

	Year ended 31 March 2012	Year ended 31 March 2012	Year ended 31 March 2011	Year ended 31 March 2011
	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share Pence
Basic	197.8	21.1	1,504.5	162.2
Exceptional items and certain re-measurements (note 6)	702.7	74.9	(607.4)	(65.5)
Basic excluding exceptional items and certain re-measurements	900.5	96.0	897.1	96.7
Adjusted for:				
Deferred tax (note 8)	122.9	13.1	109.6	11.8
Deferred tax from share of jointly controlled entities and associates results	33.4	3.6	35.2	3.8
Adjusted	1,056.8	112.7	1,041.9	112.3
Basic	197.8	21.1	1,504.5	162.2
Dilutive effect of convertible debt and outstanding share options	-	-	-	(0.2)
Diluted	197.8	21.1	1,504.5	162.0

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

	2012 Number of shares (millions)	2011 Number of shares (millions)
For basic and adjusted earnings per share	937.8	927.6
Effect of exercise of share options	1.5	1.1
	939.3	928.7

Notes to the Preliminary Statement
for the year ended 31 March 2012

11. Retirement Benefit Obligations

Valuation of combined Pension Schemes

	Long- term rate of return expected at 31 March 2012 %	Consolidated		Value at 31 March 2011 £m
		Value at 31 March 2012 £m	Long- term rate of return expected at 31 March 2011 %	
Equities	7.0	1,040.3	7.8	1,032.5
Government bonds	3.3	939.4	4.3	743.8
Corporate bonds	4.6	481.2	5.5	471.0
Other investments	4.3	234.2	4.4	216.3
Total fair value of plan assets		2,695.1		2,463.6
Present value of defined benefit obligation		(3,124.6)		(2,758.0)
Pension liability (pre-IFRIC 14)		(429.5)		(294.4)
IFRIC 14 liability (i)		(302.4)		(374.2)
Deficit in the schemes		(731.9)		(668.6)
Deferred tax thereon		175.7		173.8
Net pension liability		(556.2)		(494.8)

(i) The IFRIC 14 liability represents the deficit repair obligations required to ensure a minimum funding level together with a restriction on the surplus that can be recognised in the Scottish Hydro Electric scheme.

Movements in the defined benefit obligation are as follows:

	2012 £m	2011 £m
At 1 April	(2,758.0)	(2,762.3)
Movements in the year:		
Service costs	(37.8)	(37.8)
Member contributions	(7.8)	(7.8)
Benefits paid	112.8	105.7
Interest on pension scheme liabilities	(149.8)	(150.2)
Actuarial (losses)/gains	(284.0)	94.4
At 31 March	(3,124.6)	(2,758.0)

Movements in scheme assets during the year:

	2012 £m	2011 £m
At 1 April	2,463.6	2,298.3
Movements in the year:		
Expected return on pension scheme assets	147.4	141.9
Assets distributed on settlement	(112.8)	(105.7)
Employer contributions	138.0	106.6
Member contributions	7.8	7.8
Actuarial gains	51.1	14.7
At 31 March	2,695.1	2,463.6

12. 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 foreign exchange contracts. Non-hedge accounted contracts are treated as held for trading.

Notes to the Preliminary Statement
for the year ended 31 March 2012

12. Derivative financial assets and liabilities (continued)

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

	2012 £m	2011 £m
Operating derivatives		
Total result on operating derivatives (i)	142.0	887.9
Less: amounts settled in the year (ii)	<u>(575.7)</u>	<u>573.9</u>
Movement in unrealised derivatives	<u>(433.7)</u>	1,461.8
Financing derivatives (and hedged items)		
Total result on financing derivatives (i)	(1,288.7)	(935.9)
Less: amounts settled in the year (ii)	<u>1,199.2</u>	<u>891.5</u>
Movement in unrealised derivatives	<u>(89.5)</u>	<u>(44.4)</u>
Net income statement impact	<u>(523.2)</u>	1,417.4

(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:

	2012 £m	2011 £m
Derivative financial assets		
Non-current	348.0	990.1
Current	<u>851.2</u>	<u>2,525.5</u>
Total derivative assets	<u>1,199.2</u>	3,515.6
Derivative financial liabilities		
Non-current	(399.2)	(769.3)
Current	<u>(817.6)</u>	<u>(2,307.5)</u>
Total derivative liabilities	<u>(1,216.8)</u>	<u>(3,076.8)</u>
	<u>(17.6)</u>	438.8

13. Post-balance sheet events

On 16 April 2012, the Group received proceeds of US\$700m (£446.4m) from the US private placement undertaken in February 2012.