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If you sell or have sold or otherwise transferred all your SSE Shares, please send this document together with the accompanying documents at once to the purchaser or transferee, or to the stockbroker, bank or other agent through whom the sale or transfer was effected for delivery to the purchaser or transferee. However, such documents should not be forwarded or transmitted in or into any jurisdiction in which such act would constitute a violation of the relevant laws in such jurisdiction. If you sell or have sold or otherwise transferred only part of your holding of SSE Shares, you should retain these documents and consult the stockbroker, bank or other agent through whom the sale or transfer was effected.

The release, publication or distribution of this document in jurisdictions other than the United Kingdom may be restricted by law and, therefore, any persons who are subject to the laws of any jurisdiction other than the United Kingdom should inform themselves about, and observe, any applicable requirements. This document has been prepared for the purposes of complying with English law and the listing rules of the Financial Conduct Authority (*FCA*) (the ***Listing Rules***) and the information disclosed may not be the same as that which would have been disclosed if this document had been prepared in accordance with the laws and regulations of any jurisdiction outside of England.



## **SSE PLC**

(incorporated and registered in Scotland with registered number SC117119)

### **Proposed demerger of SSE Energy Services to ShiftMCo123 Ltd (*MergeCo*) and combination with Npower Group Limited and Notice of General Meeting**

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**This Circular does not constitute or form part of any offer or invitation to purchase, otherwise acquire, subscribe for, sell, otherwise dispose of or issue, or any solicitation of any offer to sell, otherwise dispose of, issue, purchase, otherwise acquire or subscribe for, any security.**

**This Circular does not constitute a prospectus or prospectus equivalent document. The prospectus relating to MergeCo will be published and delivered to SSE Shareholders at a later date.**

The whole of this document should be read. Your attention, in particular, is drawn to the risk factors set out in Part III (*Risk Factors*) of this document and the letter from the Chairman of SSE plc that is set out in Part I (*Letter from the Chairman of SSE*) of this document and which contains a recommendation from the Directors that you vote in favour of the Resolutions to be proposed at the General Meeting.

Notice of a General Meeting of SSE plc (**SSE**) to be held at Perth Concert Hall, Mill Street, Perth, PH1 5HZ at 2.00 p.m. on 19 July 2018 is set out in Part XV (*Notice of General Meeting*) of this document.

The actions to be taken in respect of the General Meeting are set out in paragraph 19 of Part I (*Letter from the Chairman of SSE*) of this document. Whether or not you intend to attend the General Meeting in person, please complete and sign the Form of Proxy (or appoint a proxy electronically, as referred to in this document) in accordance with the instructions printed on it and return it to SSE's registrars, Link Asset Services, as soon as possible and, in any event, so as to be received no later than 48 hours (excluding any part of a day that is not a working day) prior to the time appointed for the holding of the General Meeting. Completion and return of a Form of Proxy will not preclude SSE Shareholders from attending and voting in person at the General Meeting, should they so wish. The proposals in this Circular are conditional on, among other things, the approval of Shareholders at the General Meeting.

If you are an employee who participates in SSE's UK Share Incentive Plan, you should sign and complete a Form of Direction (or complete electronically, as referred to in this document) in accordance with the instructions printed on it and return it to SSE's registrars, Link Asset Services, as soon as possible and, in any event, so as to be received by no later than 2.00 p.m. on Thursday, 12 July 2018.

If you have any questions about this document, the General Meeting or on the completion and return of the Form of Proxy or Form of Direction, please call the SSE Shareholder Helpline between 9.00 am and 5.30 pm (UK time) Monday to Friday (except UK public holidays) on +44 (0)345 143 4005. Calls are charged at the standard geographic rate and will vary by provider. Calls outside the United Kingdom will be charged at the applicable international rate. Please note that calls may be monitored or recorded and the helpline cannot provide financial, legal or tax advice or advice on the merits of the Transaction (as defined herein).

**IN ORDER TO FACILITATE THE DISTRIBUTION OF MERGECO SHARES, EACH SSE SHAREHOLDER WILL BE REQUIRED TO REPRESENT, WARRANT AND CONFIRM, IN THE MANNER AND BY THE TIMES DESCRIBED HEREIN, THAT THEY ARE, OR HOLD SSE SHARES ON BEHALF OF, A PERSON WHO EITHER (A) IS LOCATED OUTSIDE THE UNITED STATES OR (B) HAS MADE THE REPRESENTATIONS, WARRANTIES AND CONFIRMATIONS CONTAINED IN PARAGRAPH 5 OF PART XII (*FURTHER DETAILS OF THE TRANSACTION*) OF THIS CIRCULAR. SSE SHAREHOLDERS WHO DO NOT MAKE THESE REPRESENTATIONS, WARRANTIES AND CONFIRMATIONS MAY BE, AT THE ABSOLUTE DISCRETION OF SSE, DEEMED TO BE INELIGIBLE SHAREHOLDERS. MERGECO SHARES ISSUED TO AN INELIGIBLE SHAREHOLDER MAY BE PLACED IN THE MARKET WITH THE NET PROCEEDS REMITTED TO SUCH SSE SHAREHOLDER.**

**SSE ADR HOLDERS WILL NOT BE ELIGIBLE TO RETAIN MERGECO SHARES (FURTHER EXPLANATION CAN BE FOUND IN PARAGRAPH 6 OF PART XII (*IMPORTANT INFORMATION FOR ADR HOLDERS*)).**

Credit Suisse International (**Credit Suisse**) and Morgan Stanley & Co. International plc (**Morgan Stanley**), which are each authorised by the Prudential Regulation Authority and regulated in the United Kingdom by the Financial Conduct Authority and the Prudential Regulation Authority, are each acting exclusively for SSE and for no one else in connection with the matters described in this document and will not regard any other person (whether or not a recipient of this document) as a client in connection with the matters described in this document and is not, and will not be, responsible to anyone other than SSE for providing the protections afforded to clients of Credit Suisse or Morgan Stanley nor for providing advice in connection with the matters set out in this document or any transaction, arrangement or other matter referred to in this document. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed to any other person or published in whole or in part for any purpose.

Capitalised terms have the meanings ascribed to them in Part XIV (*Definitions*) of this document.

## **OVERSEAS SHAREHOLDERS**

The implications of the Transaction for, and the distribution of this document to, overseas shareholders may be affected by the laws of the relevant jurisdictions in which such overseas shareholders are located. Such overseas shareholders should inform themselves about, and observe, all applicable legal requirements. It is the responsibility of any person into whose possession this document comes to satisfy themselves as to their full observance of the laws of the relevant jurisdiction in connection with the Transaction and the distribution of this document, including the obtaining of any governmental, exchange control or other consents which may be

required and/or compliance with other necessary formalities which are required to be observed and the payment of any issue, transfer or other taxes due in such jurisdiction.

Overseas shareholders should consult their own legal and tax advisers with respect to the legal and tax consequences of the Transaction in their particular circumstances.

The MergeCo Shares have not been and will not be registered under the US Securities Act of 1933, as amended (the *Securities Act*), or under the securities laws of any state or other jurisdiction of the United States and may not be offered or sold within the United States, except pursuant to an applicable exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States. There will be no public offer of the MergeCo Shares in the United States or elsewhere.

The MergeCo Shares have not been approved or disapproved by the US Securities and Exchange Commission, any state securities commission in the United States or any US regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the MergeCo Shares or the accuracy or adequacy of this document. Any representation to the contrary is a criminal offence in the United States.

#### **AVAILABILITY OF HARD COPIES**

If you have received this document in electronic form, you may request a hard copy of this document and/or any information incorporated by reference into this document by calling the SSE Shareholder Helpline as outlined on page 4. You may also request that all future documents, announcements and information to be sent to you in relation to the Transaction should be in hard copy form. Copies of this document and any document or information incorporated by reference into this document will not be provided unless such a request is made.

#### **INFORMATION REGARDING FORWARD-LOOKING STATEMENTS**

This document contains statements which are, or may be deemed to be, “forward-looking statements” which are prospective in nature. All statements other than statements of historical fact are forward-looking statements. They are based on current expectations and projections about future events, and are therefore subject to risks and uncertainties which could cause actual results to differ materially from the future results expressed or implied by the forward-looking statements. Often, but not always, forward-looking statements can be identified by the use of forward-looking words such as “plans”, “expects”, “is expected”, “is subject to”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates”, “believes”, “targets”, “aims”, “projects” or words or terms of similar substance or the negative thereof, as well as variations of such words and phrases or statements that certain actions, events or results “may”, “could”, “should”, “would”, “might” or “will” be taken, occur or be achieved. Such statements are qualified in their entirety by the inherent risks and uncertainties surrounding future expectations. Forward-looking statements include statements relating to (a) future capital expenditures, expenses, revenues, earnings, economic performance, indebtedness, financial condition, dividend policy, losses and future prospects of the SSE Group or the MergeCo Group, (b) business and management strategies and the expansion and growth of the SSE Group’s or MergeCo Group’s operations, and (c) the effects of global economic conditions on the SSE Group’s or MergeCo Group’s business.

Such forward-looking statements involve known and unknown risks and uncertainties that could significantly affect expected results and are based on certain key assumptions. Many factors may cause actual results, performance or achievements of the SSE Group or MergeCo Group to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Important factors that could cause actual results, performance or achievements of the SSE Group or MergeCo Group to differ materially from the expectations of SSE or MergeCo, include, among other things, general business and economic conditions globally, industry trends, competition, changes in government and other regulation and policy, commodity price fluctuations, physical and cyber security concerns, environmental factors, political and economic uncertainty and other factors discussed in Part III (*Risk Factors*) of this document. Such forward-looking statements should therefore be construed in light of such factors.

Neither SSE nor any of its directors, officers or advisers provides any representation, assurance or guarantee that the occurrence of the events expressed or implied in any forward-looking statements in this document will actually occur. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as at the date hereof.

Other than in accordance with its legal or regulatory obligations (including under the Listing Rules and the Disclosure Guidance and Transparency Rules), SSE is not under any obligation and SSE expressly disclaims

any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## **NO PROFIT FORECAST**

No statement in this document or incorporated by reference into this document is intended as a profit forecast or a profit estimate with respect to SSE plc or MergeCo and no statement in this document should be interpreted to mean that earnings per SSE Share for the current or future financial years would necessarily match or exceed the historical published earnings per SSE Share.

## **FINANCIAL INFORMATION**

References to “£”, “GBP”, “pounds”, “pounds sterling”, “sterling”, “p”, “penny” and “pence” are to the lawful currency of the United Kingdom.

## **NO INCORPORATION OF WEBSITE INFORMATION**

Information on or accessible through SSE’s website ([www.sse.com](http://www.sse.com)) and innogy’s website ([www.innogy.com](http://www.innogy.com)) or any other website referred to in this Circular (including any hyperlinks accessible from those websites) do not form part of, and are not incorporated into, this Circular unless specifically noted in paragraph 13 of Part XIII (*Additional Information*).

## **ABOUT SSE**

The SSE group of businesses (formerly known as Scottish and Southern Energy) was formed in 1998 through the merger of Scottish Hydro Electric and Southern Electric, companies which themselves were formed as a result of the privatisation of the electricity supply industry in the United Kingdom following the Electricity Act 1989. In 2000, SSE purchased the Swalec energy supply business. SSE later acquired the energy supply business Atlantic in 2004. Throughout this time, SSE has been one of the leading suppliers of electricity and gas to customers throughout Great Britain.

SSE has been listed on the London Stock Exchange since June 1991.

## **ABOUT NPOWER**

The npower business was launched in 1999 when National Power plc (the then parent company of Npower Limited) acquired the electricity supply business of Midlands Electricity plc and the gas supply business of Calortex Limited. In 2000, National Power plc was de-merged to form innogy Holdings plc and International Power plc. innogy Holdings plc later acquired the supply businesses of Yorkshire Electricity and Northern Electric. In 2002, innogy Holdings plc was purchased by RWE AG (**RWE**) and renamed RWE npower Holdings plc in 2004. Since April 2016, npower has been part of the innogy Group which was formed when RWE AG combined its renewables, retail and grid and infrastructure businesses. innogy SE became a separate listed company on 7 October 2016 through an IPO and entry on the MDAX (Frankfurt Stock Exchange) in December 2016.

On 12 March 2018, RWE announced that it had concluded an agreement with E.ON SE (**E.ON**) on the sale of RWE’s 76.8 per cent. stake in innogy (the **E.ON/RWE Transaction**). If the E.ON/RWE Transaction completes, E.ON would therefore become the majority owner and ultimate controller of innogy and, indirectly, innogy’s holding in MergeCo, should the Transaction described in this Circular complete.

**SSE SHAREHOLDER HELPLINE: +44 (0)345 143 4005**

(Calls are charged at the standard geographic rate and will vary by provider. Calls outside the United Kingdom will be charged at the applicable international rate.)

LINES ARE OPEN 9.00 am TO 5.30 pm, MONDAY TO FRIDAY.

Calls may be monitored or recorded and the helpline cannot provide financial, legal or tax advice or advice on the merits of the Transaction

## TABLE OF CONTENTS

	<u>Page</u>
EXPECTED TIMETABLE OF PRINCIPAL EVENTS . . . . .	6
DIRECTORS, COMPANY SECRETARY, REGISTERED OFFICE AND ADVISERS . . . . .	7
PART I LETTER FROM THE CHAIRMAN OF SSE . . . . .	8
PART II SOME QUESTIONS AND ANSWERS ON THE TRANSACTION . . . . .	23
PART III RISK FACTORS . . . . .	31
PART IV SUMMARY OF THE PRINCIPAL TERMS AND CONDITIONS OF THE TRANSACTION . . . . .	45
PART V MERGECO GROUP BUSINESS OVERVIEW . . . . .	51
PART VI INDUSTRY OVERVIEW . . . . .	61
PART VII MERGECO DIRECTORS AND CORPORATE GOVERNANCE . . . . .	64
PART VIII TAXATION . . . . .	66
PART IX UNAUDITED PRO FORMA FINANCIAL INFORMATION FOR THE SSE RETAINED GROUP . . . . .	72
PART X UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE MERGECO GROUP . . . . .	75
PART XI HISTORICAL FINANCIAL INFORMATION . . . . .	78
PART XII FURTHER DETAILS OF THE TRANSACTION . . . . .	167
PART XIII ADDITIONAL INFORMATION . . . . .	176
PART XIV DEFINITIONS . . . . .	185
PART XV NOTICE OF GENERAL MEETING . . . . .	190
APPENDIX 1 SSE QUANTIFIED FINANCIAL BENEFITS STATEMENT . . . . .	195

## EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Publication of this Circular and Notice of General Meeting . . . . .	27 June 2018
Latest date and time for receipt of Forms of Direction for the General Meeting . . . . .	2:00 p.m. on 12 July 2018
Latest date and time for receipt of Forms of Proxy, electronic proxy voting and/or CREST proxy instructions for the General Meeting . . . . .	2:00 p.m. on 17 July 2018
SSE Annual General Meeting . . . . .	12:30 p.m. on 19 July 2018
SSE General Meeting . . . . .	2:00 p.m. on 19 July 2018
Expected date of satisfaction of conditions under the Contribution Agreement	Q1 2019
Latest date and time to make Investor Declarations . . . . .	3:00 p.m. on D
Demerger Record Time . . . . .	6:00 p.m. on D
Demerger Effective Time (issue of MergeCo Shares to SSE Shareholders), the date of the Demerger being <b>D</b> . . . . .	11:00 p.m. on D
Transfer of Npower Group Limited ( <b>npower</b> ) to MergeCo by the innogy Group (and issue of MergeCo Shares to the innogy Group) . . . . .	D + 1
Admission to trading, listing of, and commencement of dealings in the MergeCo Shares on the London Stock Exchange, and completion of the Transaction ( <b>Completion</b> ) . . . . .	8:00 a.m. on D + 1
Crediting of uncertificated MergeCo Shares to CREST accounts . . . . .	D + 1
Payment of sale proceeds relating to ineligible overseas MergeCo Shareholders . . . . .	From D + 6
Issuance of share certificates to certificated MergeCo Shareholders . . . . .	By D + 15
Long stop date for Completion . . . . .	30 June 2019

### Notes:

All time references in this document are to UK time.

These dates are provided by way of indicative guidance and are subject to change. If any of the above times and/or dates change, SSE will give adequate notice by issuing an announcement through the Regulatory News Service (**RNS**). The date of “D” will be announced by SSE through the RNS as soon as practicable.

## DIRECTORS, COMPANY SECRETARY, REGISTERED OFFICE AND ADVISERS

SSE Directors . . . . .	Richard Gillingwater CBE—Chairman Alistair Phillips-Davies—Chief Executive Gregor Alexander—Finance Director Martin Pibworth—Wholesale Director Crawford Gillies—Senior Independent Director Jeremy Beeton CB—Non-Executive Director Dame Sue Bruce DBE—Non-Executive Director Peter Lynas—Non-Executive Director Helen Mahy CBE—Non-Executive Director Tony Cocker—Non-Executive Director
Proposed MergeCo Directors . . . . .	Katie Bickerstaffe—Chief Executive Designate Gordon Boyd—Chief Financial Officer Designate
SSE Group Company Secretary . . . . .	Sally Fairbairn
SSE Registered Office . . . . .	Inveralmond House 200 Dunkeld Road Perth Perthshire PH1 3AQ
Financial Advisers . . . . .	Credit Suisse One Cabot Square London E14 4QJ  Morgan Stanley & Co. International plc 25 Cabot Square Canary Wharf London E14 4QA
Legal Advisers to SSE . . . . .	Freshfields Bruckhaus Deringer LLP 65 Fleet Street London EC4Y 1HS
Legal Advisers to the Financial Advisers . . .	Linklaters LLP 1 Silk Street London EC2Y 8HQ
Reporting Accountants to SSE . . . . .	KPMG LLP 15 Canada Square Canary Wharf London E14 5GL
Reporting Accountants to npower . . . . .	PricewaterhouseCoopers LLP 19 Cornwall St Birmingham B3 2DT
Registrars . . . . .	Link Asset Services The Registry 34 Beckenham Road Beckenham Kent BR3 4TU



## PART I LETTER FROM THE CHAIRMAN OF SSE

SSE PLC

(registered in Scotland with No. SC117119)

Directors:

Richard Gillingwater CBE—Chairman  
Alistair Phillips-Davies—Chief Executive  
Gregor Alexander—Finance Director  
Martin Pibworth—Wholesale Director  
Crawford Gillies—Senior Independent Director  
Jeremy Beeton CB—Non-Executive Director  
Dame Sue Bruce DBE—Non-Executive Director  
Peter Lynas—Non-Executive Director  
Helen Mahy CBE—Non-Executive Director  
Tony Cocker—Non-Executive Director

Registered Office:

Inveralmond House  
200 Dunkeld Road  
Perth  
Perthshire  
PH1 3AQ

27 June 2018

Dear Shareholder,

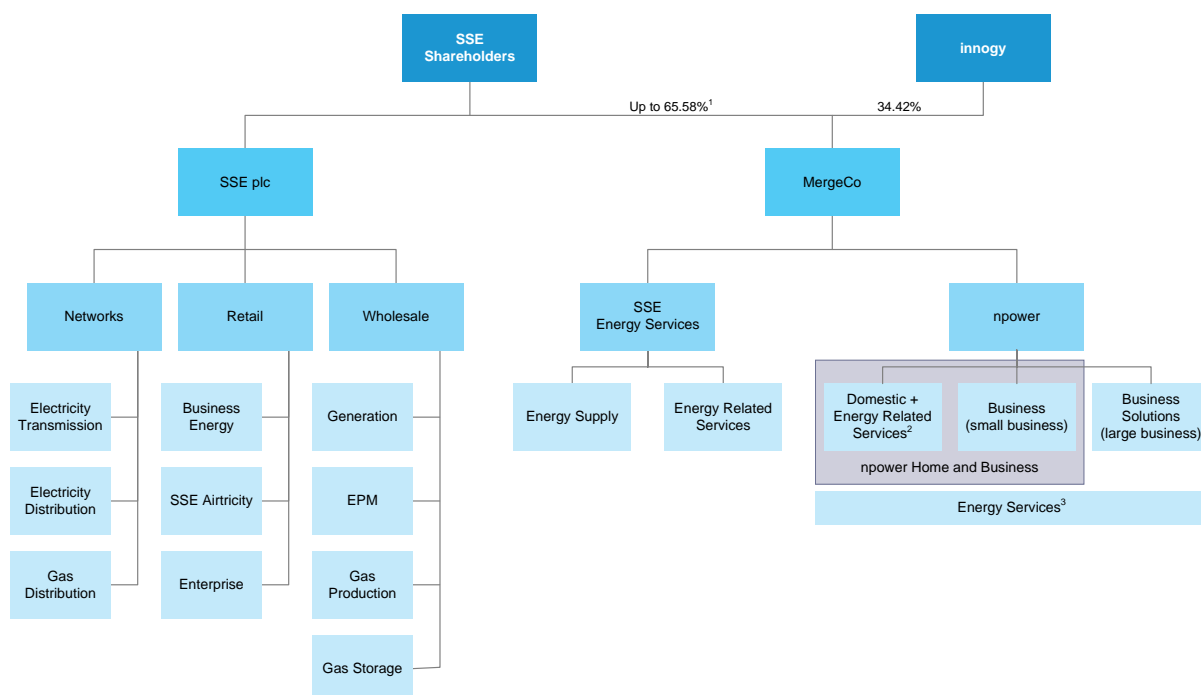
**Proposed demerger of  
SSE Energy Services to MergeCo and  
combination with Npower Group Limited  
and  
Notice of General Meeting**

### 1. Introduction

On 8 November 2017, the board of directors of SSE (the **Board**) announced it had entered into an agreement with innogy in respect of a proposed demerger of SSE's household energy and services business in Great Britain (now named **SSE Energy Services**) and subsequent combination of that business with innogy's subsidiary npower to form a new, independent UK-based group. The new independent business is expected to be separately listed on the London Stock Exchange and, following Completion, will be owned up to 65.58 per cent. by SSE Shareholders (on the register at the Demerger Record Time) and 34.42 per cent. by innogy. SSE Shareholders will retain their existing SSE Shares and will also hold one share in the newly listed MergeCo business for every existing SSE Share they hold at the Demerger Record Time.

