SSE plc

NOTIFICATION OF CLOSE PERIOD, VALUE PROGRAMME AND HOUSEHOLD ENERGY PRICES IN GREAT BRITAIN

SSE plc will enter its close period on 31 March 2014, prior to the publication on Wednesday 21 May of its financial report for the year to 31 March 2014. This statement:

- details developments since SSE published its Interim Management Statement (IMS) on 23 January;
- summarises SSE's expected financial results for the year to 31 March 2014, which are forecast to be in line with the financial outlook in the IMS;
- as part of a value programme, announces a programme of planned asset and business disposals that will secure proceeds and debt reduction estimated to total around £1bn and simplify significantly the SSE group;
- also as part of a value programme, announces the identification of further operational efficiencies that will result in annual savings in overheads of around £100m by March 2016 but which will result in a reduction, compared with previous plans, of around 500 in the number of people employed by SSE in Great Britain;
- announces that there will be legal separation of the businesses within SSE's Retail and Wholesale segments, planned to be completed by March 2015;
- announces that SSE will freeze at current levels its household energy prices in GB until at least January 2016;
- sets out the conclusions of SSE's review of its offshore wind development portfolio, which will result in SSE narrowing significantly the focus of its near-term development plans to no more than 375MW of capacity in the Beatrice project;
- forecasts capital and investment expenditure by SSE of around £1.6bn in 2014/15 and then an average of up to £1.3bn (net of disposals) across the three years to March 2018;
- states that SSE expects adjusted earnings per share[1] for 2014/15 to be around or slightly greater than in 2013/14 but to be subject to greater risks in the following two years; and

- states that SSE is targeting an increase in the full-year dividend for 2014/15 of at least RPI inflation[2], with annual increases thereafter of at least RPI inflation[2] also being targeted.

Alistair Phillips-Davies, Chief Executive of SSE, said:
"We're setting out a positive agenda for customers, including our price freeze to 2016; we're making sure our own house is in order for the future by streamlining and simplifying our business; and we're making clear we wish to work with people to find more ways of taking costs out of energy bills. In all of this, I hope that people will see a company like SSE not as part of the problem but as part of the solution."

Developments since publication of IMS
Since the publication of the Interim Management Statement (IMS) on 23 January 2014:

- SSE has been ranked as one of the most significant taxpayers in the UK, according to the report on the UK's top 100 Group companies published by accountants PwC in January 2014. The company paid £310m in UK taxes in 2013, giving it a ranking of 22nd among the survey participants.
- A total of 30,116 SSE shareholders elected to receive the interim dividend for the year to 31 March 2014 in the form of Scrip dividend. This resulted in a reduction in interim dividend cash funding of just over £112m, taking the total reduction in dividend cash funding since the Scrip dividend was introduced to just over £619m.
- SSE has decided not to proceed further with the development of two onshore wind farms (Dalnessie and Fairburn extension) with a total capacity of 117MW because they are no longer financially viable.
- The UK government has approved the Carbon Capture and Storage project at SSE's Peterhead power station for Front End Engineering Design study funding, as part of which SSE is responsible for modifying the power station for the CCS plant.
- Scottish and Southern Energy Power Distribution (SSEPD) has published an update to its business plan for the eight-year RIIO-ED1 period to 31 March 2023. Its proposals mean that the electricity distribution element of the average household energy bill for SSEPD's more than 3.5 million customers

should fall by around 15% in 2015/16, and change in line with inflation thereafter.

- The UK government confirmed in Budget 2014 that it 'remains committed to the Carbon Price Floor as a means to stimulate investment in low carbon' but is capping the Carbon Price Support rate at £18 from 2016/17 to 2019/20.

Financial outlook for 2013/14

SSE will publish its results for the financial year to 31 March 2014 on 21 May 2014. As set out in its IMS in January, it expects that it will report:

- an increase in the full-year dividend of around 3% - SSE's target for 2013/14 is to deliver an above-RPI inflation[2] dividend increase;
- an increase of between 2% and 4% in adjusted earnings per share[1], which SSE uses to monitor financial performance over the medium term because it defines the amount of profit *after* tax that has been earned for each Ordinary share; and
- an increase in adjusted profit before tax[1] across the SSE group of businesses that is expected to be around 9%, reflecting in particular the acquisition of new gas production assets in April 2013.