The purpose of this document is to provide you with information on the demerger (the **Demerger**) of SSE Energy Services and subsequent combination of that business with the npower Group under a new holding company, provisionally named ShiftMCo123 Ltd (the **Combination** and, together with the Demerger, the **Transaction**), as well as to explain the background to and reasons for the Transaction and why the Board believes the Transaction to be in the best interests of SSE and the SSE Shareholders taken as a whole.

The following chart shows the structure of the SSE and MergeCo businesses immediately following the Transaction. The businesses are described in further detail in Part V (*MergeCo Group Business Overview*).



(1) The exact percentage of MergeCo Shares that will be owned by SSE Shareholders at this time is dependent on the number of SSE Shareholders who are located outside the United States or who make the Investor Declarations as discussed in more detail in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

(2) npower's Energy Related Services comprise Powershop, electric vehicles and boiler/central heating care and are reported within the domestic business.

(3) Energy Services provides metering services for the three npower divisions and is reported within each division.

SSE Shareholders are being asked to approve the Demerger Resolution and the Whitewash Resolution (each as defined herein and, together, the **Resolutions**). The Directors recommend that you vote in favour of the Resolutions, and they intend to vote in favour of the Resolutions at the General Meeting in respect of their SSE Shares to which they are beneficially entitled (representing approximately 0.015 per cent. of the total issued share capital of SSE as at 21 June 2018 (being the latest practicable date prior to publication of this Circular)).

## 2. Background to and Reasons for the Transaction

The SSE group of businesses has been undergoing significant evolution for some time. As a result of its capital and investment expenditure in recent years, the large majority of SSE's asset base and adjusted operating profit is driven by economically-regulated energy networks and government-mandated renewable sources of energy including wind. In the three financial years to 31 March 2018, SSE Energy Services contributed between 12.8 and 15.0 per cent. of the adjusted operating profit of the SSE Group as shown in the following table.

### SSE Group adjusted operating profit

	Year ended 31 March		
	2016	2017	2018
	(£ millions) (audited)		
SSE Energy Services . . . . .	267.9	239.7	274.2
SSE Group . . . . .	1,824.4	1,874.0	1,828.7
Contribution to SSE Group of SSE Energy Services (%) . . . . .	14.7	12.8	15.0

Energy markets for businesses such as SSE Energy Services, engaged in the supply of energy to retail customers in Great Britain, are rapidly transforming. The energy retail market is highly competitive, with more

than 80 competing suppliers (including White Labels<sup>1</sup>), a large range of products and services available to customers and customer switching at historically high levels (a record 9.3 million customer accounts, or one in six, switching supplier in 2017, according to the UK Department for Business, Energy & Industrial Strategy). Further, the market continues to change through a combination of disruptive technology, an evolving regulatory environment and changing consumer behaviour brought about by digitalisation, smart metering, micro generation and evolving channels to market.

In view of the evolution of the SSE Group as a whole, and in light of the changes in the energy retail market, the Board undertook a strategic review of SSE's household energy and services business in Great Britain in 2017. This is in line with SSE's stated commitment to embrace change in each of its businesses, adapting them to the economic, social and technological requirements of customers and of society as a whole. In carrying out this review, the Board gave important consideration to the interests of energy customers and other stakeholders.

The Board reached the conclusion that a separation of SSE Energy Services from the SSE Group has strong strategic logic and the potential to drive significant benefits for the business and its customers. It believes that a standalone household energy and services business will benefit from its own dedicated board of directors and specialist management team, supported by skilled employees and focused entirely on strategic and operational developments in the British energy retail sector, including the competitive and regulatory environment. A standalone business will also have the ability to access and allocate its own capital, allowing day-to-day decision-making to be more closely aligned with its own strategy and thereby facilitating the delivery of greater benefits to all stakeholders going forward, including customers and employees.

After careful consideration of the options available to SSE, and following discussions with innogy regarding the future of its own UK-based household energy and services business (npower), the Board concluded that a combination of both companies' household energy and services businesses would facilitate the delivery of greater benefits to all stakeholders going forward, including customers and employees. In addition to the standalone benefits described above, a combination with npower is expected to deliver enhanced benefits by creating a more efficient new independent household energy and services business and helping to create a new market model by combining the resources and experience of two established players with the focus and agility of an independent supplier. These factors will enable MergeCo to respond more effectively to the rapidly evolving competitive landscape as well as meet the changing expectations of customers, regulators and other stakeholders, respond to the needs of vulnerable customers and make progress with the rollout of smart meters.

### ***Expected synergies***

The SSE Directors believe that, as a result of the Combination, MergeCo will generate cash cost synergy benefits of at least £175 million by the end of the fourth full year following Completion. Of this, £156 million relates to operating expense savings and £19 million of recurring capital maintenance savings.

The expected sources of quantified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis.

Further detail can be found in paragraph 3 of this Part I (*Letter from the Chairman of SSE*). References to these anticipated synergies should be read in conjunction with Appendix 1 (*SSE Quantified Financial Benefits Statement*), which has been prepared in accordance with the requirements of the City Code.

As at 31 March 2018, the SSE Energy Services business had total assets of £2,043.6 million (extracted without material adjustment from the historical financial information of the SSE Energy Services business for the year ended 31 March 2018; see Part A of Part XI (*Historical Financial Information*) of this document.) The parties to the Contribution Agreement shall work together in good faith to agree a capital structure for the MergeCo Group that will target achieving an investment grade credit rating for MergeCo. It is anticipated that this will be made public prior to Admission.

### ***Remuneration of MergeCo Shareholders***

MergeCo is expected to have its own premium listing and its own board and management team able to determine and pursue its own strategy, including with regard to remunerating shareholders for their investment. This means, as was described in the announcement of the Transaction on 8 November 2017, MergeCo's policy on dividends will be determined by its board in due course and will be based on the earnings directly generated by the supply business. MergeCo's dividend policy is expected to be included in the prospectus relating to the MergeCo Shares, which is anticipated to be published shortly prior to Admission in the first quarter of 2019.

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<sup>1</sup> "White Labels" are defined as organisations that do not hold a supply licence, but instead work in partnership with a licensed 'partner supplier' to offer tariffs under the white label brand.

The SSE Directors expect that MergeCo will have opportunities to secure value from:

- focusing entirely on strategic and operational developments in the energy retail sector;
- combining resources to be a stronger competitor; and
- delivering efficiencies expected to be at least £175 million per annum by the end of the fourth year following Completion and to recur subsequently.<sup>2</sup>

After Completion, your present dividend instructions on SSE at the Demerger Record Date will apply in respect of your new shareholdings in MergeCo (this excludes any scrip dividend mandates). If you wish to change your instructions, you should contact the SSE Shareholder Helpline on +44 (0)345 143 4005 or visit [www.sse-shares.com](http://www.sse-shares.com) where you will be able to view your holding, update your account preferences and provide your investor declaration as described in paragraph 5 of Part XII (*Further details of the Transaction*) of this Circular.

### ***Rebranding***

Immediately following the Transaction customers of MergeCo will not see any immediate change to the brand under which their energy is supplied. MergeCo will have the right to use certain SSE corporate brands in connection with the home energy and services business in Great Britain for three years (subject to certain conditions). These SSE corporate brands include ‘SSE’, ‘SSE PROUD TO MAKE A DIFFERENCE’ and the SSE “swoosh” logo.

As part of the Transaction, SSE will transfer to MergeCo certain SSE retail brands including but not limited to ‘SOUTHERN ENERGY’, ‘SOUTHERN ELECTRIC’, ‘SWALEC’ and ‘SCOTTISH HYDRO’. MergeCo will be subject to certain restrictions on its use of some of these transferred SSE retail brands which will be licensed back to SSE for use outside of a home energy and services business. SSE will have the right to use the licensed-back brands in the United Kingdom and Ireland for three years (subject to certain conditions). These licensed-back brands include ‘SOUTHERN ELECTRIC’, ‘SWALEC’ and ‘SCOTTISH HYDRO’.

SSE and MergeCo will enter into a Brand Licence and Assignment Agreement which sets out the conditions of use of these brands and contains customary co-existence provisions which are designed to prevent confusion and ensure the brands are used in a consistent way.

The MergeCo Group is expected to develop and operate under a new brand in due course, and its company name will reflect the new brand.

### ***Shared IT systems and ongoing servicing arrangements***

In connection with the Transaction, SSE will be transferring to the MergeCo Group certain IT systems relating to customer service including registration, deregistration, metering, billing, payments and collections (the **CS Systems**). Following the Transaction, MergeCo will provide to the SSE Retained Group (defined as SSE and its subsidiaries and subsidiary undertakings following the Demerger) continued access to the CS Systems for the benefit of the business energy business under the Transitional Services Agreements. Both retail and business energy customers will remain on the CS Systems until the platform is no longer required. The arrangement will remain in place for a number of years determined in part by the approach to consolidate MergeCo IT systems.

The Transitional Services Agreements contain customary arm’s length provisions governing each party’s access to, and use of, IT systems under the agreement (including the CS Systems) to help maintain information security.

The confidentiality and data protection obligations in the Transitional Services Agreements also protect the shared use of the CS Systems.

The SSE Retained Group and the innogy Group will each continue to provide, and receive, certain services, including various finance, IT, HR and procurement services to and from the MergeCo Group for a period following Completion under the terms of two Transitional Services Agreements as between each party and MergeCo. None of the parties to the Transitional Services Agreements is under an obligation to provide any services for more than five years pursuant to such agreements.

The SSE Retained Group will continue to provide telecoms, logistics and wholesale energy portfolio management services to SSE Energy Services through separate arm’s length long-term services agreements that will be entered into between SSE (or one of its affiliates) and MergeCo (or one of its affiliates) before

<sup>2</sup> References to these anticipated synergies should be read in conjunction with Appendix 1 (*SSE Quantified Financial Benefits Statement*), which has been prepared in accordance with the requirements of the City Code.

Completion. The telecoms agreements will last for a minimum period of four years from 1 April 2018 with an option to extend. The logistics agreement will last for a minimum period of three years from Completion with an option for MergeCo to extend for two years on seven months' notice. The wholesale energy portfolio management services agreement will last for a minimum period of three and a half years from 1 April 2018, up to a maximum of four years.

The MergeCo Group will provide metering services to the SSE Retained Group through separate arm's length long-term services agreements that will be entered into before Completion. These agreements will each last for a minimum period of three years from Completion.

For more detail on these agreements, see paragraph 3 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this document.

### **3. Synergies from the combination of SSE Energy Services and npower**

The SSE Directors believe that, as a result of the Combination, MergeCo will generate cash cost synergy benefits of at least £175 million by the end of the fourth full year following Completion. Of this, £156 million relates to operating expense savings and £19 million of recurring capital maintenance savings.

The expected sources of quantified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis.

The run rate at the end of Year One is expected to be approximately 27 per cent., with 47 per cent. achieved by the end of Year Two, 63 per cent. by the end of Year Three, and the full run rate achieved by the end of Year Four.

The expected sources of quantified cost synergies comprise:

- **IT system consolidation:** approximately 30 per cent. of full run-rate cost synergies are expected to be generated from the consolidation of both corporate and customer service / billing systems;
- **Procurement:** approximately 15 per cent. of full run-rate cost synergies generated from direct and indirect procurement synergies which are expected to be driven by scale economies, sharing of best practice procurement processes, and removal of duplicate expenditure; and
- **Other Selling, General and Administrative expenses:** approximately 55 per cent. of full run-rate cost synergies are expected to be delivered through functional excellence and the removal of duplicate selling, general and administrative expenses.

Following Completion, MergeCo will assess the potential impact of the anticipated synergies on the overall workforce within the MergeCo Group, and the MergeCo board of directors will have regard to their statutory directors' duties with regard to the interests of MergeCo's employees in making this assessment. MergeCo will take into account the effect of natural attrition and management of contingent worker arrangements. To the extent that any of the anticipated synergies result in change for employees, appropriate consultation with employee representative bodies will take place before any final decisions are taken.

The synergy benefits described above are shown pre-tax and net of identified cost dis-synergies.

SSE estimates that the programme will require net cash one-off costs to achieve of approximately £260 million (including contingency) with around 19 per cent. incurred in Year One, 32 per cent. incurred in Year Two, 27 per cent. in Year Three and the remainder in Year Four. These costs are mainly driven by IT and systems integration, re-branding spend and people-related costs (including training where appropriate) associated with the Combination.

In addition to the £175 million annualised cost synergy benefits, SSE expects MergeCo to realise approximately £50 million of one-off capex benefits by the end of the fourth year following Completion.

References to these anticipated synergies should be read in conjunction with Appendix 1 (*SSE Quantified Financial Benefits Statement*), which has been prepared in accordance with the requirements of the City Code.

### ***Pro forma financial information***

An unaudited pro forma statement showing the consolidated profit and loss statement and the consolidated net assets and liabilities of MergeCo is set out in Part X (*Unaudited Pro Forma Financial Information of the MergeCo Group*) of this Circular. As shown in this statement, the illustrative consolidated net assets of MergeCo on a pro forma basis as if Completion had occurred before 31 March 2018 would have been £554.0 million. Consolidated pro forma operating profits generated by MergeCo for the year ended 31 March

2018, as though it had been a combined business for the preceding 12 months, would have been £255.9 million (excluding any benefits from opex and capex synergies as detailed above). This figure comprises a net operating profit from SSE Energy Services of £279.7 million for the year ended 31 March 2018, a net operating loss from npower of £46.9 million for the year ended 31 December 2017 and a pro forma adjustment of £23.1 million as detailed in Part X (*Unaudited Pro Forma Financial Information of the MergeCo Group*) of this Circular. Consolidated pro forma losses after tax for MergeCo for the year ended 31 March 2018 would have been £122.5 million. This includes a prepayment penalty expense by npower of £272.8 million in 2017 arising as a result of a debt-for-equity swap whereby £1,883.8 million of share capital was issued to repay £1,565.0 million of intercompany debt, a prepayment penalty of £272.8 million on that debt and outstanding interest of £46.0 million.

#### **4. Strategy for the SSE Retained Group**

Completion of the Transaction will give the SSE Retained Group greater focus on the infrastructure and related services relied on by energy customers which is more aligned to its core competencies. It will also give investors greater visibility of assets and earnings in the future, the majority of which is expected to come from regulated energy networks and renewable energy.

Going forward, therefore, regulated energy networks and renewable energy will be core to the SSE Retained Group with flexible thermal generation also having a key role. Other businesses within the SSE Retained Group are complementary and benefit from direct and indirect synergies. In all these remaining business areas the needs of energy customers will continue to be a key focus.

In a fast-changing energy and infrastructure sector, optionality is very important. Retaining a range of complementary businesses helps to maintain the ability to create attractive longer-term growth and value options.

##### ***Purpose, vision and strategy***

The SSE Retained Group will have a simple purpose: to responsibly provide energy and related services needed now and in the future. Its vision is to be a leading provider of energy and related services in a low carbon world. Its strategy is to create value for shareholders and society from developing, operating and owning energy and related infrastructure and services in a sustainable way. Looking at each element of the strategy in turn:

- **Create value** means focusing on earning returns for shareholders, sustaining skilled jobs and making a positive economic and social contribution to the countries in which SSE operates.
- **Developing, owning and operating** means being efficient in developing, owning and operating infrastructure and services and being agile in creating and securing value from them.
- **Energy and related infrastructure and services** means maintaining a range of complementary business activities with a depth of insight on a core sector and related infrastructure.
- **Sustainable way** means doing things responsibly.

##### **In practice, this means the core strategic focus of the SSE Retained Group will be:**

- delivering the best possible performance in the networks businesses so they can operate as successfully as possible in future price controls set by the regulator and play a major role in developing localised energy systems;
- growing its renewables business to have the necessary capabilities, pipeline and scale to thrive over the long term, complemented by flexible thermal generation;
- securing value from its range of complementary businesses through operating them more efficiently, developing them and creating options for the future; and
- continuously improving its structures, skills and tools so it has the capability and agility to create value for shareholders and society.

##### ***Remunerating SSE Shareholders' investment through payment of dividends***

The financial objective of this strategy is to remunerate shareholders' investment through the payment of dividends. SSE believes that its dividends should be sustainable, based on the quality and nature of its assets and operations, the earnings derived from them and the longer-term financial outlook.

In line with this, taking account of the impact of the expected key developments in 2018/19, and reflecting the underlying quality and value of its assets and earnings and the cash flows they deliver, SSE's plan for the dividend for the five years to 2023 is as follows:

- for **2018/19**, SSE is intending to recommend a full-year dividend of **97.5 pence per share**, an increase of three per cent. on 2017/18, which is broadly in line with expectations for RPI inflation. This provides clarity in a year of transition and is not subject to the timing of either the Transaction or the Domestic Gas and Electricity (Tariff Cap) Bill.
- for **2019/20**, SSE is planning to set the first post-transaction dividend at **80 pence per share**, which reflects the impact of the changes in the SSE Group expected to take effect by then. This provides a sustainable basis for future dividend growth.
- for **2020/21, 2021/22 and 2022/23** SSE is targeting annual increases in the full-year dividend that at least keep pace with RPI inflation. This reflects SSE's confidence in the quality and value of its assets and earnings and cash flows they deliver.

This plan for the dividend for the five years to March 2023, when the current electricity distribution price control comes to an end, supersedes SSE's previous reference to a dividend cover range and is a plan which:

- aims to provide shareholders with certainty in 2018/19, a year of transition for SSE;
- reflects the changes in the SSE Group expected to take effect by the start of the 2019/20 financial year; and
- sets the dividend on a path for sustainable growth for the three years from 2020.

SSE intends to retain a scrip dividend scheme but where take-up of the full year dividend exceeds 20 per cent., SSE now intends to buy back shares so the dilutive effect of the scrip is limited.

In addition to the dividend plan above, subject to the necessary approvals being secured, the Transaction means SSE Shareholders will receive one share in MergeCo for every one SSE share they hold at the relevant record date. This will entitle SSE Shareholders who continue to hold the shares they receive as a result of the Transaction to receive any future dividend distributions from MergeCo.

### ***Focusing on adjusted earnings per share***

To help assess its financial performance over the medium term, SSE will continue to report on its adjusted earnings per share measure. This measure is calculated by excluding the charge for deferred tax, interest costs on net pension liabilities, exceptional items and the impact of certain re-measurements. It provides an important and meaningful measure of underlying financial performance.

### ***Investing efficiently in energy assets that the United Kingdom and Ireland need***

Central to SSE's strategy is investing in assets for which returns are expected to be greater than the cost of capital. New assets should complement SSE's existing portfolio of assets and their development and construction should be governed and executed in an efficient manner and in line with SSE's commitment to strong financial management.

The SSE Retained Group is currently expecting capital and investment expenditure to total around £6 billion across the five years to March 2023. Economically-regulated electricity networks and renewable sources of energy are expected to account for around 70 per cent. of this. As is to be expected, the investment is weighted more towards the first half of the five-year period than the second; and includes around £1.7 billion planned for 2018/19 and around £1.2 billion currently planned for 2019/20.

Around 80 per cent. of the £6 billion is committed. It includes around £2.8 billion of investment in electricity networks, which should support further growth in the Regulatory Asset Value to around £10 billion in 2023. It also includes investment in electricity generation such as a new £350 million flexible gas-fired power station at Keadby 2 in Lincolnshire, an additional multi-fuel plant and some potential investment in offshore wind farms.

Final investment decisions will be determined by the need to secure returns that are greater than the cost of capital, enhance earnings and support the delivery of dividend commitments. Indeed, SSE believes that strict financial discipline is more important than ever as auctions become an increasing feature of energy infrastructure provision and the SSE Retained Group will aim to ensure that it does not take on inappropriate risks or accept returns on investment that are financially unsustainable.

### ***Setting out consolidated net assets and pro forma information***

As at 31 March 2018, SSE had consolidated net assets of £5,230.2 million. An unaudited pro forma statement showing the effect of the Demerger on SSE's consolidated profit and loss statement and its consolidated net assets and liabilities is set out in Part IX (*Unaudited Pro Forma Financial Information for the SSE Retained Group*) of this Circular. As shown in this statement, the illustrative consolidated net assets of SSE on a pro forma basis and adjusted to reflect the Demerger as if Completion had occurred on that date would have been £4,566.7 million. The Demerger is not expected to materially affect SSE's net debt. In the 12 months to 31 March 2018, reported operating profits generated by SSE were £1,379.2 million, of which £279.7 million was generated by SSE Energy Services, with reported profits after tax generated by SSE of £920.1 million, of which £230.6 million was generated by SSE Energy Services.

SSE estimates that its total costs related to the Transaction will be approximately £100 million. This estimate is subject to a number of variables including timing of Completion, and the actual total costs incurred by SSE related to the Transaction may therefore differ.

### **5. Information on SSE Energy Services**

SSE Energy Services is currently in the top three energy suppliers across Wales, England and Scotland with over 12 per cent. of market share (according to Cornwall Insight). SSE Energy Services also provides other essential services through its home and essential services and metering businesses. For the financial year ended 31 March 2018, SSE Energy Services made adjusted operating profit of £274.2 million, from total revenues of £3,984.4 million.

SSE Energy Services operates under the brands: SSE, SSE Hydro, SSE Southern Electric, SSE SWALEC and SSE Atlantic in the Great Britain market. Consistently achieving a high level of customer satisfaction (as demonstrated by being continuously among the best suppliers in the Citizens Advice Bureau complaints table since 2010), the business also provides its customers with gas boiler installation services, gas boiler maintenance, metering, energy solutions as well as phone and broadband services.

As a core part of its services to household customers, the core responsibilities of SSE Energy Services are to:

- ensure the business secures sufficient electricity and gas to meet customers' needs as affordably as possible;
- provide a high quality of associated services such as customer service, metering and billing; and
- deliver on obligations in respect of energy efficiency and any related social or environmental schemes mandated by government.

SSE Energy Services supplies energy and services to household customers in Great Britain only. The SSE Retained Group will continue to provide energy supply and infrastructure services to business and public sector customers in Great Britain. This, amongst other things, provides a route to market for output from SSE's power generating plant and enables the potential to design bespoke products and services for business and public sector customers.

### **6. Information on npower**

npower is one of Great Britain's largest suppliers of electricity and gas, and is currently part of the innogy Group. As of 31 March 2018, npower served around 4.8 million accounts across Great Britain. For the financial year ended 31 December 2017, npower made a net loss of £371.8 million, from total revenues of £6,014.6 million. The net loss from npower includes a prepayment penalty of £272.8 million in 2017 arising as a result of a debt-for-equity swap whereby £1,883.8 million of share capital was issued to repay £1,565.0 million of intercompany debt, a prepayment penalty of £272.8 million on that debt and outstanding interest of £46.0 million.

npower supplies electricity and gas to a full range of customers, including households, small and medium businesses, and some of the largest businesses in the United Kingdom. It also provides home services to householders, including through partners, and a range of energy and energy related services to large business customers.

All divisions and subsidiaries of npower are intended to be transferred to MergeCo as part of the Transaction—including npower home and business (comprising npower Domestic and npower Business), npower Business Solutions, npower Energy Services and the recently formed digital energy start up, Powershop. npower home and business is the business segment supplying domestic and small business



customers, npower Business Solutions supplies larger industrial and commercial (**I&C**) customers and the npower Energy Services segment delivers metering services, ECO (Energy Company Obligation) related services and Feed in Tariff administration services for the supply business. Powershop is a brand operated under licence in the United Kingdom by npower which is an innovative small supplier business model utilising a low cost, end-to-end retail system allowing customers to self-serve.

## **7. Current trading and prospects**

### ***SSE Energy Services***

It is expected that SSE Energy Services will continue to form part of the SSE Group for most of the 2018/19 financial year. The adjusted operating profit from SSE Energy Services will be subject, amongst other things, to the progress and timing of the planned Transaction and the timing and impact of the Domestic Gas and Electricity (Tariff Cap) Bill.

On 30 May 2018 in response to increasing costs, SSE Energy Services took the difficult decision to raise standard electricity and gas prices in a change that will increase a typical dual fuel bill by an average of 6.7 per cent., effective from 11 July 2018. This rise equates to an increase of 5.7 per cent. for gas and 7.7 per cent. for electricity, meaning a typical dual fuel customer will see a rise of around £1.50 each week. Customers who are on fixed-price tariffs, have a prepayment meter, or are on the vulnerable customer safeguard tariff will not be affected.

### ***npower***

The npower retail business continues to operate across both the B2C and B2B market segments with a key focus on delivering the planned Recovery Programme targets (established following performance issues identified in 2015). The npower Recovery Programme is targeting more than £200 million of sustainable cost savings by December 2018. As of June 2018, the programme is on track.

During the first quarter of 2018, progress was made on the B2B system developments with a large proportion of npower business customers having been transferred for service and billing on the existing B2C SAP platform. Progress has also been made in the earlier stage development of the npower business solutions system - this has been achieved whilst maintaining npower's position as number two in the market in respect of the volume of electricity supplied to UK businesses, as at 31 October 2017. The npower home business has experienced a challenging business environment during the first quarter of 2018. Customer switching levels remained at high levels in the first quarter of 2018, which npower expects has continued into the second quarter of 2018, with other market participants aiming to boost their customer numbers through heavily discounted offers. This has adversely impacted the npower customer numbers and gross margin, notwithstanding progress on costs and in operational performance.

### ***SSE Retained Group***

In 2018/19 SSE Wholesale's adjusted operating profit will be affected by the cessation of 'in the money' power purchase agreements and by the fact renewable energy output is forward-hedged at a price lower than in 2017/18.

Total adjusted operating profit in the economically-regulated Networks segment is expected to increase by a mid-single digit percentage in 2018/19, mainly as a result of the phasing of income recovery in Electricity Transmission and a higher expected contribution from SGN.

SSE's Retail segment's adjusted operating profit attributable to SSE will be subject, amongst other things, to the progress and timing of the planned Transaction and the timing and impact of the Domestic Gas and Electricity (Tariff Cap) Bill.

SSE's actual level of adjusted operating profit and profit before tax will also be determined by the range of factors set out in previous years that continue to apply in its market-based businesses, in which energy portfolio management is a major influence. These include:

- the impact of wholesale prices for energy;
- electricity market conditions, the ability of its thermal power stations to be available and to generate electricity efficiently;
- the output of renewable energy from its hydro-electric stations and wind farms and the price achieved for the output;

- the output from its gas production assets and the price achieved for the output; and
- the actual and underlying level of customers' energy consumption.

## 8. Regulatory Developments

In June 2016, the CMA published a final report on its market investigation into competition in the British energy market (the **Final Report**). Following the Final Report, the CMA published orders to implement a large number of remedies (including a price cap on domestic prepayment meter (**PPM**) customers), which would be administered by Ofgem. The PPM price cap or safeguard tariff came into effect on 1 April 2017 and is due to expire at the end of 2020 when the smart meter roll out is expected to complete.

The remedies have required, and in the case of the disengaged customer database, will continue to require significant resource and investment to implement. Furthermore, suppliers are under pressure to evolve and adapt in response to competition and changing customer expectations at a time of considerable regulatory and technological change (e.g. the smart meter roll out and the faster switching programme). This significant pipeline, as well as the prospect of further regulatory intervention on tariffs under tight timescales places real constraints on suppliers' IT systems and resources.

On 2 February 2018, Ofgem extended the PPM price cap to include around one million customers (of suppliers with more than 250,000 customers) who are on their supplier's default tariff and in receipt of the Warm Home Discount benefit (the **Vulnerable Safeguard Tariff**). The Vulnerable Safeguard Tariff will end in December 2019 if it is not replaced by other tariff interventions.

In October 2017, the UK government proposed legislation to allow Ofgem to set an absolute cap for standard variable tariff (**SVT**) customers in Great Britain. On 26 February 2018, the UK government introduced the Domestic Gas and Electricity (Tariff Cap) Bill into Parliament and stated its intention that Ofgem should implement the tariff cap by the end of the year. The proposed legislation would allow Ofgem to set a temporary price cap for SVT and certain other default tariff customers in Great Britain (the **Default Tariff Cap**) and would last until 2020. At this point Ofgem will undertake a review as to whether conditions are in place for effective competition and make a recommendation about whether the Default Tariff Cap should be extended or not. The Secretary of State would decide whether to extend the cap, with a maximum of three one-year possible extensions. The Default Tariff Cap must end at the end of 2023. In May 2018 Ofgem published a formal consultation on its approach to delivering the Default Tariff Cap being legislated for through the Bill, setting out its intention to publish a statutory consultation and impact assessment in early August 2018 ahead of a planned implementation by the end of December 2018.

In the event that the Default Tariff Cap is not in place by the end of 2018, Ofgem has consulted on implementing an extension to the Vulnerable Safeguard Tariff to at least another two million vulnerable or low-income households ahead of winter 2018/19.

Both the PPM price cap and the Vulnerable Safeguard Tariff required significant resource and investment to implement. The prospect of further regulatory intervention on tariffs under tight timescales places real constraints on suppliers IT systems and resources. Furthermore, suppliers are under pressure to evolve and adapt in response to competition and changing customer expectations at a time of considerable regulatory and technological change (e.g. the smart meter roll out and the faster switching programme). See "*Proposed price caps in the UK energy supply market could have a material adverse effect on the MergeCo Group*" in Part III (*Risk Factors*) of this Circular.

## 9. Summary of key terms of the Transaction

The Transaction will be implemented by the demerger of SSE Energy Services and the subsequent combination of SSE Energy Services with npower. Until the Transaction is completed, SSE Energy Services and npower will continue to operate separately and to compete with each other in the same way as with other competitors.

The Demerger will be effected by SSE declaring a special dividend (in kind in the form of MergeCo Shares) in respect of the SSE Shares of an amount equal to the book value of SSE's shareholding in SSE Energy Services Group Limited (**Retail HoldCo**), the holding company of SSE Energy Services (the **Demerger Dividend**). The special dividend will be satisfied by the transfer to MergeCo of the entire issued share capital of Retail HoldCo, and in consideration for that transfer, MergeCo will allot and issue MergeCo Shares to SSE Shareholders. SSE Shareholders who are registered on the SSE share register at the Demerger Record Time will receive one MergeCo Share for each SSE Share held at the Demerger Record Time. As an example, if you hold 10 SSE Shares at the Demerger Record Time, you will hold 10 SSE Shares and 10 MergeCo Shares following the Demerger.

On the day following the Demerger, the innogy Group will transfer the entire issued share capital of npower to MergeCo in consideration for which MergeCo will allot and issue MergeCo Shares to the innogy Group.

Upon completion of the Combination, MergeCo's ordinary shares are expected to be admitted to the premium listing segment of the Official List of the FCA (the **Official List**) and to trading on the main market for listed securities of the London Stock Exchange.

Subject to the restrictions described in paragraph 16 (*Overseas Shareholders*) in this letter, following Admission SSE Shareholders will own shares in two independent, separately listed companies: SSE and MergeCo (to be subsequently renamed).

In aggregate, SSE Shareholders will own 100 per cent. of the SSE Shares in issue and up to 65.58 per cent. of the MergeCo Shares in issue as at the date of Completion. The exact percentage of MergeCo Shares that will be owned by SSE Shareholders at this time is dependent on the number of SSE Shareholders who are located outside the United States or who make the Investor Declarations as discussed in more detail in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular. The innogy Group will hold 34.42 per cent. of the MergeCo Shares in issue as at the date of Completion. This proportionate ownership of the combined business has been agreed on the basis of the relative value contribution of each business to MergeCo, as well as the earnings contribution, customer numbers, revenue and cost base of each separate business. innogy has contractually agreed to retain its 34.42 per cent. holding in MergeCo for a period of at least six months from the date of Admission, subject to certain limited exceptions.

Completion of the Transaction is conditional upon various conditions being satisfied or waived. Conditions that have not yet been satisfied or waived include:

- the Competition and Markets Authority (**CMA**) approving the Transaction on terms reasonably satisfactory to SSE and innogy;
- SSE obtaining shareholder approval for the Demerger by 31 July 2018 (which is the subject matter of this Circular);
- no material adverse change arising in either the SSE Energy Services or npower businesses before the date on which the condition relating to CMA approval is satisfied;
- the Panel on Takeovers and Mergers (the **Takeover Panel**) agreeing that innogy is not obliged to make a mandatory offer for MergeCo as a result of the Transaction (subject to SSE Shareholders passing the Whitewash Resolution (as defined herein));
- FCA change of control consents being obtained in respect of the regulated businesses of SSE Energy Services and npower (namely, SSE Home Services Ltd and Npower Northern Limited);
- key licences for each of SSE Energy Services and npower not having been revoked or terminated and no notice of revocation from Ofgem in relation to any such licence having been received, and Ofgem not proposing any material modification or replacement of such licences on terms other than those reasonably satisfactory to SSE and innogy; and
- the FCA and the London Stock Exchange approving Admission.

The condition that has already been satisfied is:

- innogy obtaining supervisory board approval by 31 December 2017.

If the conditions of the Transaction are not satisfied (or, where applicable, waived) by 30 June 2019, the Transaction may become terminable. If the SSE Shareholders fail to approve the Demerger by 31 July 2018, SSE shall be obliged to make to innogy a £60 million compensatory break payment if innogy elects to terminate the Contribution Agreement within 30 business days after such date.

More detail on the implementation of the Transaction can be found in Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) and Part XII (*Further details of the Transaction*) of this Circular.

## **10. Board structure and corporate governance**

It is intended that the composition of the MergeCo Board will comply with the provisions of the UK Corporate Governance Code. The UK Corporate Governance Code states, in part, that at least half of a board of directors, excluding the chairperson, should comprise independent non-executive directors. SSE notes that the Financial Reporting Council is consulting on changes to the board composition provisions in the UK Corporate Governance Code, and any such changes will be considered by MergeCo.

As described in “*Relationship Agreement with innogy*” in Part VII (*MergeCo Directors and Corporate Governance*), innogy will be able to appoint two non-executive directors to the MergeCo Board for so long as it and its associates hold at least 20 per cent. of the ordinary shares in MergeCo. innogy will be able to appoint one non-executive director to the MergeCo Board for so long as it and its associates hold at least ten per cent. but less than 20 per cent. of the ordinary shares in MergeCo.

SSE and innogy have appointed Katie Bickerstaffe as Chief Executive Designate of MergeCo. Katie will take up her new appointment on 24 September 2018 and will lead the work being done to prepare for the formation and listing of MergeCo. Katie previously served as a non-executive director of SSE from 2011 until April 2018. She has diverse retail experience from her career with Dixons Carphone plc as Chief Executive, UK and Ireland and at Kwik Save, Somerfield, Dyson, PepsiCo and Unilever. Katie will bring extensive experience of organisational change and recent insight derived from merging two companies into one as well as experience of the growing digitalisation of retail markets. Her new role will not include involvement in the leadership or management of SSE, npower or innogy. Katie is also a non-executive director of Marks and Spencer Group plc.

Gordon Boyd has been appointed as Chief Financial Officer Designate of MergeCo. Gordon will take up his appointment on 4 July 2018. Gordon has significant experience both in the energy sector and in major listed companies, acquired over more than 30 years. He originally joined the energy sector in 1989 and went on to hold a variety of senior finance leadership positions in this sector including British Energy and EDF Energy, as well as overseeing the initial public offerings of both Drax and Infinis. Gordon also has highly relevant experience of mergers and business transformation. Gordon’s role will not include involvement in the leadership or management of SSE, npower or innogy.

## 11. Share Schemes

### ***SSE***

SSE operates a number of share schemes for its employees and senior management team. SSE considers that the SSE Share Schemes are an important component of employee remuneration and that they encourage long-term employee engagement, commitment and performance to the benefit of its customers and shareholders. These share-based arrangements are kept under review to ensure that SSE is best supporting the long-term interests of the business and developing and retaining committed employees for the long term.

Options or awards held pursuant to the SSE Share Schemes will be affected by the Transaction as described in Part XIII (*Additional Information*) of this Circular. SSE will write to participants in the SSE Share Schemes as appropriate in due course to explain in more detail the impact of the Transaction on their outstanding options and awards.

### ***MergeCo***

MergeCo will seek to establish appropriate incentive arrangements for its employees and management, which may include share-based arrangements, although the specific arrangements that may be put in place will be a matter for the MergeCo remuneration committee to determine.

## 12. Pensions

### ***SSE***

SSE and its subsidiaries currently sponsor two defined benefit pension schemes: the Southern Electric Pension Scheme and the Scottish Hydro-Electric Pension Scheme (the ***SSE DB Schemes***). The SSE DB Schemes will continue to be sponsored by SSE and its subsidiaries following the Transaction.

The Group Personal Pension Plan which SSE operates on a money purchase basis, and which has been arranged through Aviva, shall continue in place for employees of SSE following the Transaction.

### ***MergeCo***

All employees who will be employed by the MergeCo Group as a result of the Transaction, and are active members of one of the SSE DB Schemes or the defined benefit pension scheme operated by npower (the ***npower DB Scheme***) prior to Completion, will become members of new defined benefit arrangements which will be operated by the MergeCo Group (the ***MergeCo DB Schemes***). Approximately 1,600 employees are expected to become members of the MergeCo DB Schemes. Transfers of assets and past service pension liabilities from the SSE DB Schemes and the npower DB Scheme to the MergeCo DB Schemes in respect of members will take place as a result of the Transaction.

The remaining employees of the MergeCo Group will be members of a defined contribution pension scheme.

### 13. Director Remuneration

#### ***SSE***

The SSE Executive Directors' remuneration is currently governed by the remuneration policy approved by SSE Shareholders at the SSE annual general meeting held on 21 July 2016. SSE will seek shareholder approval for a new remuneration policy at its AGM in 2019, when shareholder approval for its current policy expires. SSE will consult with major SSE Shareholders and advisory firms on the proposed terms of its new policy as well as other matters during the course of 2018, taking account also of the wider public debate on executive pay.

#### ***MergeCo***

MergeCo will seek shareholder approval for a directors' remuneration policy at its first annual general meeting following Admission. Although the contents of the policy will be a matter for the MergeCo remuneration committee to determine, the likely aim of the remuneration policy will be to attract and retain high calibre directors with a long-term commitment to the business so as to deliver MergeCo's strategy, taking account also of the wider public debate on executive pay.

### 14. Risk Factors

As required in documents of this type, a discussion of the risks and uncertainties which you should take into account when considering whether to vote in favour of the Resolutions is included in Part III (*Risk Factors*) of this Circular. These risks and uncertainties are expected to be included in the prospectus relating to the MergeCo Shares that will be published prior to Admission. SSE and MergeCo are each expected to take steps to mitigate any such risks. SSE continues to comply with provision C.2.2 of the FRC Corporate Governance Code relating to risk reporting, with full details of the Principal Risks to the SSE Group and corresponding mitigations published in the SSE Annual Report and Accounts.

### 15. Taxation

Certain information about UK and US taxation issues in relation to the Transaction is set out in Part VIII (*Taxation*). **That summary relates only to the position of certain categories of SSE Shareholders (as explained further in Part VIII (*Taxation*) of this document), does not constitute tax advice and does not purport to be a complete analysis of all potential UK and US tax consequences of the Demerger or the Transaction. If you are in any doubt about your own tax position or you may be subject to taxation in any jurisdiction other than the United Kingdom or the United States, you are strongly recommended to consult an appropriately qualified independent professional tax adviser.**

### 16. Overseas Shareholders

The MergeCo Shares may only be transferred, distributed or delivered, directly or indirectly, within the United States to qualified institutional buyers (***QIBs***) (within the meaning of Rule 144A of the Securities Act) or to accredited investors (within the meaning of Rule 501 of Regulation D under the Securities Act) in transactions exempt from or otherwise not subject to the registration requirements of the Securities Act, and to persons outside the United States in offshore transactions in reliance on Regulation S. Accordingly, each SSE Shareholder will be required to represent, warrant and confirm, in the manner and by the times described in this Circular, that they are, or hold SSE Shares on behalf of, a person who either (a) is located outside the United States or (b) has made the Investor Declarations contained in paragraph 5 of Part XII (*Further details of the Transaction*) of this Circular.

#### ***Uncertificated shares held through CREST***

Each SSE Shareholder who holds SSE Shares in uncertificated form will be required to make the abovementioned representations, warranties and confirmations through the electronic CREST proxy appointment service by 3:00 p.m. (UK time) on the Demerger Record Date. Such uncertificated SSE Shareholders will be able to input this instruction following the CMA's approval of the Transaction, and CREST will notify all such uncertificated SSE Shareholders of this date by means of a CREST bulletin issued by Euroclear UK & Ireland (***Euroclear***). Failure to input this instruction by 3:00 p.m. (UK time) on the Demerger Record Date may result in such SSE Shareholder being deemed an Ineligible Shareholder. The legal title to MergeCo Shares issued to such Ineligible Shareholders may be transferred (pursuant to provisions to be included in MergeCo's articles of association) to a trustee and being re-materialised and held in certificated form. Instructions on how to do this are found in paragraph 5 of Part XII (*Further details of the Transaction*).

### ***Certificated shares***

Each SSE Shareholder who holds SSE Shares in certificated form will be required to certify the eligibility of their entire holding in order to retain new MergeCo Shares. Certificated Shareholders wishing to certify their holding and provide the abovementioned representations, warranties and confirmations should visit [www.sse-shares.com](http://www.sse-shares.com) or call the Shareholder Helpline as outlined on page 4 of this Circular and follow the instructions provided. Failure to input this instruction by 3:00 p.m. (UK time) on the Demerger Record Date may result in such SSE Shareholder being deemed an Ineligible Shareholder. Legal title to the MergeCo Shares issued to such Ineligible Shareholders may be transferred (pursuant to provisions to be included in MergeCo's articles of association) to a trustee.

MergeCo Shares issued to Ineligible Shareholders may be, at the absolute discretion of SSE, placed in the market with the net proceeds remitted to such Ineligible Shareholder. If the net proceeds due to any Ineligible Shareholder is £2.99 or less, such sum will be donated to charity. The net proceeds due to any Ineligible Shareholder whose registered address is in the United States of America will be converted from pounds sterling and paid in US dollars.

For more detail, see paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

### ***SSE ADR Holders***

Certain SSE Shares are traded in the United States in the form of American Depositary Shares (**ADSs**) evidenced by American Depositary Receipts (**ADRs**). SSE ADR holders should read paragraph 6 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular, which contains information about how SSE ADR holders may vote and how their ADRs will be treated in the Demerger.