SSE has three business segments – Networks, Retail and Wholesale – the financial performance of which is reported by operating profit ie profit before payment of interest and tax. Expected financial performance for the year to 31 March 2014 (comparisons with the results for the year to 31 March 2013):

- **Networks**: operating profit is expected to be around 10% higher, reflecting in particular the level of capital investment in the electricity transmission business, which will have totalled around £1bn in the five years to March 2014.
- **Retail**: operating profit is expected to be around 25% lower, reflecting, amongst other things, customers' reduced consumption of energy.
- **Wholesale**: operating profit is expected to be around 20% higher, reflecting in particular significantly increased output from gas production, including the contribution of the Sean gas field assets acquired by SSE in April 2013, and of energy from renewable sources, in which SSE has invested around £3bn in

the five years to March 2014. Gas-fired power stations and gas storage facilities, however, have continued to struggle in difficult market conditions.

SSE expects to report capital and investment expenditure of over £1.5bn for 2013/14 as a whole, taking the total for the five years to 31 March 2014 to almost £7.5bn, all of which has been invested in the UK and Ireland to maintain and build assets. This is more than SSE's adjusted profit after tax[1] in the same period, which is expected to have totalled around £5.7bn.

Undertaking a value programme to ensure SSE is well-positioned for the future

Energy policy and politics in the UK and Ireland are dominated by the so-called energy 'trilemma': security of supply; decarbonisation and affordability. SSE's decision-making, for both operations and investment, aims to reflect all three parts of the 'trilemma' and in this way be as consistent as possible with the direction of energy policy and politics in the UK and Ireland. This means, for example, that while it supports action to address climate change, it also believes steps should be taken to ensure such action does not make energy unaffordable for the most vulnerable electricity and gas customers.

In addition, SSE believes that operational and financial discipline, supported by a commitment to reform that is in the interests of customers, is the best way to ensure it can continue to fulfil its core purpose of providing the energy people need in a reliable and sustainable way and therefore remunerate shareholders for their investment with dividend growth. In line with that, it is undertaking a value programme with two important features to help ensure that SSE is well-positioned for the period to 2020 and beyond.

- **Simplifying SSE to focus on what's important** SSE has identified a range of assets and businesses which are not core to its future plans or which result in a disproportionate financial burden to SSE. It has started a programme of disposal of such assets that will be completed over the next two years. Some disposal processes, such as SSE's portfolio of PFI street lighting contracts, are already under way. Proceeds and debt reduction from all of these disposals are estimated to total around £500m. In addition, there are other assets such as onshore wind farms which present, through disposal, opportunities to release capital to support future investment. SSE currently envisages securing proceeds of around £500m through disposals of such assets. In total, therefore, the disposal programme is expected to result in a financial benefit of around £1bn including proceeds received and balance sheet debt reduced. The disposal programme is also intended to enable SSE to ensure its resources are fully focused on what is important and relevant to its core purpose of providing the energy people need in a reliable and sustainable way.

- **Securing more operational efficiencies across SSE** Independent evidence such as the Consolidated Segmental Statements shows that SSE is an efficient company with relatively low operating costs. Nevertheless, the programme of asset disposals now being undertaken, a renewed company-wide focus on the key issues of concern to customers and a re-focusing of resources required to support its capital and investment expenditure programme means that SSE has been able to identify annual savings in overheads that will total in the first instance around £100m by the end of 2015/16. This includes, for example, savings arising from the closure of Units 1 and 2 at SSE's coal-fired power station at Ferrybridge, which will take place on 28 March. In total, as a result of this programme, SSE now expects to see a cumulative reduction, compared with previous plans, of around 500 in the number of jobs across its businesses and in its corporate functions, to be achieved by a programme of voluntary early release and it should not require any compulsory redundancies. SSE still expects to employ over 20,000 people in Great Britain and Ireland at the end of 2014/15.