## **17. Controlling Shareholder**

As a result of the Transaction, it is envisaged that SSE Shareholders will hold up to 65.58 per cent. and the innogy Group will hold 34.42 per cent. of the MergeCo Shares in issue as at the date of Completion.

Because the innogy Group will control 30 per cent. or more of the voting rights of MergeCo, innogy will be considered a controlling shareholder of MergeCo under the Listing Rules. As such, innogy is required, and has in connection with the Contribution Agreement agreed, to enter into a relationship agreement with MergeCo (the **Relationship Agreement**) which will regulate the on-going relationship between innogy and MergeCo and ensure that MergeCo can carry on an independent business as its main activity. The Relationship Agreement is described in more detail in Part VII (*MergeCo Directors and Corporate Governance*).

By virtue of the innogy Group's acquisition of 30 per cent. or more of the voting rights of MergeCo pursuant to the Transaction, innogy would typically be required to make a mandatory offer under Rule 9 of the City Code on Takeovers and Mergers (the **City Code**) for all the remaining MergeCo Shares. However, the Takeover Panel has agreed to waive the obligation on innogy to make a general offer for all of the issued MergeCo Shares, such waiver being subject to approval by SSE Shareholders of an ordinary resolution at the General Meeting (the **Whitewash Resolution**). Approval of the Whitewash Resolution is a condition precedent for the Transaction to complete. For more information, see paragraph 7 of Part XII (*Further details of the Transaction*) of this Circular.

On 12 March 2018, RWE announced that it had concluded an agreement with E.ON on the sale of RWE's 76.8 per cent. stake in innogy. If the E.ON/RWE Transaction completes, E.ON would therefore become the majority owner and ultimate controller of innogy and, indirectly, innogy's 34.42 per cent. stake in MergeCo should the Transaction complete. One of the conditions of the Contribution Agreement was innogy's supervisory board approval which was obtained in December 2017 and the Contribution Agreement does not include provision relating to change of control. SSE therefore does not believe that its agreement with innogy should be affected by the potential E.ON/RWE Transaction. See "*Merger clearance consents may take longer than expected to obtain and/or may not be granted or may be granted subject to conditions or remedies*" in Part III (*Risk Factors*) of this Circular.

## **18. General Meeting**

A General Meeting is being convened at Perth Concert Hall, Mill Street, Perth, PH1 5HZ at 2.00 p.m. on 19 July 2018 for the purpose of seeking SSE Shareholder approval for the Transaction.

At the General Meeting, the following ordinary resolutions will be proposed:

- an ordinary resolution to approve the declaration of a special dividend to give effect to the Demerger (the **Demerger Resolution**); and

- an ordinary resolution to approve the waiver of the obligation on innogy to make a general offer for all of the issued MergeCo Shares (the **Whitewash Resolution**).

Voting on each of the Resolutions to be put to the General Meeting will be taken on a poll demanded by the chairman of the meeting, rather than a show of hands, to reflect the number of SSE Shares held by a shareholder, whether or not the shareholder is able to attend the meeting. The Transaction will not become effective unless all the Resolutions are passed by SSE Shareholders representing a simple majority of the total voting rights of SSE Shareholders who (being entitled to do so) vote.

## 19. Action to be Taken

Please vote on the Resolutions. If you cannot attend and vote at the General Meeting in person, please vote by proxy which you may do by post, through CREST or electronically.

Whether or not you propose to attend the General Meeting in person, you are asked to complete the Form of Proxy (or appoint a proxy electronically, as referred to in this Circular) in accordance with the instructions printed on it and return it to SSE's registrars, Link Asset Services, so as to arrive as soon as possible, but in any event so as to be received by no later than 2:00 p.m. on 17 July 2018.

You may, if you wish, register the appointment of a proxy or proxies electronically by logging on to [www.sse.com](http://www.sse.com). Further details of the procedure are set out in the Notice of General Meeting set out in Part XV (*Notice of General Meeting*) at the end of this document.

CREST members may also choose to use the CREST electronic proxy appointment service in accordance with the procedures set out in the Notice of General Meeting set out in Part XV (*Notice of General Meeting*) at the end of this document.

Completion and return of the Form of Proxy (or the electronic appointment of a proxy) will not preclude you from attending and voting at the General Meeting in person if you so wish.

If you are an employee who participates in SSE's UK Share Incentive Plan, you should sign and complete a Form of Direction (or complete electronically, as referred to in this document) in accordance with the instructions printed on it and return it to SSE's registrars, Link Asset Services, as soon as possible and, in any event, so as to be received by no later than 2.00 p.m. on Thursday, 12 July 2018.

## 20. Further Information

The expected timetable of principal events for the Transaction is set out on page 6 of this document. Further information regarding the terms of the Transaction is set out in Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this document. SSE Shareholders are advised to read the whole of this document and not merely rely on the summarised information set out in this letter.

## 21. Recommendation

The Directors, who have been so advised by Credit Suisse and Morgan Stanley, consider the Transaction and the Waiver (as defined herein) to be fair and reasonable and in the best interests of SSE and the SSE Shareholders taken as a whole. In providing its financial advice to the Board, each of Credit Suisse and Morgan Stanley has relied upon the Board's commercial assessment. The Transaction and the Waiver have been unanimously approved by the Board, and **the Board unanimously recommends that you vote in favour of the Resolutions to be proposed at the General Meeting.**

The Directors intend to vote in favour of the Resolutions at the General Meeting in respect of their SSE Shares to which they are beneficially entitled (representing approximately 0.015 per cent. of the total issued share capital of SSE as at 21 June 2018 (being the latest practicable date prior to publication of this Circular)).

Each SSE director also intends to retain the MergeCo Shares which they receive under the Demerger and over which they have discretion for a period of at least six months after the Demerger.

Yours faithfully,

for and on behalf of SSE PLC

**Richard Gillingwater CBE**  
Chairman

## PART II SOME QUESTIONS AND ANSWERS ON THE TRANSACTION

The following summary of questions and answers has been prepared to help you understand what is involved in the Transaction. You should read the whole of this document and not rely solely on the summary questions and answers set out below. If you require any further information, please contact the SSE Shareholder Helpline, details of which appear on page 4.

**Please note that for legal reasons the SSE Shareholder Helpline will only be able to provide practical information and will not provide advice on the merits of the Transaction or give any financial or taxation advice. For financial or taxation advice, you will need to consult an independent adviser.**

### 1. What is being proposed?

The Transaction would result in the separation of SSE's household energy and services business in Great Britain (named SSE Energy Services) from the rest of SSE and the subsequent combination of the newly demerged business with npower, the domestic and business retail operations of innogy in Great Britain. The SSE Retained Group will continue to develop, own and operate energy and related infrastructure and services, including providing energy and infrastructure services to business customers throughout the United Kingdom and Ireland and to household customers in Northern Ireland and Ireland.

SSE proposes to separate SSE Energy Services from the SSE Group by way of a demerger into a new company, MergeCo, in return for which SSE Shareholders will receive shares in MergeCo. The Demerger will be effected by SSE declaring a special dividend (in kind in the form of MergeCo Shares) in respect of the SSE Shares pursuant to which SSE Shareholders will receive one MergeCo Share for each SSE Share held at the Demerger Record Time. As an example, if you hold 10 SSE Shares at the Demerger Record Time, you will hold 10 SSE Shares and 10 MergeCo Shares following the Demerger.

On the day following the Demerger, the innogy Group will transfer npower to MergeCo in consideration for which MergeCo will allot and issue MergeCo Shares to the innogy Group.

MergeCo will then apply for a premium listing on the main market for listed securities of the London Stock Exchange, such listing to become effective on Completion. The innogy Group will hold 34.42 per cent. of the shares of MergeCo and has contractually agreed to retain them for a period of at least six months from Admission, subject to certain limited exceptions.

### 2. Why am I being sent this document?

The Demerger requires the approval of SSE Shareholders at the General Meeting. Although the Transaction is not expected to be of a size requiring classification as Class 1 and therefore for which separate approval by ordinary resolution is required from shareholders under the Listing Rules, the Demerger is being implemented via a special dividend (in kind in the form of MergeCo Shares) and therefore requires SSE Shareholder approval by ordinary resolution pursuant to SSE's articles of association. This document contains information to assist you in your voting decision.

The General Meeting is to be held at 2:00 p.m. on Thursday 19 July 2018 and the Notice of the General Meeting is set out at the end of this document.

### 3. Why is SSE proposing the separation of SSE and SSE Energy Services?

Energy markets for businesses such as SSE, engaged in the supply of energy to retail customers in Great Britain, are rapidly transforming. The energy retail market is highly competitive, with more than 80 competing suppliers (including White Labels), a large range of products and services available to customers and customer switching at historically high levels (a record 9.3 million customer accounts, or one in six, switching supplier in 2017, according to the UK Department for Business, Energy & Industrial Strategy). Further, the market continues to change through a combination of disruptive technology, an evolving regulatory environment and changing consumer behaviour brought about by digitalisation, smart metering, micro generation and evolving channels to market.

In view of the evolution of the SSE Group as a whole, and in light of the changes in the energy retail market, the Board undertook a strategic review of SSE's household energy and services business in Great Britain in 2017. This is in line with SSE's stated commitment to embrace change in each of its businesses, adapting them to the economic, social and technological requirements of customers and of society as a whole. In carrying out this review, the Board gave important consideration to the interests of energy customers and other stakeholders.



The Board reached the conclusion that a separation of SSE Energy Services from the SSE Group has strong strategic logic and the potential to drive significant benefits for the business and its customers. It believes that a standalone household energy and services business will benefit from its own dedicated board of directors and specialist management team, supported by skilled employees and focused entirely on strategic and operational developments in the British energy retail sector, including the competitive and regulatory environment. A standalone business will also have the ability to access and allocate its own capital, allowing day-to-day decision-making to be more closely aligned with strategy and thereby facilitating the delivery of greater benefits to all stakeholders going forward, including customers and employees.

#### **4. Why is SSE proposing the combination of SSE Energy Services with npower?**

After careful consideration of the options available to SSE, and following discussions with innogy regarding the future of its own UK-based household energy and services business (npower), the Board concluded that a combination of both companies' household energy and services businesses would facilitate the delivery of greater benefits to all stakeholders going forward, including customers and employees. In addition to the standalone benefits described above, a combination with npower is expected to deliver enhanced benefits by creating a more efficient new independent energy supply and services business and helping to create a new market model by combining the resources and experience of two established players with the focus and agility of an independent supplier. These factors will enable MergeCo to respond more effectively to the rapidly evolving competitive landscape as well as meet the changing expectations of customers, regulators and other stakeholders, respond to the needs of vulnerable customers and make progress with the rollout of smart meters.

As indicated at the time of the announcement of the Transaction on 8 November 2017, the SSE Directors expect a significant benefit of the combination to be the anticipated synergies derived from operational cost efficiencies and capital expenditure savings.

The SSE Directors believe that, as a result of the Combination, MergeCo will generate cash cost synergy benefits of at least £175 million by the end of the fourth full year following Completion. Of this, £156 million relates to operating expense savings and £19 million of recurring capital maintenance savings.

The expected sources of quantified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis.

The run rate at the end of Year One is expected to be approximately 27 per cent., with 47 per cent. achieved by the end of Year Two, 63 per cent. by the end of Year Three, and the full run rate achieved by the end of Year Four.

The expected sources of quantified cost synergies comprise:

- **IT system consolidation:** approximately 30 per cent. of full run-rate cost synergies are expected to be generated from the consolidation of both corporate and customer service / billing systems;
- **Procurement:** approximately 15 per cent. of full run-rate cost synergies generated from direct and indirect procurement synergies which are expected to be driven by scale economies, sharing of best practice procurement processes, and removal of duplicate expenditure; and
- **Other Selling, General and Administrative expenses:** approximately 55 per cent. of full run-rate cost synergies are expected to be delivered through functional excellence and the removal of duplicate selling, general and administrative expenses.

Following Completion, MergeCo will assess the potential impact of the anticipated synergies on the overall workforce within the MergeCo Group, and the MergeCo board of directors will have regard to their statutory directors' duties with regard to the interests of MergeCo's employees in making this assessment. MergeCo will take into account the effect of natural attrition and management of contingent worker arrangements. To the extent that any of the anticipated synergies result in change for employees, appropriate consultation with employee representative bodies will take place before any final decisions are taken.

The benefits described above are shown pre-tax and net of identified cost dis-synergies.

SSE estimates that the programme will require net cash one-off costs to achieve of approximately £260 million (including contingency) with around 19 per cent. incurred in Year One, 32 per cent. incurred in Year Two, 27 per cent. in Year Three and the remainder in Year Four. These costs are mainly driven by IT and systems integration, re-branding spend and people-related costs (including training where appropriate) associated with the Combination.

In addition to the £175 million annualised cost synergy benefits, SSE expects MergeCo to realise approximately £50 million of one-off capex benefits by the end of the fourth year following Completion.

References to these anticipated synergies should be read in conjunction with Appendix 1 (*SSE Quantified Financial Benefits Statement*), which has been prepared in accordance with the requirements of the City Code.

## 5. What will SSE plc's business focus on following the separation of SSE Energy Services?

Completion of the Transaction will give the SSE Retained Group greater focus on the infrastructure and related services relied on by energy customers, which is more aligned to its core competencies. It will also give investors greater visibility of assets and earnings in the future, the majority of which will come from regulated energy networks and renewable energy.

Going forward, therefore, regulated energy networks and renewable energy will be core to the SSE Retained Group with flexible thermal generation also having a key role. Other businesses within the SSE Retained Group are complementary and benefit from direct and indirect synergies. In all these remaining business areas the needs of energy customers will continue to be a key focus.

In a fast-changing energy and infrastructure sector, optionality is very important. That is why the SSE Retained Group will feature a range of complementary businesses and so maintain the ability to create attractive longer-term growth and value options.

**In practice, this means the core business focus of the SSE Retained Group will be:**

- delivering the best possible performance in the networks businesses so they can operate as successfully as possible in future price controls set by the regulator and play a major role in creating localised energy systems;
- growing its renewables business to have the necessary capabilities, pipeline and scale to thrive over the long term, complemented by flexible thermal generation;
- securing value from its range of complementary businesses through operating them more efficiently, developing them and creating options for the future; and
- continuously improving its structures, skills and tools so it has the capability and agility to create value for shareholders and society.

## 6. Will this mean a change in how the two businesses are run?

Following Completion, SSE and MergeCo will be separate, independent companies, each with its own board of directors, management teams and strategy, as detailed in paragraph 10 of Part I (*Letter from the Chairman of SSE*) of this document.

## 7. How big is SSE Energy Services relative to the SSE Group?

In the three financial years to 31 March 2018, SSE Energy Services contributed between 12.8 and 15.0 per cent. of the adjusted operating profit of the SSE Group as shown in the following table.

### SSE Group adjusted operating profit

	Year ended 31 March		
	2016	2017	2018
		(£ millions)	
		(audited)	
SSE Energy Services . . . . .	267.9	239.7	274.2
SSE Group . . . . .	1,824.4	1,874.0	1,828.7
Contribution to SSE Group of SSE Energy Services (%) . . . . .	14.7	12.8	15.0

## 8. What will this mean for the share price of SSE plc?

Subject to the restrictions described in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular, following completion of the Demerger SSE Shareholders will hold one MergeCo Share for every one SSE Share they hold as at the Demerger Record Time (as well as continuing to hold all of their SSE Shares). As a result, the economic value of SSE Shareholders will then be split between the two listed companies of SSE and MergeCo.

The price of the SSE Shares and MergeCo Shares following the Transaction will be set by the market and, together, may not necessarily equal the market price of SSE Shares prior to the Transaction and may be higher or lower.

#### **9. Can I elect to receive cash instead of shares in MergeCo?**

This is not an option under the Transaction.

All SSE Shareholders will be entitled to sell their SSE Shares or, following receipt, their MergeCo Shares in the usual course. It should be noted however, that if you transfer or sell your SSE Shares prior to the Demerger Record Time, you will not receive any MergeCo Shares as part of the Demerger.

Also, SSE may procure purchasers for any MergeCo Shares in respect of Ineligible Shares and remit the net proceeds to the respective SSE Shareholders (see paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular).

SSE ADR holders will be unable to retain MergeCo Shares pursuant to the Demerger. SSE will procure purchasers of the MergeCo Shares issued to the ADR Depositary (as defined herein), and the ADR Depositary will remit such net proceeds to the SSE ADR holders. SSE ADR holders who wish to retain MergeCo Shares pursuant to the Demerger will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement and ensure that they are registered as SSE Shareholders by the Demerger Record Time. Additional information can be found in paragraph 6 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

#### **10. How will the Transaction be implemented?**

The Transaction will be implemented by the demerger of SSE Energy Services and the subsequent combination of SSE Energy Services with npower.

The Demerger will be effected by SSE declaring a special dividend in respect of the SSE Shares (in kind in the form of MergeCo Shares) of an amount equal to the book value of SSE's shareholding in Retail HoldCo, the holding company of SSE Energy Services. The special dividend will be satisfied by the transfer to MergeCo of the entire issued share capital of Retail HoldCo, and in consideration for that transfer, MergeCo will allot and issue MergeCo Shares to SSE Shareholders. SSE Shareholders will receive one MergeCo Share for each SSE Share held at the Demerger Record Time. As an example, if you hold 10 SSE Shares at the Demerger Record Time, you will hold 10 SSE Shares and 10 MergeCo Shares following the Demerger.

On the day following the Demerger, the innogy Group will transfer the entire issued share capital of npower to MergeCo in consideration for which MergeCo will allot and issue MergeCo Shares to the innogy Group.

Upon completion of the Combination, MergeCo's ordinary shares are expected to be admitted to the premium listing segment of the Official List and to trading on the main market for listed securities of the London Stock Exchange.

Subject to the restrictions described in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular, following Admission SSE Shareholders will own shares in two independent, separately listed companies: SSE and MergeCo (to be subsequently renamed).

#### **11. What proportion of MergeCo Shares will SSE Shareholders own?**

In aggregate, SSE Shareholders will own up to 65.58 per cent. of the MergeCo Shares in issue as at the date of Completion. The exact percentage of MergeCo Shares that will be owned by SSE Shareholders at this time is dependent on the number of SSE Shareholders who are located outside the United States or who make the Investor Declarations as discussed in more detail in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular. The innogy Group will hold 34.42 per cent. of the MergeCo Shares in issue as at the date of Completion and has contractually agreed to retain them for a period of at least six months from Admission, subject to certain limited exceptions.

#### **12. What happens if the conditions relating to the Transaction are not satisfied?**

If the conditions of the Transaction are not satisfied (or where applicable, waived) by 30 June 2019, the Transaction may become terminable; and in the meantime, until the Transaction is completed, SSE Energy Services and npower will continue to operate separately and to compete with each other in the same way as with other competitors.

More detail on the implementation of the Transaction can be found in Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) and Part XII (*Further details of the Transaction*) of this Circular.

**13. Will I receive a prospectus relating to the shares that I am being issued in MergeCo?**

In connection with the listing of the MergeCo Shares on the London Stock Exchange, a prospectus relating to the MergeCo Shares will be published and made publicly available in accordance with the Prospectus Rules of the FCA. It is anticipated that the MergeCo prospectus will be published shortly prior to Admission in the first quarter of 2019.

**14. Will there be any ongoing relationship between SSE or innogy and SSE Energy Services?**

***Shared IT Systems***

In connection with the Transaction, SSE will be transferring to the MergeCo Group certain IT systems relating to customer service including registration, deregistration, metering, billing, payments and collections. Following the Transaction, MergeCo will provide to the SSE Retained Group continued access to the CS Systems under the Transitional Services Agreements. Both retail and business energy customers will remain on the CS Systems until the platform is no longer required. This arrangement will remain in place for a number of years determined in part by the approach to consolidate MergeCo IT systems.

The Transitional Services Agreements contain customary arm's length provisions governing each party's access to, and use of, IT systems under the agreement (including the CS Systems) to help maintain information security.

***Servicing arrangements***

The SSE Retained Group and the innogy Group will each continue to provide, and receive, certain services, including various finance, IT, HR and procurement services to and from the MergeCo Group for a period following Completion under the terms of two Transitional Services Agreements as between each party and MergeCo. The majority of services under the Transitional Services Agreement between SSE (or one of its affiliates) and MergeCo are to be provided for a minimum term of two years (except for IT services, which will be provided for a minimum term of three years), with a service recipient under such Transitional Services Agreement having the right to extend a service by providing between three and six months' notice to the service provider (depending on the service concerned). None of the parties to the Transitional Services Agreements is under an obligation to provide any services for more than five years pursuant to such agreements. The Directors do not consider any services provided under the Transitional Services Agreement to be material to the SSE Retained Group or the MergeCo Group.

The SSE Retained Group will continue to provide telecoms, logistics and wholesale energy portfolio management services to SSE Energy Services through separate arm's length long-term services agreements that will be entered into between SSE (or one of its affiliates) and MergeCo (or one of its affiliates) before Completion. The telecoms agreements will last for a minimum period of four years from 1 April 2018 with an option to extend by 12 months. The logistics agreement will last for a minimum period of three years from Completion with an option for MergeCo to extend for two years on seven months' notice. The wholesale energy portfolio management services agreement will last for a minimum period of three and a half years from 1 April 2018, up to a maximum of four years.

The MergeCo Group will provide traditional- and smart- metering services to the SSE Retained Group through separate arm's length long-term services agreements that will be entered into before Completion. These agreements will each last for a minimum period of three years from Completion.