Demonstrating SSE's appetite for reform

In addition to simplifying and streamlining its business through its value programme, SSE is also committed to demonstrating its appetite for reform.

In line with that, while SSE believes that the integrated management of Retail and Wholesale businesses brings significant benefits for customers, including protection from price volatility in wholesale markets, it has also acknowledged that more needs to be done to make the energy sector easier to understand and has already confirmed that it has no objections in principle to greater separation of Retail and Wholesale businesses.

Subject to securing the necessary third party consents, SSE will reorganise its companies so that there are separate legal entities for its energy supply (Retail) and its electricity generation and energy portfolio management (Wholesale) activities. This change, which is scheduled to be completed by 31 March 2015, will enhance the transparency of the measurement and reporting of the performance of these businesses and be consistent with the expected evolution of the Consolidated Segmental Statements.

Longer term, SSE remains open-minded about further reform that is in the clear interests of customers, including further steps that would enhance the transparency of financial reporting and operations.

Fulfilling SSE's core purpose

SSE's core purpose is to provide the energy people need in a reliable and sustainable way. Its strategy is to deliver the efficient operation of, and investment in, a balanced range of economically-regulated and market-based businesses in energy production, storage, transmission, distribution, supply and related services in the UK and Ireland, with the financial objective of increasing annually the dividend payable to shareholders, by at least RPI inflation[2].

In fulfilling this core purpose and implementing this strategy, SSE has three long-term objectives:

- **Networks - efficiency and innovation** to help keep the lights on and provide the necessary connections to the electricity system;
- **Retail - digital excellence and a brand people trust** so that operating costs are kept to a minimum, opportunities to increase the efficient use of energy are maximised and customers trust SSE to do the right things for them; and
- **Wholesale - sustainability in energy production** through a diverse generation portfolio, including the largest amount of renewable energy capacity in the UK and Ireland, that helps keep the lights on by being available to generate electricity when required and is flexible enough to respond to changes in demand when they occur.

In each of these areas, there is significant regulatory and political activity, including the competition study process instigated by the UK government in October 2013. As stated in its Annual Report 2013, SSE recognises that there is legitimate regulatory, political and public interest in its activities and it is SSE's responsibility to provide value for money, fairness and transparency to customers.

At the same time, just as its decision-making aims to reflect all three parts of the energy 'trilemma', SSE urges politicians and regulators to do all they can to ensure that all of their decisions are robust, consistent and sustainable. In line with this, SSE's response to the Labour Party's 'green paper', *Powering Britain: One Nation Labour's plans to reset the energy market*, is published today (26 March).

The significant political activity includes the Scottish referendum on 18 September, about which SSE remains strictly neutral. While SSE believes that a single energy market in Great Britain would be the most likely outcome in the event of a 'Yes' vote, it has long recognised that the processes of negotiation between the Scottish government, the United Kingdom government and the European Union following a 'Yes' vote would be likely to take time, be complex and may result in changes to the existing single energy market. As SSE stated in its IMS, the uncertainty associated with any constitutional change represents increased legislative and regulatory risk, of which SSE has to take account in making decisions.

SSE has already put in place arrangements to ensure that it takes account of this uncertainty in its decision-making and is undertaking work to ensure that it: has a clear view of the issues that would arise should there be a 'Yes' vote; and is in a good position to engage constructively with the Scottish and UK governments in the event of Scotland ceasing to be part of the United Kingdom. SSE's approach is to ensure that its operational and investment decisions continue to meet the needs of all of its networks and energy supply customers in particular, while safeguarding the interests of investors.

Networks – meeting the needs of customers now and in the future

In 2012/13, economically-regulated electricity networks became the largest element of SSE's capital and investment expenditure, with 46% of the total, and they will continue to comprise the largest element for the foreseeable future.