For more detail on these agreements, see paragraph 3 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

**15. What arrangements are planned in terms of brands?**

Immediately following the Transaction customers of MergeCo will not see any immediate change to the brand under which their energy is supplied. MergeCo will have the right to use certain SSE corporate brands in connection with the home energy and services business in Great Britain for three years (subject to certain conditions). These SSE corporate brands include 'SSE', 'SSE PROUD TO MAKE A DIFFERENCE' and the SSE "swoosh" logo.

As part of the Transaction, SSE will transfer to MergeCo certain SSE retail brands including but not limited to 'SOUTHERN ENERGY', 'SOUTHERN ELECTRIC', 'SWALEC' and 'SCOTTISH HYDRO'. MergeCo will be subject to certain restrictions on its use of some of these transferred SSE retail brands which will be licensed-back to SSE for use outside of a home energy and services business. SSE will have the right to use the licensed-back brands in the United Kingdom and Ireland for three years (subject to certain conditions). These licensed-back brands include 'SOUTHERN ELECTRIC', 'SWALEC' and 'SCOTTISH HYDRO'.

SSE and MergeCo will enter into a Brand Licence and Assignment Agreement which sets out the conditions of use of these brands and contains customary co-existence provisions which are designed to prevent confusion and ensure the brands are used in a consistent way.

The MergeCo Group is expected to develop and operate under a new brand in due course, and its company name will reflect the new brand.

#### **16. Why is there a general meeting and do I need to attend?**

The General Meeting has been convened by SSE in accordance with its articles of association to approve the Transaction by voting on the Resolutions. All SSE Shareholders are entitled to attend the General Meeting. If you are not able to attend, you are still entitled to vote at the General Meeting by appointing a proxy.

You may appoint your proxy by either completing the Form of Proxy and returning it, or alternatively submitting your vote via the internet, in accordance with the instructions printed on the Form of Proxy and set out in the Notice of General Meeting at the end of this document.

If you hold SSE Shares in uncertificated form, you may also appoint a proxy by completing and transmitting a CREST proxy instruction in accordance with the procedures set out in the CREST Manual, ensuring that it is received by Link Asset Services (under CREST participant ID RA10) by no later than 2:00 p.m. on 17 July 2018, being 48 hours before the time appointed for the holding of the General Meeting (excluding any part of a day that is not a working day).

More information about voting by proxy is in Part XV (*Notice of General Meeting*) of this Circular.

Should you later change your mind and decide to attend the General Meeting in person, then returning the Form of Proxy will not preclude you from doing so.

#### **17. Do I need to vote?**

It is important that as many SSE Shareholders as possible cast their votes. If you do not wish, or are unable, to attend the General Meeting you may appoint someone (known as a proxy) to act and vote on your behalf. Your proxy must attend the meeting. Alternatively, you can choose to appoint the chairman of the General Meeting as your proxy. More information about voting by proxy is in question 17 above, and in Part XV (*Notice of General Meeting*) of this Circular.

At the General Meeting the following separate resolutions will be proposed and voted on:

- an ordinary resolution to approve the declaration of a special dividend to give effect to the Demerger; and
- an ordinary resolution to approve the waiver of the obligation on innogy to make a general offer for all of the issued MergeCo Shares.

The Transaction will not become effective unless all the Resolutions are passed by SSE Shareholders representing a simple majority of the total voting rights of SSE Shareholders who (being entitled to do so) vote.

#### **18. When will the Transaction come into effect?**

Subject to the necessary conditions being satisfied or waived, the Transaction is expected to become effective in the first quarter of 2019.

#### **19. Do I have to pay anything under the Transaction proposals?**

No payment is required.

#### **20. Will I have to pay any tax as a result of the Transaction proposals?**

Certain information about UK and US taxation issues in relation to the Transaction is set out in Part VIII (*Taxation*). **That summary relates only to the position of certain categories of SSE Shareholders (as explained further in Part VIII (*Taxation*) of this document), does not constitute tax advice and does not**

**purport to be a complete analysis of all potential UK and US tax consequences of the Demerger or the Transaction. If you are in any doubt about your own tax position or you may be subject to taxation in any jurisdiction other than the United Kingdom or the United States, you are strongly recommended to consult an appropriately qualified independent professional tax adviser.**

## **21. What will happen to my SSE Shares?**

The Transaction will not affect the number of SSE Shares you own.

Provided you have not disposed of your SSE Shares prior to the Demerger Record Time, and subject to the restrictions described in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular, you will receive one MergeCo Share for each of the SSE Shares that you own at the Demerger Record Time. As an example, if you hold 10 SSE Shares at the Demerger Record Time, you will hold 10 SSE Shares and 10 MergeCo Shares following the Demerger.

As a result, the economic value of SSE Shareholders will then be split between the two listed companies of SSE and MergeCo (to be subsequently renamed). The price of the SSE Shares and MergeCo Shares following the Transaction will be set by the market and, together, may not necessarily equal the market price of SSE Shares prior to the Transaction and may be higher or lower.

## **22. When will I receive my new share certificates?**

Share certificates for MergeCo Shares are expected to be issued within 14 days following admission of the MergeCo Shares to the premium listing segment of the Official List and to trading on the London Stock Exchange's main market for listed securities.

## **23. What will happen if the Transaction is not approved by SSE Shareholders?**

In the event that the Transaction is not approved by SSE Shareholders, SSE Energy Services would not be legally separated from SSE and would continue to trade within the SSE Group. You would continue to hold shares in SSE. As long as SSE Energy Services remains part of the SSE Group, your SSE Shares will also represent an interest in SSE Energy Services, as they do today.

If the SSE Shareholders fail to approve the Demerger by 31 July 2018, SSE shall be obliged to make to innogy a £60 million compensatory break payment if innogy elects to terminate the Contribution Agreement within 30 business days after such date.

## **24. What will be the dividend policy of each of SSE and MergeCo following the Transaction?**

SSE's plan for the dividend for the five years to 2023 is as follows:

- for **2018/19**, SSE is intending to recommend a full-year dividend of **97.5 pence per share**, an increase of three per cent. on 2017/18, which is broadly in line with expectations for RPI inflation. This provides clarity in a year of transition and is not subject to the timing of either the Transaction or the Domestic Gas and Electricity (Tariff Cap) Bill.
- for **2019/20**, SSE is planning to set the first post-transaction dividend at **80 pence per share**, which reflects the impact of the changes in the SSE Group expected to take effect by then. This provides a sustainable basis for future dividend growth.
- for **2020/21, 2021/22 and 2022/23** SSE is targeting annual increases in the full-year dividend that at least keep pace with RPI inflation. This reflects SSE's confidence in the quality and value of its assets and earnings and cash flows they deliver.

This plan for the dividend for the five years to March 2023, when the current electricity distribution price control comes to an end, supersedes SSE's previous reference to a dividend cover range and is a plan which:

- aims to provide shareholders with certainty in 2018/19, a year of transition for SSE;
- reflects the changes in the SSE Group expected to take effect by the start of the 2019/20 financial year; and
- sets the dividend on a path for sustainable growth for the three years from 2020.

SSE intends to retain a scrip dividend scheme but where take-up of the full year dividend exceeds 20 per cent., SSE now intends to buy back shares so the dilutive effect of the scrip is limited.

The future policy on dividends of MergeCo will be a matter for the MergeCo board of directors once appointed. MergeCo's dividend policy is expected to be included in the prospectus relating to the MergeCo Shares, which is anticipated to be published shortly prior to Admission in the first quarter of 2019. SSE Shareholders will receive one share in MergeCo for every one SSE Share they hold at the Demerger Record Time. This will entitle SSE Shareholders who continue to hold the MergeCo Shares they receive as a result of the Transaction to receive any future dividend distributions from MergeCo, in addition to the dividends to be paid by SSE.

**25. Do I need to change my existing instructions so far as the payment of dividends is concerned?**

After Completion, your present dividend instructions on SSE at the Demerger Record Date will apply in respect of your new shareholdings in MergeCo (this excludes any scrip dividend mandates). If you wish to change your instructions, you should contact the SSE Shareholder Helpline on +44 (0)345 143 4005 or visit [www.sse-shares.com](http://www.sse-shares.com) where you will be able to view your holding, update your account preferences and provide your investor declaration as described in paragraph 5 of Part XII (*Further details of the Transaction*) of this Circular.

**26. What if I hold my SSE Shares in the form of ADRs?**

SSE ADR holders will be unable to retain MergeCo Shares pursuant to the Demerger. SSE will procure purchasers of the MergeCo Shares issued to the ADR Depositary (as defined herein). The ADR Depositary will receive the proceeds of such sales (net of the expenses of procuring such purchasers, including any applicable brokerage commissions and amounts in respect of any value added tax, and any stamp duty or SDRT) and remit such net proceeds (after deducting its own fees and expenses) to the SSE ADR holders, in US dollars, in accordance with the terms of the Deposit Agreement (as defined herein). The amount of money received by each SSE ADR holder will be calculated on an averaged basis so that all SSE ADR holders will receive the same price for each MergeCo Share, subject to rounding down to the nearest whole US cent.

SSE ADR holders will not be entitled to attend the General Meeting. In order to vote their underlying SSE Shares, SSE ADR holders will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement (as defined herein) and ensure that they are registered as SSE Shareholders at, and have voted by proxy (if applicable) by, 2:00 p.m. on 17 July 2018 or, in the event that the General Meeting is adjourned, registered in the Register of Members of the Company 48 hours before the time of the adjourned meeting(s). Instructions for voting by proxy are found in Part XV (*Notice of General Meeting*) of this Circular. SSE ADR holders wishing to do this should withdraw their ADRs in time to permit processing to be completed by the ADR Depositary and should note that certain fees, expenses and taxes may apply. SSE ADR holders who wish to take such action and who hold their SSE ADRs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which the SSE ADRs are held. SSE ADR holders are encouraged to consult their own legal and tax advisers.

SSE ADR holders who wish to retain MergeCo Shares pursuant to the Demerger will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement and ensure that they are registered as SSE Shareholders by the Demerger Record Time. SSE ADR holders wishing to do this should withdraw their ADRs in time to permit processing to be completed by the ADR Depositary and should note that certain fees, expenses and taxes may apply. Such SSE ADR holders are encouraged to read paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

Additional information can be found in paragraph 6 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

SSE ADR holders who hold their SSE ADRs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which the SSE ADRs are held. SSE ADR holders are encouraged to consult their own legal and tax advisers.

**27. What if I still have questions?**

If you have read this document and still have questions, then please call the SSE Shareholder Helpline, further details of which appear on page 4.

For legal reasons the SSE Shareholder Helpline will only be able to provide practical information and will not provide advice on the merits of the Transaction or give any financial or taxation advice. For financial or taxation advice, you will need to consult an independent financial or taxation adviser.

### PART III RISK FACTORS

As is required in documents of this type, this Part III (*Risk Factors*) addresses the risks known to SSE and the Directors to which the SSE Group is exposed in connection with the Transaction and to which the MergeCo Group is exposed, which could materially and adversely affect the business, results of operations, cash flow, financial performance, revenue, profits, assets, liquidity and/or capital resources of the SSE Group or the MergeCo Group, as appropriate. If certain risks materialise, the market price of SSE Shares or MergeCo Shares could decline and SSE Shareholders or MergeCo Shareholders may lose some or all of their investment.

Prior to voting on the Resolutions at the General Meeting, SSE Shareholders should carefully consider, together with all other information contained in this document, the specific risks and uncertainties described below.

Additional risks and uncertainties currently unknown to SSE and the Directors, or which SSE and the Directors currently deem immaterial, may also have an adverse effect on the SSE Group or MergeCo Group business, financial performance, results of operations and prospects if they materialise.

#### 1. Risks resulting from the Transaction

##### ***Completion is subject to a number of conditions which may not be satisfied or waived***

Completion is subject to the satisfaction (or waiver, where applicable) of a number of conditions, some of which are outside of the parties' control, and which are further described under paragraph 1 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular. There can be no certainty that these conditions will be satisfied (or waived, if applicable) in a timely manner or at all, in which case Completion may be delayed or may not occur and the benefits expected to result from the Transaction may not be achieved. Further, the Contribution Agreement is subject to a long stop date of 30 June 2019, after which the Transaction may become terminable.

Failure to complete, or a delay in completing, the Transaction for whatever reason could have a significant impact on the SSE Group's or MergeCo Group's (as applicable) reputation and business strategy, as considerable resources have been devoted to effect the Transaction, including substantial expenses and management's time and attention. Further, as described in the announcement of the Transaction on 8 November 2017, the SSE Group has agreed to make to the innogy Group a compensatory break payment equal to £60 million in cash (as set out in more detail in paragraph 1 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular) if the SSE Shareholders do not approve the Demerger Resolution on or before 31 July 2018 and innogy terminates the Contribution Agreement by written notice within 30 business days after that date.

The aggregate consequences of a failure to complete, or a material delay in completing, the Transaction could have a material adverse effect on the SSE Group's or MergeCo Group's business, financial performance, results of operations and prospects.

##### ***Merger clearance consents may take longer than expected to obtain and/or may not be granted or may be granted subject to conditions or remedies***

The Transaction is subject to merger control approval from the CMA in the United Kingdom.

The energy sector is subject to a high degree of regulatory and legislative intervention at both domestic and EU level and the Transaction will be subject to detailed scrutiny from the CMA with observations from the Office of Gas and Electricity Markets (*Ofgem*). Approval from the CMA may take longer than expected to obtain and/or may not be granted or may be granted subject to conditions or remedies. These outcomes may be more likely if the CMA decided to take the E.ON/RWE Transaction into account in its analysis. Remedies could include: (i) the divestment by SSE Energy Services or npower of certain assets (including customers) or businesses; (ii) the imposition of restrictions on the conduct of the MergeCo Group's business; and/or (iii) other behavioural remedies. Any such remedies could delay or jeopardise Completion. They could also impose sustained additional costs for the MergeCo Group and/or materially reduce the anticipated benefits (including synergy benefits) of the Transaction. Finally, each of SSE and innogy may be able to terminate the Transaction if the remedies mandated by the CMA are not reasonably satisfactory to either party or if CMA approval is not obtained by 30 June 2019.

Any of the aforementioned outcomes could result in a material adverse effect on the business, financial performance, results of operations and prospects of the MergeCo Group.



***Costs and expenses related to the Transaction could exceed amounts currently estimated***

The SSE Group expects to incur a number of costs in relation to the Transaction, including integration costs, post-Completion costs and tax (including stamp duty) costs, which could exceed the amounts currently estimated. There may also be further additional and unforeseen expenses incurred in connection with the Transaction either due to delays or otherwise. Whilst the Board believes that the costs related to the Transaction will be offset by the realisation of the benefits of the Transaction, there can be no certainty that any benefits of the Transaction that are realised will offset such costs, which could have a material adverse effect on the business, financial performance, results of operations and prospects of the SSE Group or the MergeCo Group.

***The Separation is complex and there can be no certainty that it will be successfully completed***

The reorganisation and separation of SSE Energy Services from the SSE Retained Group (the ***Separation***) is complex. There can be no certainty that the Separation will be successfully implemented and there may be unforeseen barriers to the completion of the intended separation steps in the intended time frame, or at all. There may for example be unintended consequences such as termination or modification of certain customer or supplier agreements if third party consents under such agreements are not obtained (see “*Third parties may terminate or seek to modify existing contracts with SSE, SSE Energy Services, npower or MergeCo as a result of the Transaction*” in this Part III (*Risk Factors*)).

The Separation may also not have the intended consequences, including in respect of ensuring that the correct or sufficient assets and liabilities sit with the appropriate parties to operate the business or in respect of the transfer to the MergeCo Group of certain IT systems (see “*The MergeCo Group and the SSE Retained Group could experience operational difficulties or losses if any party is unable to perform under the agreements entered into as part of the Transaction*” in this Part III (*Risk Factors*)). Any such complications relating to the Separation could have a material adverse effect on the business, financial performance, results of operations and prospects of the MergeCo Group and the SSE Retained Group.

***npower may not meet planned objectives prior to Completion***

The anticipated benefits and operational efficiencies to be created by the Transaction are based on assumptions regarding, amongst other things, the financial and operational performance of npower, including in the period prior to Completion, when the financial and operational performance of npower is outside the control of the SSE Group. Until Completion, it is possible that an adverse event, or events, could affect the business, financial performance, results of operations and prospects of npower and the MergeCo Group. The risks identified in section 2 below as having the potential to impact on the MergeCo Group industry, business and operating markets could in addition impact on financial and operational performance of npower in the period prior to Completion.

***The Transaction may result in a loss of customers for SSE, SSE Energy Services or npower and, following Completion, the MergeCo Group***

As a result of the Transaction (including as a result of its public announcement and during the period prior to or following Completion) some of SSE’s, SSE Energy Services’ or npower’s corporate customers may seek to terminate or renegotiate business contracts with the SSE Group, the npower Group or the MergeCo Group (as applicable) due to, for example, their perception of the risk of interruption of operations that may result from the integration of the businesses or negative media coverage about the Transaction. Furthermore, potential customers may delay entering into, or decide not to enter into, contracts with SSE, SSE Energy Services or npower on account of any perceived uncertainty in connection with the Transaction.

SSE Energy Services and npower may lose retail customers or have difficulty attracting new customers as a result of the Transaction, including potentially as a result of challenges associated with MergeCo’s new company name and brand identity (see “*Following the Transaction, the MergeCo Group may fail to meet the challenges involved in operating successfully as a standalone business or to realise the anticipated benefits of the Transaction*” in this Part III (*Risk Factors*)).

If SSE’s, SSE Energy Services’ or npower’s relationships with their current or potential future customers are negatively impacted by the Transaction, the SSE Group’s or the MergeCo Group’s business, financial performance, results of operations or prospects could be materially adversely affected.

The npower Group provides wholesale electricity and gas and certain other related services to certain members of the Telecom Plus Group under a long-term supply contract. Telecom Plus is the largest customer of npower, providing revenue of £486.1 million in 2017. If Telecom Plus were to terminate the contract in 2019, in certain

circumstances it would be required under the terms of the contract to pay a break fee of £176 million to npower as compensation for the loss of the value of the contract. As a result of the Transaction, Telecom Plus may seek to renegotiate or exercise the termination provisions in the long-term supply contract it has entered into with the npower Group without payment of any break fee. Although, on a renegotiation or termination in certain circumstances, compensation arrangements would apply pursuant to the Contribution Agreement to replace a significant proportion of the loss of the value of the contract to MergeCo that would otherwise be compensated by the break fee, in either case MergeCo would not be compensated fully. Accordingly, any termination or renegotiation of the long-term supply contract with Telecom Plus in connection with the Transaction may have a material adverse effect on the Group's business, financial performance, results of operations or prospects.

***Third parties may terminate or seek to modify existing contracts with SSE, SSE Energy Services, npower or MergeCo as a result of the Transaction***

As part of the Transaction, it is intended that MergeCo or its subsidiaries will become counterparties by assignment and/or novation of a number of contracts of SSE, the innogy Group, or any of their respective subsidiaries, with third party suppliers, distributors, clients, customers, licensors, licensees, lessees, lessors, lenders, insurers, landlords, other business partners and/or other counterparties. Some of these contracts require the counterparty's consent to assignment and/or novation. If these consents cannot be obtained, or if a number of these consents remain outstanding following the Transaction, the MergeCo Group may be unable to obtain some of the benefits, assets and/or contractual commitments that are intended to be allocated to it as part of the Transaction. In addition, certain agreements require amendment or renegotiation to the extent that the counterparty will continue to receive or provide services from or to both MergeCo and the SSE Retained Group or both MergeCo and the innogy Group. Counterparties may seek to renegotiate the contracts on terms less favourable to MergeCo.

Furthermore, if MergeCo does not obtain, and subsequently maintain, an investment grade credit rating similar to that of the innogy Group (with respect to contracts entered into by the npower Group) or similar to that of the SSE Group (with respect to contracts entered into by SSE Energy Services), counterparties may seek more onerous contractual terms, additional collateral or to terminate contracts, any of which could have a material adverse effect on the business, financial performance, results of operations and prospects of the MergeCo Group.

In addition, some of the contracts to which the MergeCo Group is, or following the Transaction will be, a party, contain "change of control" or similar clauses that allow the counterparty to terminate or change the terms of their contract as a result of the Transaction, or may otherwise enable the counterparty to seek to modify the terms of the existing contract. This is especially relevant for contracts with longer contractual terms. There can be no assurance that the MergeCo Group will be able to contract on the same terms as SSE, SSE Energy Services or npower (as applicable) have done prior to Completion.

If a large number of third party consents cannot be obtained, or the terms of such contracts are modified in a manner that is adverse to any of the MergeCo Group, the SSE Retained Group or the npower Group, there may be a material adverse effect on the business, financial performance, results of operations and prospects of the MergeCo Group, the SSE Retained Group and/or the npower Group.

***The MergeCo Group and the SSE Retained Group could experience operational difficulties or losses if any party is unable to perform under the agreements entered into as part of the Transaction***

In connection with the Transaction, MergeCo has entered into or will, prior to Completion, enter into several agreements with SSE and/or innogy or their respective subsidiaries, including among others, the Transitional Services Agreements, which in general provide for the performance of certain services or obligations by each of MergeCo, SSE and innogy for the benefit of each other for a transitional period following the Transaction. The durations of such transitional periods vary between six months and five years depending on the service concerned. If any party is unable to satisfy its obligations under such agreements in a timely manner or at all, or if such agreements fail to provide for or cover certain essential services needed by any party during the transitional period the MergeCo Group or the SSE Retained Group could experience operational difficulties or losses that could have a material adverse effect on its business, financial performance, results of operations and prospects.