On 17 March, Scottish and Southern Energy Power Distribution (SSEPD) submitted its revised business plan for the electricity distribution price control period for the eight years to March 2023. The updated business plan includes proposals to improve the resilience of the networks, increase support for vulnerable customers and achieve in 2015 a reduction in SSEPD's part of the electricity bill, and with only inflationary increases thereafter.

While Ofgem has reduced its central estimate of the appropriate allowed base return on equity from 6.3% to 6.0% post-tax real, this is just one part of a wider package of measures that will comprise the final proposals for electricity distribution between 2015 and 2023 that should be agreed before the end of the year. SSEPD believes that its revised business plan should lead to a price control that is fair to customers and investors alike.

In the meantime, SSEPD is considering the responses it has received to the consultation it launched on 3 January following the impact of extreme weather on the network serving its customers in central southern England and will publish its findings later this year. It has already implemented a number of initiatives to improve customer communications, including better information on expected electricity supply restoration times.

Scottish Hydro Electric Transmission has almost completed the first year of the Transmission price control period for the eight years to 31 March 2021. During the year, it has undertaken capital works totalling over £350m to improve and increase the capacity of its network, connecting over 250MW of generation. SHE Transmission is already committed to investment of around £750m over the next four years.

In addition to this, SHE Transmission has in place advanced plans and associated planning consents for a new transmission link between Caithness and Moray, including a subsea electricity cable in the Moray Firth. The assessment from SHE Transmission demonstrates that the customer benefit of the new link, which is required to transmit a large volume of electricity from renewable sources in the north of Scotland, is clear. Ofgem is expected to undertake further detailed consultations on the project in the next few weeks.

The link has a forecast investment requirement of around £1.3bn (2012/13 prices), which would take SHE Transmission's total investment in the next four years to around £2bn. If it is approved, revenue recovery is expected to begin in 2015/16.

Retail – doing the right things for customers

SSE has consistently argued that politicians can help energy bill payers by transferring to taxpayers the costs of the environmental and social policies put in place over the last decade by governments featuring all three main UK parties. In December 2013, it was announced that the Warm Home Discount is going to be paid for by taxpayers for two years and the Energy Company Obligation (ECO) is due to be reformed and extended, so that customers will continue to benefit from energy saving measures, but in a way that should be simpler and less expensive.

SSE has therefore reduced its energy prices in Great Britain and, unlike some companies, is also passing on savings to customers on fixed and capped price tariffs. Nevertheless, the issue of affordability of energy for household customers has become more prominent as a result of the higher level of energy prices seen in recent years, which have coincided with the wider financial pressures faced by households since 2008. This is likely to remain the case, with significant costs expected to be added to bills in the second half of this decade through the continuing impact of government-sponsored environmental and social policies.

Against this background, SSE has decided it will freeze household electricity and gas prices in Great Britain at their current level, until at least January 2016. By that stage, SSE will not have increased its prices since November 2013, a period of 26 months. Around eight million customers in Great Britain will benefit from what is the longest–lasting comprehensive energy price freeze in the market.

SSE is able to make this commitment now as a result of the planned changes to the Warm Home Discount and ECO announced in December 2013, which it is assuming will be confirmed, through its work to secure customers' energy supplies in wholesale markets and as a result of its wider focus on operational efficiency.

SSE believes that its price freeze also provides an opportunity for it to work constructively with legislators, regulators, consumer bodies, customers and other stakeholders to secure practical changes that will benefit energy bill payers now and in the future.

Despite the changes to the Warm Home Discount and ECO announced in December 2013, energy bill payers are still expected to meet significant and increasing costs resulting from environmental and social policies and schemes such as the nationwide roll-out of smart meters. SSE acknowledges the benefits arising from what these policies and schemes are designed to achieve. It believes, however, that if politicians extend the principle recognised in December 2013 – that government and taxpayers can ease the impact on energy bill payers of environmental and social costs and schemes - it will be able to extend its price freeze commitment beyond January 2016, subject to there being no marked and sustained increase in wholesale prices and no new environmental, social or other policy costs.