Pursuant to the innogy transitional services agreement, innogy will provide limited corporate and IT services to the MergeCo group. MergeCo will provide limited reverse services to the innogy Group. Pursuant to the SSE transitional services agreement, the SSE Retained Group will provide some corporate and IT services to the

MergeCo Group. MergeCo will also provide certain reverse services to the SSE Retained Group, including: IT, services for business energy customers and metering services.

For more detail on these agreements including the duration of the transitional services, see paragraph 3 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this document.

If either party fails to provide for or cover certain essential services needed by any party during the transitional period the MergeCo Group or the SSE Retained Group could experience operational difficulties or losses that could have a material adverse effect on its business, financial performance, results of operations and prospects.

In connection with the Transaction, SSE and innogy will be transferring to the MergeCo Group certain IT systems relating to customer service including registration, deregistration, metering, billing, payments and collections. Pursuant to the Transitional Services Agreements, the SSE Retained Group and innogy, as applicable, will continue to rely on these IT systems for a period following Completion. Any failure by the MergeCo Group to effectively manage these IT systems could adversely affect its or the SSE Retained Group's operations or harm its ability to compete effectively, which could materially adversely affect its business, financial performance, results of operations and prospects. See also "*The Separation is complex and there can be no certainty that it will be successfully completed*" in this Part III (*Risk Factors*).

In addition, the failure of the SSE Retained Group or the MergeCo Group, as applicable, to procure services from alternative providers following expiration of the Transitional Services Agreement on reasonable terms or at all could have a material adverse effect on the business, financial performance, results of operations and prospects of either the SSE Retained Group or the MergeCo Group.

***Integration of SSE Energy Services and npower may be more time consuming, challenging and costly than anticipated***

SSE Energy Services and npower currently operate and, until Completion, will continue to operate as two separate, competing businesses. Following Completion, the Transaction will require the integration of the businesses, and the success of the MergeCo Group will depend, in part, on the effectiveness of the integration process.

The key potential difficulties of combining businesses which currently compete with each other following Completion include:

- co-ordinating and consolidating services and operations, particularly across different service areas and business cultures;
- consolidating infrastructure, IT systems, procedures, facilities, accounting functions, compensation structures and other policies;
- migration of customer and other data to MergeCo's IT platform;
- integrating the management teams, retaining and engaging employees, industrial relations and harmonisation of employee terms;
- managing changes to strategy and planned investments by each of SSE Energy Services and npower;
- co-ordinating communications with, and/or the provision of services by the MergeCo Group to customers of both SSE Energy Services and npower; and
- disruption to the business of the SSE Retained Group.

There may also be additional challenges to the combination of the businesses which will not be known until after Completion, and any delays or difficulties encountered in connection with the integration of the businesses could result in an interruption to the MergeCo Group's operations, reputational damage to the MergeCo Group and/or regulatory penalties or fines (such fines being up to ten per cent. of total revenue). In addition, the management team will be required to devote significant attention and resources to integrating business practices and operations. There is a risk that the challenges associated with managing the integration of SSE Energy Services and npower may result in the distraction of management and employees and that, consequently, the underlying businesses may not perform in line with expectations. Any such difficulties or delays encountered in connection with the integration of the businesses could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The Transaction may affect the ability of SSE Energy Services, npower, the MergeCo Group or the SSE Retained Group to attract, retain and motivate employees***

Uncertainty regarding the impact of the Transaction on people's employment may impair the ability of SSE Energy Services, npower, the MergeCo Group or the SSE Retained Group to attract, retain and motivate employees before and after Completion. This could cause their customers, suppliers and other stakeholders that deal with them to seek to change existing business relationships. The departure or distraction of key and/or a significant number of management or other employees could also materially adversely affect the ability to manage SSE Energy Services, npower, the MergeCo Group or the SSE Retained Group. It could also materially adversely affect the ability to realise the expected benefits and operational efficiencies of the Transaction. The departure of key and/or a significant number of management or other employees could have a material adverse effect on the business, financial performance, results of operations and prospects of SSE Energy Services, npower, the MergeCo Group and/or the SSE Retained Group.

***MergeCo will be a newly listed company on the London Stock Exchange, and significant trading volumes of SSE Shares or MergeCo Shares in the public market in the period post-Completion and subsequently could negatively affect the share price***

Following Completion, there may be a period of relatively high volume trading in the SSE Shares and MergeCo Shares as the shareholder registers of each business find their natural composition. As with any publicly traded company, the Directors are unable to predict whether substantial numbers of the SSE Shares or MergeCo Shares will be sold in the open market following Completion. Sales of a substantial number of SSE Shares or MergeCo Shares in the public market after Completion, or the perception that these sales might occur, could depress the market price of the SSE Shares or MergeCo Shares.

The trading market for the MergeCo Shares will rely in part on the research and reports that equity research analysts publish about MergeCo. Prior to Completion there will have been no research coverage by such analysts, and sustainable coverage may never be obtained. Analysts may elect not to provide coverage of the MergeCo Shares, and such lack of coverage may adversely affect the market price of the MergeCo Shares.

Following Completion, the innogy Group will own 34.42 per cent. of MergeCo's issued ordinary share capital. The innogy Group is subject to restrictions for a period of six months from Admission on the sale and/or transfer of its holdings in MergeCo's issued share capital. As a result of such restrictions, there may be insufficient liquidity in the market to enable shareholders to trade in MergeCo Shares freely.

The issue or sale of a substantial number of MergeCo Shares by the innogy Group in the public market after the lock up restrictions in the Relationship Agreement expire, or the perception that these sales may occur, may depress the market price of the MergeCo Shares and could impair MergeCo's ability to raise capital through the sale of additional equity securities.

***MergeCo Shares issued to SSE Shareholders who cannot be identified by SSE as non-US shareholders or "qualified institutional buyers" (within the meaning of Rule 144A of the Securities Act) or "accredited investors" (within the meaning of Rule 501 of Regulation D under the Securities Act) in the US, and to Deutsche Bank as SSE's American depositary (together, "Ineligible Shareholders"), will be sold and any such sales could adversely affect the market price of the MergeCo Shares***

Due to restrictions imposed by SSE to facilitate compliance with US securities laws (described in detail in paragraph 5 of Part XII (*Further details of the Transaction*)), MergeCo Shares issued to Ineligible Shareholders will be sold in the market. SSE Shareholders would only be able to retain the MergeCo Shares if they can demonstrate they are not Ineligible Shareholders by providing certain Investor Declarations that have been requested by SSE. Instructions on how to provide the Investor Declarations are found in paragraph 5 of Part XII (*Further details of the Transaction*) of this Circular. Link Corporate Trustees (UK) Limited is expected to act as trustee (the **Trustee**) and hold the relevant MergeCo Shares on behalf of the Ineligible Shareholders. The Placing Agent (as defined herein) on behalf of MergeCo, will sell such MergeCo Shares held by the Trustee within five days of the Demerger Record Date, with the net proceeds remitted to the Ineligible Shareholders.

Although SSE has estimated that a substantial majority of its US shareholders will not be Ineligible Shareholders, there can be no assurance that SSE Shareholders will provide the required Investor Declarations or that there are not additional persons holding SSE Shares indirectly that are located in the United States of which SSE is not aware who might also qualify as Ineligible Shareholders. Should a significant number of MergeCo Shares be sold in the market, there can be no assurance that such sales would not materially affect the market price of the MergeCo Shares.

***The MergeCo Group will be exposed to risks relating to financing and the replacement of parent company guarantees, letters of credit and/or other similar arrangements***

The MergeCo Group will be smaller and less diverse than either SSE or the innogy Group. As a result, the overall amount of any future debt or equity financing that the MergeCo Group may obtain may be less, and the terms less favourable, than the financial resources available to SSE Energy Services and npower prior to the Transaction as part of larger corporate groups. Furthermore, depending on the amount of and terms on which the MergeCo Group is able to obtain debt financing, the MergeCo Group's credit rating may be substantially lower than that of either SSE or innogy. In addition to affecting its ability to obtain future debt financing on favourable terms or at all, a lower credit rating may affect the ability of the MergeCo Group, or the terms on which the MergeCo Group is able, to do business with counterparties.

The current parent companies of npower (innogy and RWE) and SSE Energy Services (SSE) are required to provide parent company guarantees (**PCGs**) mainly related to guaranteeing the financial obligations of the npower Group and SSE Energy Services, respectively, under a significant proportion of the mandatory industry agreements and arrangements (such as network and energy costs), some commercial agreements (such as power purchase agreements, smart metering arrangements and a small number of large energy supply contracts) and property agreements (such as leases). The expectation is that these PCGs will be replaced with parent company guarantees and letters of credit provided by MergeCo shortly after Completion. In the event that MergeCo does not obtain and retain an investment grade credit rating, there is a risk that the relevant subsidiary of MergeCo would have to procure letters of credit or similar from appropriate financial institutions, which could incur substantial costs and materially adversely affect the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group will be exposed to risks relating to its pension funds***

SSE and its subsidiaries currently sponsor two defined benefit pension schemes: the Southern Electric Pension Scheme and the Scottish Hydro-Electric Pension Scheme (the **SSE DB Schemes**). The SSE DB Schemes will continue to be sponsored by SSE and its subsidiaries following the Transaction. npower operates a defined benefit pension scheme which will continue to be operated by innogy following the Transaction for the benefit of employees that will not transfer to MergeCo.

All employees who will be employed by the MergeCo Group as a result of the Transaction, and are active members of one of the SSE DB Schemes or the npower DB Scheme prior to Completion, will become members of new defined benefit arrangements which will be operated by the MergeCo Group (the MergeCo DB Schemes). Approximately 1,600 employees are expected to become members of the MergeCo DB Schemes. Transfers of assets and past service pension liabilities from the SSE DB Schemes and the npower DB Scheme to the MergeCo DB Schemes in respect of members will take place as a result of the Transaction. The remaining employees of the MergeCo Group will be members of a defined contribution pension scheme.

There is currently an actuarial deficit between the current value of the projected liabilities of one of the SSE DB Schemes (the Southern Electric Pension Scheme) and the npower DB Scheme and the value of the assets that each holds. As a result of the transfer of assets and past service pension liabilities from the SSE DB Schemes and the npower DB Scheme to the MergeCo DB Schemes, at least two sections of the MergeCo DB Schemes will have a deficit which is broadly proportionate to the deficit in respect of those past service liabilities in the existing schemes. However, approximately £500 million worth of assets are expected to be transferred to the MergeCo DB Schemes, resulting in an expected funding level of around 95 per cent. of the MergeCo DB Schemes on a technical provisions basis immediately following Completion. The deficit levels in such schemes can be affected by a number of factors including asset volatility, changes in bond yields, fluctuations in interest and inflation rates, and changes in the life expectancy of scheme members. Although the defined benefit pension schemes each have investment advisors in place who have developed road-map planning towards the schemes becoming fully funded, like all defined benefit schemes changes in the valuation of assets and/or liabilities may occur due to both market movements and changes in the assumptions used to calculate funding levels. This in turn could result in the MergeCo Group being required to make higher ongoing contributions, and/or make deficit repair payments which could affect the MergeCo Group's business, financial performance, results of operations and prospects.

***Following the Transaction, the MergeCo Group may fail to meet the challenges involved in operating successfully as a standalone business or to realise the anticipated benefits of the Transaction***

The success of the MergeCo Group will, in part, depend on its ability to realise the anticipated benefits and operational efficiencies from combining the businesses of SSE Energy Services and npower. These anticipated benefits include, among other things, synergies derived from rationalisation of corporate overheads, alongside operational efficiencies and capital expenditure savings.

The MergeCo Group may not realise these benefits due to the challenges associated with operating successfully as a standalone business or otherwise, and these challenges may be particularly acute in the first two years following Completion. These challenges include (i) implementing organisational design alongside integrating systems and processes, (ii) demonstrating that the Transaction will not result in adverse changes in standards of business and impairment of relationships with customers, employees, regulators or other stakeholders, (iii) distraction of management, (iv) difficulty in effectively marketing and communicating the capabilities of the MergeCo Group as a successful standalone business, (v) managing an independent cash flow and (vi) retaining key personnel.

The MergeCo Group is also expected to operate under a new company name and brand. Whilst npower is the registered owner of the ‘npower’ brand and SSE Energy Services is to have a right to continue using certain SSE-related brands (see “*Will there be any ongoing relationship between SSE and SSE Energy Services?*” in Part II (*Some questions and answers on the Transaction*) of this Circular), such rebranding poses significant operational and commercial challenges, including a risk that the new brand will not, on its own, have the same strength of the SSE and npower brands. Managing the challenges resulting from this rebranding may result in customer losses and lower returns than expected from the investments in rebranding. Further, for a transitional period of up to three years following Completion, both the SSE Retained Group and the MergeCo Group will share certain SSE brands and trademarks. During this period, either the SSE Retained Group or the MergeCo Group could suffer reputational damage as a result of the actions of the other party, which could have a material adverse effect on either of their businesses, financial performance, results of operations and prospects.

Any failure of the MergeCo Group to meet the challenges involved in setting up and/or separating its systems and functions; operating as a smaller, standalone business with a different capital structure; and/or realising the anticipated benefits of the Transaction could have a material adverse effect on its business, financial performance, results of operations and prospects.

**2. Risks relating to the MergeCo Group’s industry, businesses and operating markets**

SSE Energy Services and npower are already exposed to a number of risks relating to their industry, businesses and operating markets. The MergeCo Group will be exposed to the same risks which, if they materialise, could materially adversely affect its business, financial performance, results of operations and prospects. The below risks are those known to SSE and the Directors and which SSE and the Directors consider could materially adversely affect the MergeCo Group. These risks are also reflected in the context of the current Group Principal Risks identified by SSE and published in its Annual Report and Accounts.

***The MergeCo Group’s operations will be subject to macroeconomic risk***

The global economic environment is subject to a number of uncertainties, including mounting government deficits, discontinuation of certain stimulus programmes, potential inflation or deflation, continuing high levels of unemployment, political intervention and tensions over global trade of goods, labour and capital mobility, terrorism and concerns over the stability of the monetary and political union in the European Union. Financial markets and the supply of credit are likely to continue to be impacted by concerns surrounding the sovereign debt of periphery EU countries and potentially other EU countries as well; the possibility of further credit rating downgrades of, or defaults on, such sovereign debt; and concerns about a slowdown in growth in certain economies.

In addition, macroeconomic conditions may be affected by the United Kingdom’s decision to withdraw from the European Union (commonly referred to as ***Brexit***). Macroeconomic conditions and/or the United Kingdom’s withdrawal from the European Union may result in the depreciation of, or create volatility affecting, the pound sterling against the US dollar and other foreign currencies, which would make gas and other key commodities more expensive in the United Kingdom. For more detail on the United Kingdom’s decision to withdraw from the European Union, see “*The MergeCo Group will be exposed to political risks at both the domestic and EU level*” in this Part III (*Risk Factors*).

These developments, or the perception that any of them could occur, have had and may continue to have a material adverse effect on global and UK economic conditions and the stability of global and UK financial markets, and may significantly reduce global market liquidity and restrict the ability of key market participants to fund their capital and liquidity requirements and operate in certain financial markets. Any of these factors could depress household income, economic activity or commodities markets; restrict access to capital for the MergeCo Group; or impact energy affordability which, in turn, could contribute towards an increase in customer bad debt levels, any of which could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group will be exposed to risks related to commodity price fluctuations***

The MergeCo Group will be exposed to fluctuations in the physical volume and price of key commodities, including electricity, gas and CO<sub>2</sub> allowances. A significant proportion of the MergeCo Group's profitability will be dependent on the successful management of these exposures. An ineffective trading strategy could lead to significant financial loss, loss of customers and increased political scrutiny. Furthermore, following Completion the MergeCo Group will no longer be part of a vertically integrated business that is able to offset margin pressure in its downstream energy supply business during periods of high commodity prices with higher prices in its upstream energy production business, which may make management of fluctuations in the volume and price of commodities more difficult.

The markets for these commodities are driven by global supply and demand, which is itself influenced by a number of complexities including global economic growth, the weather and technological advancement.

Further, geopolitical events can impact commodity prices. For instance, Russia, which is an important source of European gas supply, has, over the past several years, been involved in various matters that have resulted in the deterioration of Russia's relations with other members of the international community, including various countries in Europe. These and other geopolitical events have a significant impact on gas prices in the United Kingdom.

Global commodity prices make up a significant part of the energy cost to the customer. Increasing commodity prices affect the overall affordability of energy and can have an impact on demand and customers' ability to pay.

There is a risk that surplus commodity positions cannot be sold to the wholesale markets profitably and that any commodity short position cannot be covered at a cost that can be passed on to customers.

Although SSE Energy Services and npower have historically entered into long-term contracts for the supply of key commodities to protect their commercial positions, significant price fluctuations and/or failure to secure key materials and/or maintain adequate supply chains and strategic alliances could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***MergeCo could be required to make significant payments, including in respect of collateral, under energy trading service agreements with members of the SSE Group and the innogy Group, which could impact its liquidity***

Prior to Admission MergeCo will enter into certain energy trading service agreements with each of SSE EPM Limited (**EPM**) (a member of the SSE Group), and RWE Supply & Trading GmbH (**RWEST**) (a member of the RWE Group), to procure wholesale electricity and gas on behalf of the MergeCo Group, in order to meet customer demand. As is typical with these types of agreements, EPM and RWEST protect against their credit risk by requiring trading counterparties, which will include MergeCo, to post collateral against their credit exposure. The value of the collateral required to be posted by MergeCo will be linked to the wholesale price of electricity and gas, the MergeCo Group's projected electricity and gas consumption, and mark-to-market revaluation. MergeCo could be required to post significant amounts of collateral in respect of these agreements if prices rise significantly. MergeCo would expect to enter into credit arrangements with certain banks pursuant to which they will fund its collateral requirements under the agreements, up to a certain value and for a certain period of time. If MergeCo's collateral requirements rise significantly, MergeCo's cost of credit under these arrangements would increase, they could commit insufficient funds to cover its collateral requirements, and MergeCo would be required to post any shortfall. If these credit arrangements expired or were terminated, or the banks failed to perform under them, MergeCo would be required to fund its collateral obligations itself. Any of the above outcomes could impact the MergeCo Group's liquidity, and have a material adverse effect on its business, financial performance, results of operations and prospects.

***The MergeCo Group may not be able to secure its energy supply adequately***

As UK gas reserves have declined, the UK energy market has become increasingly reliant on supplies from Norway and mainland Europe together with liquefied natural gas supplies from other parts of the world. Accordingly, a key element of security of supply (at adequate prices) is access to these reserves and the reliability of the pipeline and gas processing infrastructure operated by third parties both in the United Kingdom and abroad. Any break in this supply chain could result in an increase of gas prices or an inability to supply gas in sufficient quantities and impact the MergeCo Group's earnings.

The MergeCo Group will be dependent on third party supply and cannot guarantee the security of such supply nor the stability of commodity prices. There is a risk of terrorist activity including cyber attacks, as well as acts and threats to the energy sector which may include sabotage of power stations or pipelines. This may, in turn, affect security of supply or lead to increasing commodity prices or electricity shortages, which could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group could be exposed to an increase in essential costs***

The MergeCo Group could be exposed to certain increases in its costs which it would need to pay in order to operate effectively. Such increased costs could relate to an increase in taxes payable by the MergeCo Group, purchases of gas and electricity from its suppliers, an increase in charges payable by the MergeCo Group to electricity network and gas pipeline operators, in relation to such operators' building, maintenance and operating costs (which are often passed to downstream energy supply businesses, either directly pursuant to contractual arrangements or indirectly, by way of an increase in access or use charges at a later time), or any increase in the MergeCo Group's costs in relation to national government and/or EU energy subsidy policies, among other things.

In light of the regulatory and competitive environment in the retail energy supply and related services market in the United Kingdom, the MergeCo Group may not be able to increase or maintain tariff prices paid by the consumer in order to cover these costs and accordingly, they could have a material adverse effect on the business, financial performance, results of operations and prospects of the MergeCo Group.

***The MergeCo Group's business may be affected by seasonal factors***

Gas and electricity sales volumes are affected by temperature and other environmental factors, which are beyond the MergeCo Group's control. In the United Kingdom, the demand for power and gas is seasonal, with higher demand typically experienced during the cold weather months of October to March and lower demand during the warm weather months of April to September.

The MergeCo Group's profitability will be partly dependent on its ability to manage its exposure to ordinary course seasonal fluctuations in temperature, and to stabilise the impact of such fluctuations through adjustments to its tariffs.

Any sustained period of negative cash flow resulting from a seasonal increase in temperature may require the MergeCo Group to have a significant amount of working capital to protect its liquidity, and the MergeCo Group will have to actively manage its working capital in order to do so.

Failure to do any of the above could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group's business may be affected by climate change and other environmental factors***

As gas and electricity sales volumes are affected by temperature and other environmental factors, which are beyond the MergeCo Group's control, climate change induced changes to the environment may present challenges for the MergeCo Group. Any sustained increase in temperature may serve to reduce energy consumption and impact the MergeCo Group's cash flow and profitability. Increased frequency of extreme weather poses additional challenges. The MergeCo Group's profitability will be partly dependent on its ability to manage its exposure to unseasonably warm or cold weather and to stabilise the impact of such fluctuations through adjustments to its tariffs—unpredictable weather makes this more difficult to achieve. Poor weather conditions typically result in an increase in operating costs, though these may be offset by increased energy consumption. Failure to respond adequately to the risks posed by climate change may present added reputational risk.



Further, the increasing focus by the UK and European governments and consumers on sustainable energy initiatives and practices may put downward pressure on demand for energy.

Any of these outcomes could affect the MergeCo Group's profitability, as well as result in adverse publicity, negative customer perception and possible regulatory action, any of which could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***Proposed price caps in the UK energy supply market could have a material adverse effect on the MergeCo Group***

In June 2016, the CMA published a final report on its market investigation into competition in the British energy market (the ***Final Report***). Following the Final Report, the CMA published orders to implement a large number of remedies (including a price cap on domestic prepayment meter (***PPM***) customers), which would be administered by Ofgem. The PPM or safeguard tariff cap came into effect on 1 April 2017 and is due to expire at the end of 2020 when the smart meter roll out is expected to complete. The remedies have required, and in the case of the disengaged customer database, will continue to require significant resource and investment to implement. Furthermore, suppliers are under pressure to evolve and adapt in response to competition and changing customer expectations at a time of considerable regulatory and technological change (e.g. the smart meter roll out and the faster switching programme). This significant pipeline, as well as the prospect of further regulatory intervention on tariffs under tight timescales places real constraints on suppliers' IT systems and resources.

On 2 February 2018, Ofgem extended the PPM price cap to include the customers (of suppliers with more than 250,000 customers) who are on their supplier's default tariff and in receipt of the Warm Home Discount benefit (the ***Vulnerable Safeguard Tariff***). The Vulnerable Safeguard Tariff will end in December 2019 if it is not replaced by other tariff interventions.

In October 2017, the UK government proposed legislation to allow Ofgem to set an absolute cap for SVT customers in Great Britain. On 26 February 2018, the UK government introduced the Domestic Gas and Electricity (Tariff Cap) Bill into Parliament and stated its intention that Ofgem should implement the tariff cap by the end of the year. The proposed legislation would allow Ofgem to set a temporary price cap for SVT and certain other default tariff customers in Great Britain (the ***Default Tariff Cap***) and would last until 2020. At this point Ofgem will undertake a review as to whether conditions are in place for effective competition and make a recommendation about whether the Default Tariff Cap should be extended or not. The Secretary of State would decide whether to extend the cap, with a maximum of three one-year possible extensions. The Default Tariff Cap must end at the end of 2023.

In May 2018 Ofgem published a formal consultation on its approach to delivering the Default Tariff Cap being legislated for through the Bill, setting out its intention to publish a statutory consultation and impact assessment in early August 2018 ahead of a planned implementation by the end of December 2018.

In the event that the Default Tariff Cap is not in place by the end of 2018, Ofgem has consulted on implementing an extension to the Vulnerable Safeguard Tariff to at least another two million vulnerable or low-income households ahead of winter 2018/19.

There remains uncertainty about the methodology that will be used to set the level of the Default Tariff Cap and the Vulnerable Safeguard Tariff.

The extension of the Vulnerable Safeguard Tariff and/or the introduction of a Default Tariff Cap could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group may be subject to regulatory and legislative intervention and uncertainty***

The markets in which the MergeCo Group will operate are subject to a high degree of regulatory and legislative intervention and uncertainty. This legal and regulatory framework can change explicitly with the introduction of new or revised legislation and regulations, or implicitly due to evolving interpretation and legal precedent.

The MergeCo Group will be subject to oversight from a wide range of regulatory bodies including Ofgem, governed by the Gas and Electricity Markets Authority (the ***Authority***) and the FCA. For instance, the licensed supply companies of MergeCo Group will continue to require GB supply licences from Ofgem and any new subsidiary will need a supply licence for gas and for electricity. Regulatory bodies have the power to amend or revoke licences and conditions, modify the levels for certain tariffs and require actions in relation to meters, conduct investigations into companies' operations and issue financial penalties and enforcement notices. In the

case of certain licence breaches in Great Britain, fines could be up to ten per cent. of a licenced entity's turnover. Any failure by the MergeCo Group to comply with its licences, or any adverse regulatory actions against the MergeCo Group, could have a material adverse impact on it. See also "*Proposed price caps in the UK energy supply market could have a material adverse effect on the MergeCo Group*" in this Part III (*Risk Factors*).

Any consequences of the legal and regulatory risks discussed above could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The smart meter rollout is an important and complex programme and there can be no certainty that it will be successfully completed within the required regulatory timeframe or on budget***

The MergeCo Group has a regulatory obligation to take all reasonable steps to roll out smart meters to all of its household and small business customers by the end of 2020 and additionally to submit and achieve annual milestones. The success of this rollout is highly dependent on factors over which the MergeCo Group will have limited control. Adverse media coverage, problems with technology, an increase in costs and a decrease in customer demand for smart meters would negatively affect the MergeCo Group's ability to meet its commitment.

As a result, the MergeCo Group may be exposed to regulatory penalties of up to ten per cent. of its total turnover. The rollout may also result in the distraction of MergeCo's management and the use of financial and other resources from other commercial and operational priorities. Any of the aforementioned outcomes could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group will be exposed to political risks at both the domestic and EU level***

The markets in which the MergeCo Group will operate are subject to a high degree of political intervention and uncertainty at both the domestic and EU level.

The MergeCo Group will have substantial operations in the United Kingdom and will therefore be exposed to macro-economic conditions in the United Kingdom. These conditions may be affected by a variety of domestic and international factors, including the potential impacts of Brexit. The terms of the withdrawal from the European Union will be negotiated over a period which may extend at least until March 2019. There may also be a transitional period between March 2019 and December 2020 in which further negotiations may take place. As a result, there is significant uncertainty about the future relationship between the United Kingdom, the European Union and its other Member States and the impact that any such future relationship may have on macroeconomic conditions in the United Kingdom.

Certain political parties in the United Kingdom have made statements in respect of their intended actions in the UK energy supply market. For instance, the Labour party has stated its intention to regain control of the energy industry including regulated energy networks, and to transition retail and generation to a publicly owned, decentralised energy system, and the Scottish National Party has made reference to introducing a publicly owned energy supplier. Any changes to UK government policy or, if an early general election were to be called, a change in government may trigger new announcements, proposals or interventions in the UK energy supply market.

In addition, the Scottish Government has kept open the option of calling for a second referendum on Scotland's independence from the United Kingdom. It is unclear whether any such referendum will occur, what the outcome might be should it occur, and if a referendum occurred and Scotland voted to leave the United Kingdom, what Scotland's future relationship with the rest of the United Kingdom and the European Union would be. The consequences of a potential future referendum on the MergeCo Group's business are therefore uncertain.

Any consequences of the political risks discussed above could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group will be exposed to risks relating to the implementation of certain efficiency improvement projects by npower***

Following a reduction in profitability in 2015 and costs incurred relating to Ofgem penalties resulting from a standards of conduct investigation linked to issues with the SAP domestic billing platform, innogy introduced a new npower executive team in 2015 with a focus on improving financial performance through a ***Recovery Programme***. The Recovery Programme is focused on cost reduction and operational performance initiatives to streamline processes and drive out costs from the organisation. In 2015, a three-year £185 million enduring net opex target was set in order to return the business to a sustainable level of performance and profitability.

The three-year programme has delivered on a substantial number of Recovery Programme initiatives and in 2017 realised £163 million in net opex savings. npower is targeting an additional £46 million enduring net opex savings in 2018 and will aim for further savings in 2019.

The Recovery Programme is demonstrating performance improvements, but if it is not delivered as anticipated, this may have a material adverse effect on the business, financial performance, results of operations and prospects of the MergeCo Group.

In an initiative complementary to the Recovery Programme, npower is expected to deliver a new IT platform for the B2B business that will be used for all IT operations including customer billing and customer services. It will aim to tackle customer satisfaction as well as reduce costs and waste by redesigning npower's end-to-end processes. The introduction of any IT system of this scale and scope is complex. If it were not to be fully implemented, or if it were to be delayed, the MergeCo Group's business, financial performance, results of operations and prospects could be materially adversely affected.

***The MergeCo B2B business may be more adversely affected by higher value customer claims or disputes than the domestic business***

Larger (I&C) customers, supplied under more complex arrangements than domestic customers, have in a small number of cases brought claims challenging npower contractual terms and/or the calculations carried out thereunder which have been settled for amounts that npower considers not to be material to its business. However, the outcome of any similar future claims, whether settled or decided adversely to the MergeCo Group, could have a material adverse effect on the business, financial performance, results of operations and prospects of npower and the MergeCo Group.

***The MergeCo Group's business may be adversely affected if it fails to deliver high-quality customer service***

In an environment where energy suppliers have less opportunity to compete through large price differentials, trust and service levels become increasingly important factors for the retention and growth of the customer base. Any failure to maintain good quality customer service levels or to improve service levels in certain parts of the MergeCo Group's business could negatively affect the MergeCo Group's reputation and could result in loss of customers and/or increased regulatory scrutiny or fines.

A failure to provide and maintain good quality customer service levels could materially adversely affect the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group's business may be adversely affected if its IT systems experience any significant failures or interruptions or if the migration of customer data onto the MergeCo Group's system is not properly effected***

Large, effective and secure information systems are critical for the efficient management and accurate billing of customers as well as supporting energy trading and optimisation activities. Any significant disruption to these systems could adversely affect the MergeCo Group's operations. Interruption to the MergeCo Group's information technology systems could be caused by a number of factors, including: software or hardware issues, including telecoms networks and connectivity and power supplies; malicious cyber attack; ineffective operational performance, for example a breach of information security rules or poor management of resilience expertise; and, employee and contractor understanding and awareness of information security requirements. Furthermore, the MergeCo Group could be exposed to reputational and regulatory liability if the migration of customer data onto the MergeCo Group's system is not properly effected. There can be no certainty that recovery plans and contingency plans will be effective in the event that they need to be activated. Outages and interruptions could affect the MergeCo Group's ability to conduct day-to-day operations, which could result in licence condition breaches, inability to process or collect payments and resulting issues with cash flow, reputational damage due to failure to provide basic services to customers, failure to deliver the smart meter

rollout or other serious operational failures. Any of the aforementioned outcomes could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***Failure to comply with privacy and data protection laws and regulations may lead to liability or regulatory action against the MergeCo Group***

The MergeCo Group will have to comply with restrictions on the use of customer data and provide for secure transmission of confidential information to ensure the security of financial and personal data (including sensitive personal data) provided over public networks. For example, the MergeCo Group will be subject to the General Data Protection Regulation (Regulation (EU) 2016/679) (**GDPR**) and the Data Protection Act 2018, each of which became effective from 25 May 2018. This new regime is more onerous to comply with in relation to data protection compliance than past regimes, and penalties for any breach of the GDPR would potentially be more severe.

Despite controls to ensure the confidentiality, availability and integrity of customer and company data, the MergeCo Group may breach restrictions or fail to comply with the provisions of the GDPR, or may be subject to malicious cyber attacks that attempt to penetrate network security and misappropriate confidential or personal information. Due to advances in the sophistication and prevalence of these cyber attacks and fast-paced technological advancements, computing capabilities and other developments, there can be no certainty that the MergeCo Group's security measures will be sufficient to prevent breaches. Breaches could result in legal liability, negative publicity and/or regulatory action against the MergeCo Group, any of which could have a material adverse effect on its business, financial performance, results of operations and prospects.

***The MergeCo Group may not be able to keep up with technological advancements and changing trends in the industry***

The energy sector is undergoing constant technological advancements and political and regulatory change. It is important that the MergeCo Group is able to stay at the forefront of the industry by identifying emerging trends and developing strategies to exploit competitive opportunities. New technologies could reduce the MergeCo Group's market share and adversely affect service levels to customers relative to its competitors. The introduction of smart metering, the faster switching programme and the changing expectations of the customer, for example, require a reorganisation of people, processes and supporting systems.

The MergeCo Group will be required to successfully deliver on transformative projects in order to give customers the services they expect whilst maintaining an efficient cost in connection with the provision of such services. Failure to do this could result in falling sales and customer numbers due to a lack of price competitiveness and a poor reputation for service. Poor service standards would in turn impact on revenues through foregone incentive payments as well as damaging the MergeCo Group's relationship with customers, regulators and other key stakeholders, any of which could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***The MergeCo Group will operate in competitive markets***

The ability of the MergeCo Group to maintain and grow its business and profits could be adversely affected by the actions of its competitors and the increasing competitiveness of the markets in which it operates. Customers in the MergeCo Group's markets are able to switch suppliers, with customer churn rates being affected by price changes and levels of customer service. In recent years, significant numbers of new energy suppliers have entered the market—in part due to the proliferation of price comparison websites—significantly increasing competitive pressures. The implementation of schemes such as the faster switching programme (referred to in "Regulatory Environment" section of Part V (*MergeCo Group Business Overview*) of this Circular), may also serve to increase competition in the market.

Any of the aforementioned consequences could have a material adverse effect on the MergeCo Group's business, financial performance, results of operations and prospects.

***Failure to maintain high health and safety standards could adversely affect the MergeCo Group***

The MergeCo Group, and in particular its large service engineering workforce, undertakes activities which are subject to health and safety regulation. For instance, home visits to carry out essential work on gas and electric installations and appliance maintenance present potential health and safety risks to employees and contractors carrying out work on customer premises, as well as to the customers and their property.

The failure to implement and maintain effective health and safety management and governance could generate significant human and financial costs, as well as reputational damage, as a result of injury to people, work related ill health and potential disruption of service to the MergeCo Group's customers. It can also lead to claims for employee and third party compensation; fines or other sanctions for breaches of statutory requirements; criminal sanctions initiated against the MergeCo Group, its directors and employees; and/or increased employee absence and reduced performance levels.

Any of the aforementioned outcomes could materially adversely affect the MergeCo Group's business, financial performance, results of operations and prospects.

***MergeCo may not pay dividends***

MergeCo is expected to have its own premium listing and its own board and management team able to determine and pursue its own strategy. This means, as was described in the announcement of the Transaction on 8 November 2017, MergeCo's policy on dividends will be determined by its board in due course and will be based on the earnings generated by its business. There can be no assurances that MergeCo will pay dividends. MergeCo will be incorporated under the laws of England and Wales and will therefore be subject to English law. Under English law, a company can only pay cash dividends to the extent that it has distributable reserves and cash available for this purpose. As a holding company, MergeCo's ability to pay dividends in the future, should it seek to do so, will be affected by a number of factors, including having sufficient distributable reserves and its ability to receive sufficient dividends from subsidiaries. If MergeCo does not pay dividends, SSE Shareholders will receive a lower aggregate dividend than they do currently.

## **PART IV SUMMARY OF THE PRINCIPAL TERMS AND CONDITIONS OF THE TRANSACTION**

Copies of the Contribution Agreement (which appends the Transitional Service Agreements and the Relationship Agreement) and the Separation Agreement (each described below) will be available at [www.sse.com](http://www.sse.com) from the date of this Circular until Completion or termination of the Contribution Agreement. Such documents will also be available for inspection at the General Meeting for the duration of the General Meeting, and during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the offices of SSE at Inveralmond House, 200 Dunkeld Road, Perth, PH1 3AQ, United Kingdom and at the offices of Freshfields Bruckhaus Deringer LLP at 65 Fleet Street, London, EC4Y 1HT from the date of this Circular up to and including the date of the General Meeting and for the duration of the General Meeting.

### **1. Contribution Agreement**

The Contribution Agreement was entered into on 8 November 2017 between SSE, innogy International Participations NV, innogy and MergeCo to set out the terms on which SSE would contribute the SSE Energy Services business and innogy would contribute the npower business to MergeCo.

Completion of the Transaction is conditional upon various conditions being satisfied or waived. Conditions that have not yet been satisfied or waived include:

- the CMA approving the Transaction on terms reasonably satisfactory to SSE and innogy;
- SSE obtaining shareholder approval by 31 July 2018 (which is the subject matter of this Circular);
- no material adverse change arising in either the SSE Energy Services or npower businesses before the date on which the condition relating to CMA approval is satisfied;
- the Takeover Panel agreeing that innogy is not obliged to make a mandatory offer for MergeCo as a result of the Transaction (subject to SSE Shareholders passing the Whitewash Resolution);
- FCA change of control consents being obtained in respect of the regulated businesses of SSE Energy Services and npower (namely, SSE Home Services Ltd and Npower Northern Limited);
- key licences for each of SSE Energy Services and npower not having been revoked or terminated and no notice of revocation from Ofgem in relation to any such licence having been received, and Ofgem not proposing any material modification or replacement of such licences on terms other than those reasonably satisfactory to SSE and innogy; and
- the FCA and the London Stock Exchange approving Admission.

The condition that has already been satisfied is:

- innogy obtaining supervisory board approval by 31 December 2017.

If the SSE Shareholders fail to approve the Demerger by 31 July 2018, SSE shall be obliged to make to innogy a £60 million compensatory break payment if innogy elects to terminate the Contribution Agreement within 30 business days after such date.

The Contribution Agreement will become terminable if the Transaction conditions have not been satisfied or, where relevant, waived by 30 June 2019 (or such other date as the parties may agree). A material breach of certain fundamental warranties at Completion will also entitle the party not in breach to terminate the Contribution Agreement.

The Contribution Agreement includes a financial adjustment mechanism against pre-agreed targets for the levels of cash, debt and working capital in the contributed businesses on Completion. All adjustments will be made between SSE and innogy as sellers and MergeCo (and not between SSE and innogy) in cash.

The Contribution Agreement contains a broad set of customary business warranties that both SSE and innogy as sellers have given to MergeCo at signing, as well as warranties relating to the sufficiency of assets and tax. The warranties are subject to customary financial and other limitations.

There is a requirement under the Contribution Agreement for parties to operate the contributed businesses in the ordinary course until Completion, subject to certain limited exceptions.

The Contribution Agreement also includes certain ordinary course indemnities, including:

- a) reciprocal indemnities between each of SSE and innogy as sellers and MergeCo in relation to retained and contributed group liabilities and pension scheme liabilities; and
- b) unilateral indemnities from SSE in favour of MergeCo in relation to the pre-closing reorganisation, any securities law breaches relating to the Demerger and tax liabilities.

There are no caps on the general indemnities in relation to retained and contributed group liabilities. MergeCo may only claim under the indemnity in relation to retained group liabilities within five years of Completion. The indemnity in relation to contributed group liabilities in favour of SSE and innogy are not time limited. There are no caps on the indemnities in relation to pension scheme liabilities but the parties may only claim under the pension scheme indemnities if they give written notice of the claim to the relevant party within seven years of Completion. There are no caps on the indemnities in relation to the pre-closing reorganisation or securities law breaches relating to the Demerger, and such indemnities are not time limited. The indemnities that MergeCo may claim under in relation to tax liabilities, when aggregated with MergeCo's claims against the relevant party under the tax warranties, are capped at £344,250,000 for claims against innogy and £652,000,000 for claims against SSE (in each case excluding indemnity claims for secondary tax liabilities). MergeCo may only claim under the tax indemnities or the tax warranties if it gives written notice of the claim to the relevant party no later than six years and three months after Completion.

The tax indemnity arrangements include, among other things, a mechanism for the payment by MergeCo to innogy of amounts equal to tax savings realised by MergeCo and its subsidiaries after Completion as a result of the utilisation of certain pre-existing carried-forward npower Group tax losses as and when such losses are used by the MergeCo Group after Completion.

If Telecom Plus terminates its supply agreement with npower in certain circumstances, MergeCo will be compensated for a significant proportion of the loss of the value of the contract. If the Telecom Plus supply agreement is not terminated but is renegotiated with a fixed term, in certain circumstances the compensation payment is reduced in accordance with an agreed ratchet mechanism.

The intention is that any inter-company loans in respect of SSE Energy Services or npower will be capitalised or repaid prior to or immediately following Completion. MergeCo will draw on third party debt to repay any such inter-company loans with a residual cash buffer amount being left in MergeCo. The parties to the Contribution Agreement shall work together in good faith to agree a capital structure for the MergeCo Group that will target achieving an investment grade credit rating for MergeCo. It is anticipated that this will be made public prior to Admission.

SSE and innogy have agreed for a period of 12 months from Completion not to solicit key MergeCo employees.

## **2. Separation Agreement**

### ***Overview***

The Separation Agreement was entered into on 8 November 2017 between SSE and a number of its direct and indirect subsidiaries (specifically Retail HoldCo, SSE Energy Supply Limited, Southern Electric Gas Limited, South Wales Electricity Limited (since re-named SSE Electricity Limited), SSE Retail Telecoms Limited, SSE Metering Limited, SSE Services plc and SSE Home Services Limited) to set out the terms on which SSE Energy Services would be reorganised and separated from the SSE Retained Group so as to consolidate SSE Energy Services under a newly incorporated holding company, Retail HoldCo, which is intended to be transferred to MergeCo pursuant to the Demerger.

### ***Assets, liabilities and contracts***

The Separation Agreement defines the companies, assets, liabilities, properties and employees which comprise SSE Energy Services, as well as those which are to remain with the SSE Retained Group, and sets out the terms for the transfer of these under the Separation. It also provides for flexibility on how and when these transfers are to occur. In particular, the Separation Agreement provides, among other things, for the following, subject to the terms and conditions contained therein:

- certain assets and liabilities related to SSE Energy Services (and any other assets and liabilities specified in the Separation Agreement as assets or liabilities to be transferred to the Retail HoldCo Group), will generally be retained by or transferred to Retail HoldCo or another member of the Retail HoldCo Group;

- all of the assets and liabilities other than the assets and liabilities related to SSE Energy Services will be retained by or transferred to the SSE Retained Group;
- the parties to the Separation Agreement will use reasonable endeavours to separate contracts that relate both to SSE Energy Services and the SSE Retained Group into separate contracts or arrangements so that the Retail HoldCo Group or the SSE Retained Group, as applicable, will retain the rights and benefits, and be subject to the liabilities, with respect to or arising from each shared contract to the extent relating to its business; and
- the parties will use reasonable endeavours to procure any consents, approvals, authorisations or waivers required for the transfer or assignment of any contracts to be transferred under the Separation Agreement.