In order to deliver its price freeze, SSE recognises and accepts that its profit margins in Energy Supply in the next two financial years are expected to be lower than in the past. It is now expecting to earn:

- an annual profit margin across its entire Energy Supply business that: is lower than the 4.2% (before tax) it achieved in 2012/13; and, within this,
- an annual profit margin in its household electricity and gas supply business in Great Britain that is lower than the 6.4% (before tax) that it achieved in 2012/13.

Nevertheless, as an efficient company with relatively low operating costs, SSE believes that earning a fair and reasonable profit margin in energy supply benefits everyone, including customers, by ensuring that it can fulfil its core purpose of providing the energy people need in a reliable and sustainable way.

Wholesale – responding to changes in the electricity market

The Energy Act 2013 provides a framework for Electricity Market Reform (EMR), including a Capacity Market and Contract for Difference Feed-in Tariffs (CfDs).

SSE supports the introduction of a Capacity Market in 2018, believing it to be essential to support the retention of, and investment in, electricity generation plant. It also supports the timely introduction of National Grid Electricity Transmission’s plan to introduce two new balancing services from the winter of 2014/15, including the Supplemental Balancing Reserve, which are designed to provide electricity customers with ‘additional safeguards against an uncertain security of supply outlook mid-decade’.

The first capacity auction, relating to the year from October 2018, is due to take place at the end of this year. SSE is currently confirming which of its electricity generating units are potentially eligible to take part and assessing its development portfolio to confirm eligibility also. In addition, it is focusing on the auction process itself, which must be transparent and objective if it is to achieve the Capacity Market objective of retention of, and investment in, generation plant. All of this will allow SSE to decide in the autumn of this year whether it wishes to participate in the Capacity Market and, if so, the appropriate £/kW at which it should take part.

Since the publication of the 'provisionally affordable' list of projects under the Final Investment Decision Enabling for Renewables announced by the UK government earlier this year, SSE has undertaken a wide ranging review of its offshore wind development portfolio (current ownership stake in brackets): Galloper (50%); Beatrice (75%); Seagreen (50%); Forewind (25%); and Islay (100%). As they are currently configured, the projects represent potentially up to 4,970MW (net) of offshore wind farm capacity for SSE.

In summary, SSE has decided to maintain investment in Beatrice (total capacity 750MW) over the rest of this calendar year, while reducing its stake to no more than 50%, delivering the engineering and procurement activities required to ensure the project's continued progress towards a Final Investment Decision. It does not, however, currently believe that the costs of constructing and operating Galloper, and the revenue likely to be earned from it once built, will provide a return on SSE's capital investment that will enable the project to compete successfully against other projects in SSE's wider investment portfolio over Galloper's planned construction timeline.

SSE has decided that it will continue to support the progress of development work on Seagreen and Forewind with the objective of securing the necessary consents for construction, but that it will not extend beyond that the scope of its commitments to the projects in the near term. In particular, SSE does not plan to extend its commitment to the projects until it has achieved sufficient confidence in the viability of the wider UK offshore wind sector. SSE had proposed to develop a 690MW offshore wind farm off the coast of Islay and while it will continue to work with other stakeholders in relation to the development, it will not be investing further in the project in the foreseeable future.

These decisions are entirely consistent with SSE's belief that investments should secure returns that are significantly greater than the cost of capital and enhance adjusted earnings per share[1]. A full statement on SSE's offshore wind farm development plans is available on sse.com.

Outlook for capital and investment expenditure

In its IMS in January 2014, SSE said there was greater uncertainty about the shape and extent of its future capital and investment programme, and it was likely to be lower than the £1.5bn to £1.7bn range invested in each of the years since 2010.

Looking across its Networks, Retail and Wholesale businesses, SSE currently expects that its capital and investment expenditure will total around £1.6bn in 2014/15 and then average up to £1.3bn (net) in each of the years to and including 2017/18. This includes:

- economically-regulated expenditure on electricity transmission upgrades;
- economically-regulated electricity distribution expenditure plus essential maintenance of other assets; and
- expenditure that is already committed to development of new assets (this currently includes the CCGT at Great Island in Ireland, SSE's share of the new multi-fuel plant at Ferrybridge and onshore wind farm capacity).

The transmission upgrades include the planned link between Caithness and Moray that is required to transmit the large volume of electricity from renewable sources in the north of Scotland but for which final investment authorisation has yet to be secured. This project has a forecast investment requirement of around £1.3bn (2012/13 prices).

In addition, SSE is continuing to develop options for new assets such as onshore wind farms and gas-fired power stations. SSE has, in the past, disposed of assets, in part or in whole, and its commitment to financial discipline means that it will monetise value from existing investments and assets in order to support future investment in new assets to which it decides to commit over the next few years, where that will enhance adjusted earnings per share[1] over the long term.

SSE believes that a capital and investment programme on this scale, supported by recycling of capital through asset disposals where appropriate, and a flexible approach to value-creation, should position it well for the future and is designed to be consistent with continuing to meet the current criteria for a Single A credit rating.

Focusing on adjusted earnings per share[1]

SSE uses adjusted earnings per share[1] to monitor financial performance over the medium term, because it defines the amount of profit *after* tax that has been earned for each Ordinary share.

SSE currently expects adjusted earnings per share[1] in 2014/15 to be around or slightly greater than that in 2013/14. In view of the wider energy sector conditions, however, SSE recognises that increases in adjusted earnings per share[1] are subject to greater risk in 2015/16 and 2016/17. This is because of, amongst other things:

- the continuing impact of difficult market conditions in thermal generation, which have already persisted for some years;
- the possibility of a freeze on retail energy prices being legislated upon in Great Britain after the 2015 general election;
- the possible outcome of the RIIO-ED1 process for determining electricity distribution companies' Price Controls for 2015-23, where Ofgem has already reduced its central reference point for assessing cost of equity from 6.3% to 6.0%; and
- changes arising from any other political, constitutional and regulatory developments, such as the competition study process instigated by the UK government in October 2013.

More broadly SSE, in common with other energy companies, is exposed to a range of geo-political, market and other risks which it will continue to manage through financial and operational discipline. In respect of both the possible retail price freeze legislation and the RIIO-ED1 and competition study processes, SSE will continue to argue strongly for policies and decisions that are fair to energy bill payers and to investors and support the delivery of secure, lower carbon and affordable supplies of electricity and gas over the long term.

Earning and delivering a return for investors

SSE's key financial objective is to remunerate shareholders for their investment through the payment of dividends. Shareholders have either invested directly in SSE or, as owners of the company, enabled it to borrow money from debt investors. In the last five years, SSE has invested around £7.5bn in electricity generation and electricity networks. To fund this, it has borrowed money and its net debt will have gone up from £4.8bn in 2009 to around £7.8bn at the end of this financial year. Shareholders, as the owners of SSE, have effectively taken on this debt and pay interest to debt investors; and in return for this SSE pays them dividends.

SSE's financial objective for 2014/15 is to deliver a full-year dividend increase which is at least RPI inflation[1]; thereafter, its aim is to deliver annual dividend increases that are also at least RPI inflation[1]. As a result of the risks (see above) to which adjusted earnings per share[1] are particularly subject in 2015/16 and 2016/17, SSE recognises that dividend cover could, temporarily, fall below its target range of around 1.5 times and could, in some circumstances, be closer to around 1.2 times in 2016/17. Nevertheless, it believes that it can continue to deliver a return for investors that is sustainable over the long term, based on the quality of its operations, assets and investment opportunities.

Summary

SSE has consistently said that operational and financial discipline is the best way it can fulfil its core purpose of providing the energy people need in a reliable and sustainable way and believes the package of measures it is announcing today is entirely consistent with that. It is also consistent with SSE being part of the solution to meeting the energy needs of customers in Great Britain and Ireland.

[1] As defined in SSE's six-month financial report published in November 2013.
[2] Measured against the average annual rate of RPI inflation across each of the 12 months to March.

Further information

Disclaimer
This notification of close period 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.

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