### ***Employment***

The Separation Agreement set out the basis on which SSE was required to (i) move employees assigned to SSE Energy Services (but not at that time employed in Retail HoldCo or any of those entities which will transfer to Retail HoldCo under the Separation (referred to as Retail HoldCo's "subsidiaries" in this paragraph)) into the Retail HoldCo Group and (ii) move employees not assigned to SSE Energy Services out of any Retail HoldCo subsidiaries.

The Separation Agreement contains limited indemnities for the benefit of each of (i) Retail HoldCo and its subsidiaries and (ii) SSE and any relevant employing entities within the SSE Retained Group, against any employment liabilities incurred in respect of (a) employees whose employment was expected, pursuant to the Separation, to transfer to Retail HoldCo and/or its subsidiaries under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (*TUPE*), but no such transfer occurs (for which SSE and its retained subsidiaries are indemnified); and (b) employees whose employment was not expected, pursuant to the Separation, to transfer to Retail HoldCo and/or its subsidiaries under TUPE, but such a transfer does in fact occur (for which Retail HoldCo and its subsidiaries are indemnified). innogy has provided in the Contribution Agreement equivalent indemnities in respect of its own employees. The Separation Agreement also provides for Retail HoldCo and its subsidiaries to be indemnified against liabilities incurred in respect of employees whose employment is required under the Separation Agreement to be transferred out of Retail HoldCo and/or its subsidiaries (where, for example, those employees are not assigned to SSE Energy Services), but where no such transfer occurs.

### ***Property***

Under the Separation Agreement, Retail HoldCo or its subsidiaries are to be granted or transferred certain interests in properties that are currently held (either freehold or leasehold) by a member of the SSE Retained Group. Where third party consents are required for the grant or transfer of a property interest to Retail HoldCo or its respective subsidiary, reasonable endeavours are to be used to procure such consents.

With effect from closing under the Separation Agreement the Retail HoldCo Group has agreed to reimburse the SSE Retained Group on demand for all rents, service charges, insurance premiums and other sums payable under certain leases. The SSE Retained Group is obliged to pay such rents, service charges, insurance premiums and other sums to the relevant reversioner, and indemnities are provided by the SSE Retained Group to the Retail HoldCo Group in respect of any losses arising on account of any breach of these payment obligations. The Retail HoldCo Group has also agreed to observe the tenant's covenants in those same leases and any title documents in respect of the relevant properties. Indemnities are provided for the benefit of the SSE Retained Group with respect to all losses arising out of the breach or non-performance of those Retail HoldCo Group obligations whether before, on or after the date of the Separation Agreement.

## **3. Transitional Services Agreement and long term supply arrangements**

SSE (or one of its affiliates) and innogy shall each enter into a separate Transitional Services Agreement with MergeCo immediately before Completion under which they shall provide to and receive from MergeCo various services on a transitional basis on and after Completion.

Pursuant to the innogy transitional services agreement, innogy will provide limited corporate services to the MergeCo Group, such as: transactional, accounting, tax and IT services. MergeCo will also provide certain reverse services to the innogy group, such as: IT, travel management and HR services.

Pursuant to the SSE transitional services agreement, the SSE Retained Group will provide certain services to the MergeCo Group, such as: finance, corporate business services, procurement, corporate affairs, HR, group



risk and audit and IT. MergeCo will also provide certain reverse services to the SSE Retained Group, such as: IT for the business energy customers and metering services.

The Transitional Services Agreements were appended to the Contribution Agreement in substantially agreed form as at signing of the Transaction and will be executed and become binding immediately before Completion.

The Transitional Services Agreements terminate after the last of the services expire (unless terminated earlier). A significant proportion of the transitional services under the Transitional Services Agreement to which SSE (or one of its affiliates) is a party are provided for an initial minimum term of two years (except for IT services, which will be provided for a minimum term of three years), with a service recipient under such Transitional Services Agreement having the right to extend a service by providing between three and six months' notice to the service provider (depending on the service concerned). The longest transitional service has a total maximum term of five years. Each party, as service recipient, pays to the other, as service provider, a cost based on a recharge model calculated and agreed by the parties.

The Transitional Services Agreements also provide the parties with the ability to agree to additional transitional services to those covered by the schedules both before and for a maximum of up to six months after Completion.

A service recipient may terminate each service it is receiving for convenience (including before the expiry of the initial term, but subject to an applicable notice period) and a service provider may terminate one or more services it is providing (in part or in their entirety) where the recipient of the relevant service(s) commits a material breach of any material obligation relating to such service(s) (subject to a 90 day cure period). Where the service recipient terminates a service for convenience before the end of the minimum term of that service, the service recipient will be required to pay to the service provider any costs incurred by the service provider in connection with such termination that would not have otherwise been incurred but for the termination. SSE and MergeCo agreed to execute certain long term supply agreements (such as telecoms, logistics and metering) to replace existing intra-group arrangements with arm's length agreements.

The long term supply agreements will have minimum terms ranging from three to four years. Extension rights subject to an applicable notice period are to be agreed between the parties. The long term supply agreements' annual charges are subject to the agreement between the parties.

### ***Wholesale Energy Portfolio Management Agreement***

Pursuant to a wholesale energy portfolio management agreement, the SSE Retained Group will provide energy portfolio management services for SSE Energy Services, which shall include services such as procurement of gas and electricity to meet customer demand, balancing short term energy positions, hedging exposure to wholesale energy markets, forecasting and analysis of customer energy demand, management of credit support requirements under industry codes, validation of volume allocations, management of end-to-end processes associated with settlement of certain invoices, providing relevant data and assisting where appropriate with regulatory reporting obligations and assisting as appropriate with the discharge of obligations as supplier of last resort and offtaker of last resort. It is intended that the duration of this agreement will be for a minimum term of three and a half years from 1 April 2018, up to a maximum of four years. Under the terms of this agreement, the MergeCo Group will be able to source gas and electricity from other wholesale providers, as well.

### ***Shared IT Systems***

In connection with the Transaction, SSE will be transferring to the MergeCo Group certain IT systems relating to customer service including registration, deregistration, metering, billing, payments and collections. Following the Transaction, MergeCo will provide to the SSE Retained Group continued access to the CS Systems under the Transitional Services Agreements. Both retail and business energy customers will remain on the CS Systems until the platform is no longer required. This arrangement will remain in place for a number of years determined in part by the approach to consolidate MergeCo IT systems.

MergeCo will offer to transfer the CS Systems back to the SSE Retained Group effective on the later of: (i) the date which is 12 months before the last date on which it is estimated that the 'B2C' customers will have been migrated from the CS Systems; and (ii) 1 April 2020, on 12 months' notice to the SSE Retained Group. The SSE Retained Group can then decide to: (i) accept the offer and receive the CS Systems back from MergeCo; (ii) reject the CS Systems and confirm that the CS Systems can be decommissioned; or (iii) reject the CS Systems and require that MergeCo continues to operate the CS Systems for the purpose of continuing to deliver

the shared transitional access until the later of 1 April 2022 at the earliest, and 12 months following the expiry of the SSE Retained Group's offer.

The Transitional Services Agreements contain customary arm's length provisions governing each party's access to, and use of, IT systems (including the CS Systems) under those agreements to help maintain information security and comply with all legal and regulatory obligations. The confidentiality and data protection obligations in the Transitional Services Agreements also protect the shared use of the CS Systems.

#### **4. Relationship Agreement**

The Relationship Agreement is described in Part VII (*MergeCo Directors and Corporate Governance*).

#### **5. Overseas Shareholders**

The MergeCo Shares may only be transferred, distributed or delivered, directly or indirectly, within the United States to QIBs (within the meaning of Rule 144A of the Securities Act) or to accredited investors (within the meaning of Rule 501 of Regulation D under the Securities Act) in transactions exempt from or otherwise not subject to the registration requirements of the Securities Act, and to persons outside the United States in offshore transactions in reliance on Regulation S. Accordingly, each SSE Shareholder will be required to represent, warrant and confirm, in the manner and by the times described in this Circular, that they are, or hold SSE Shares on behalf of, a person who either (a) is located outside the United States or (b) has made the Investor Declarations contained in paragraph 5 of Part XII (*Further details of the Transaction*) of this Circular.

##### ***Uncertificated shares held through CREST***

Each SSE Shareholder who holds SSE Shares in uncertificated form will be required to make the abovementioned representations, warranties and confirmations through the electronic CREST proxy appointment service by 3:00 p.m. (UK time) on the Demerger Record Date. Such uncertificated SSE Shareholders will be able to input this instruction following the CMA's approval of the Transaction, and CREST will notify all such uncertificated SSE Shareholders of this date by means of a CREST bulletin issued by Euroclear. Failure to input this instruction by 3:00 p.m. (UK time) on the Demerger Record Date may result in such SSE Shareholder being deemed an Ineligible Shareholder. Legal title to the MergeCo Shares issued to such Ineligible Shareholders may be transferred (pursuant to provisions to be included in MergeCo's articles of association) to the Trustee, and being re-materialised and held in certificated form. Instructions on how to do this are found in paragraph 5 of Part XII (*Further details of the Transaction*).

##### ***Certificated shares***

Each SSE Shareholder who holds SSE Shares in certificated form will be required to certify the eligibility of their entire holding in order to retain new MergeCo Shares. Certificated Shareholders wishing to certify their holding and provide the abovementioned representations, warranties and confirmations should visit [www.sse-shares.com](http://www.sse-shares.com) or call the Shareholder Helpline as outlined on page 4 of this Circular and follow the instructions provided. Failure to provide a valid Investor Declaration by 3:00 p.m. (UK time) on the Demerger Record Date may result in such SSE Shareholder being deemed an Ineligible Shareholder. Legal title to the MergeCo Shares issued to such Ineligible Shareholders may be transferred (pursuant to provisions to be included in MergeCo's articles of association) to the Trustee.

MergeCo Shares issued to Ineligible Shareholders may be, at the absolute discretion of SSE, placed in the market with the net proceeds remitted to such Ineligible Shareholder in accordance with the following expected procedures:

The placing agent (expected to be Credit Suisse or one of its affiliates) (the ***Placing Agent***) will use reasonable endeavours to procure, by not later than 4:30 p.m. on the fifth day following the Demerger Record Date, purchasers for all MergeCo Shares which relate to Ineligible Shares. Such MergeCo Shares will be sold and the proceeds (net of the expenses of procuring such purchasers, including any applicable brokerage commissions and amounts in respect of any value added tax, and any stamp duty or Stamp Duty Reserve Tax (***SDRT***)) will be paid by a cheque drawn on a branch of a UK bank, without interest, to Ineligible Shareholders pro rata to the number of MergeCo Shares held by each such Ineligible Shareholder.

Net proceeds due to any Ineligible Shareholder whose registered address is in the United States of America will be converted from pounds sterling and paid in US dollars. All other Ineligible Shareholders will be paid in pounds sterling. If the net proceeds due to any Ineligible Shareholder is £2.99 or less, such sum will be donated to charity.

Cheques for the amounts due will be sent by post, at the risk of the person(s) entitled, to the registered addresses (or the registered address of the first named holder in the case of joint holders), provided that, where any SSE Shares concerned were held in uncertificated form, the amount due will, unless SSE in its absolute discretion otherwise determines, be satisfied by SSE procuring the creation of an assured payment obligation in favour of the relevant CREST member's or CREST sponsored member's real-time gross settlement (**RTGS**) bank in respect of the cash amount concerned in accordance with the RTGS payment mechanism.

None of SSE, MergeCo, the Placing Agent or any other person shall be responsible or have any liability whatsoever for any loss, expense or damage (whether actual or alleged) arising from the price achieved, terms or timing of any such transaction with respect to the Ineligible Shares.

Further information on these procedures is contained in paragraph 5 of Part XII (*Further details of the Transaction*).

## **6. ADR Holders**

Certain SSE Shares are traded in the United States in the form of American Depositary Shares evidenced by American Depositary Receipts. Each SSE ADS represents one SSE Share.

SSE ADR holders will be unable to retain MergeCo Shares pursuant to the Demerger. SSE will procure purchasers of the MergeCo Shares issued to the ADR Depositary (as defined below). The ADR Depositary will receive the proceeds of such sales (net of the expenses of procuring such purchasers, including any applicable brokerage commissions and amounts in respect of any value added tax, and any stamp duty or SDRT) and remit such net proceeds (after deducting its own fees and expenses) to the SSE ADR holders, in US dollars, in accordance with the terms of the amended and restated deposit agreement dated December 2005 between SSE, Deutsche Bank Trust Company Americas (**Deutsche Bank**), as depositary (**ADR Depositary**), and holders of SSE ADRs (the **Deposit Agreement**). The amount of money received by each SSE ADR holder will be calculated on an averaged basis so that all SSE ADR holders will receive the same price for each MergeCo Share, subject to rounding down to the nearest whole US cent.

SSE ADR holders will not be entitled to attend the General Meeting. In order to vote their underlying SSE Shares, SSE ADR holders will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement and ensure that they are registered as SSE Shareholders at, and have voted by proxy (if applicable) by, 2:00 p.m. on 17 July 2018 or, in the event that the General Meeting is adjourned, registered in the Register of Members of the Company 48 hours before the time of the adjourned meeting(s). Instructions for voting by proxy are found in Part XV (*Notice of General Meeting*) of this Circular. SSE ADR holders wishing to do this should withdraw their ADRs in time to permit processing to be completed by the ADR Depositary and should note that certain fees, expenses and taxes may apply. SSE ADR holders who wish to take such action and who hold their SSE ADRs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which the SSE ADRs are held. SSE ADR holders are encouraged to consult their own legal and tax advisers.

Following the Demerger, SSE ADR holders will continue to hold the same number of SSE ADRs as they held prior to the Demerger, and each SSE ADS will continue to represent one SSE Share.

SSE ADR holders who wish to retain MergeCo Shares pursuant to the Demerger will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement and ensure that they are registered as SSE Shareholders by the Demerger Record Time. SSE ADR holders wishing to do this should withdraw their ADRs in time to permit processing to be completed by the ADR Depositary and should note that certain fees, expenses and taxes may apply. Such SSE ADR holders are encouraged to read paragraph 5 of this Part IV (*Summary of the Principal Terms and Conditions of the Transaction*).

SSE ADR holders who hold their SSE ADRs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which the SSE ADRs are held. SSE ADR holders are encouraged to consult their own legal and tax advisers.

## PART V MERGECO GROUP BUSINESS OVERVIEW

### Introduction

The MergeCo Group will supply electricity and gas for people, businesses and public sector customers in the United Kingdom, as well as other energy-related services including telephone and broadband, boiler and heating insurance and other auxiliary products. As at 31 March 2018, SSE Energy Services and npower, on a combined basis, supplied electricity and gas services to 10.8 million household accounts, more than 167,000 SME accounts and nearly 230,000 industrial and commercial accounts, and had more than 475,000 energy-related services customer accounts.

### Proposed Strategy

The Directors believe that the Transaction provides the MergeCo Group with the opportunity to deploy a number of core strengths in support of the strategic goal of providing customer value. The MergeCo executive team, which will be fully appointed in due course, will be responsible for approving and implementing MergeCo's strategic plan.

### *Strengths*

#### *Independence and focus*

The MergeCo Group will be an independent energy supply and related services business in the United Kingdom, combining the resources and experience of two established players with the focus and agility of an independent supplier. The Directors believe that the MergeCo Group will have the opportunity to derive significant benefits from its independence, allowing it to closely align strategy, decision-making and capital allocation with the immediate operational requirements of a retail energy supply and related services business. In a downstream market characterised by increasing competition, technological change and a challenging regulatory environment for retail energy supply and services businesses in the United Kingdom, the Directors believe the MergeCo Group's independence and focus should be a key strength.

#### *Operating efficiency and cost to serve*

The SSE Directors believe that, as a result of the Combination, MergeCo will generate cash cost synergy benefits of at least £175 million by the end of the fourth full year following Completion. Of this, £156 million relates to operating expense savings and £19 million of recurring capital maintenance savings. The expected sources of quantified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis. References to these anticipated synergies should be read in conjunction with Appendix 1 (*SSE Quantified Financial Benefits Statement*), which has been prepared in accordance with the requirements of the City Code.

With focus on the digitalisation and automation of processes across its back and front office functions, it is possible that additional synergies could be identified further reducing its operating costs and capital expenditure. Accordingly, it is anticipated that the MergeCo Group will operate a more efficient operating model with lower cost to serve per customer than would be the case for the SSE Energy Services and npower businesses on a standalone basis, which should be a core strength in enabling it to deliver on its strategic aim of providing customer value.

#### *Market position and customer offering*

The combination of SSE Energy Services and npower will provide the MergeCo Group with a complementary customer base across household, SME and I&C customers. The MergeCo Group will be able to serve its nearly 11.7 million customer accounts (based on combined SSE Energy Services and npower data as at 31 March 2018) with energy in the form of electricity and gas, home services such as boiler and heating insurance and maintenance and retail telecoms and broadband services. The Directors believe that the MergeCo Group's complementary market position and multi-product customer offering could be a significant benefit to the MergeCo Group, enabling it to compete effectively in the current market, and to grow and diversify its business across products and customer segments.

#### *Mature and experienced business teams with a track record of implementing business improvements*

The existing business teams at SSE Energy Services and npower have a track record of implementing business improvements in two key areas. First, organic business development and growth (at SSE Energy Services, the expansion of its home services business and the set-up of its telecoms business, and at npower, the launch of

Powershop and its boiler and central heating care partnership with Allianz Global Assistance). Second, major operational improvement programmes, including the Smart meter roll-out by SSE Energy Services and npower, the delivery of digital transformation by SSE Energy Services, and the implementation of the 'Recovery Programme' (following performance issues identified in 2015) by npower.

### *Financial strength*

The MergeCo Group is targeting to achieve an investment grade credit rating. The Directors believe the MergeCo Group's financial position will ensure it has sufficient liquidity to meet its operating needs and is an adaptable and durable business, able to respond well to the changing nature of the energy supply and related services market in the United Kingdom.

### *Strategy*

The energy supply and related services market in the United Kingdom is undergoing significant change. The main factors impacting the market, and the main factors which may shape its future, include: (i) an increasing number of small, agile and low cost energy supply and services providers operating in the market, offering targeted and competitively priced products; (ii) growing customer fragmentation (i.e., customers becoming more clearly identifiable for specific, tailored offerings); (iii) technological change (e.g., smart meters, electric vehicles, online, mobile app); and (iv) increasing regulatory intervention (with a particular focus on increasing competition amongst suppliers, reducing customer costs and protecting those customers that do not or cannot engage in the market). It is expected that the MergeCo Group will operate with the aim of responding to these factors and to deliver successful and sustainable growth to Shareholders and other stakeholders by targeting three areas of strategic focus.

### *Market leading customer focus*

It is expected that the MergeCo Group will prioritise operating a customer focussed business, which will enable it to challenge the market including both newer, agile market entrants and established participants. Continuing to embrace technological change will be an important factor in achieving this strategic aim. It is anticipated that the MergeCo Group will prioritise: (i) developing data-driven analytics tools to assist it in establishing customer need and tailoring its commercial decisions accordingly; (ii) developing a compelling and tailored product range through continuous, fast paced innovation; (iii) enhancing its selling and cross-selling capabilities including the use of automated and digital tools; and (iv) improving customer experience by building on the existing culture of customer care while upgrading and digitalising customer service processes based on smart and digital technology.

### *Value leadership*

A key feature of the MergeCo Group's strategy will be its aim to lead the market in providing value for customers. It will enable the MergeCo Group to compete effectively and to respond pro-actively to customer needs and regulatory trends. Key elements of value for customers for MergeCo to consider as part of its strategy comprise: price, having a tailored and relevant product range, customer trust, and customer experience across all platforms (e.g., digital, telephone and mail). The SSE Directors expect that the MergeCo Group will derive significant synergies from the Transaction of at least £175 million per annum on a recurring basis, derived from identified operating expense savings and recurring capital maintenance savings, and it is possible that additional synergies will be identified. References to these anticipated synergies should be read in conjunction with Appendix 1 (*SSE Quantified Financial Benefits Statement*), which has been prepared in accordance with the requirements of the City Code. In reducing the MergeCo Group's cost to serve these synergies will help the MergeCo Group achieve competitive prices for customers and deliver customer value.

### *Focussed diversification*

The MergeCo Group will continue to focus on its core household and business energy segments and will seek to grow its existing energy related services businesses (telephone, broadband, boiler and heating insurance and other auxiliary products). As for longer term growth options, the MergeCo Group may look to explore more transformative opportunities, such as electric vehicles and distributed energy generation and trading, provided they are commercially viable at the time.

### **History—SSE Energy Services**

The SSE group of businesses (formerly known as Scottish and Southern Energy) was formed in 1998 through the merger of Scottish Hydro Electric and Southern Electric, companies which themselves were formed as a result of the privatisation of the electricity supply industry in the United Kingdom following the Electricity Act 1989. In 2000, SSE purchased the Swalec energy supply business. SSE later acquired the energy supply business Atlantic in 2004. Throughout this time, SSE has been one of the leading suppliers of electricity and gas to customers throughout Great Britain. In addition, SSE also provides a range of home and essential services to customers, such as boiler and heating cover, which was launched in 2006. It originally supplied energy as Scottish Hydro Electric, Southern Electric, Atlantic and Swalec but in recent years has increasingly adopted SSE as its brand for customers.

### **History—npower**

The npower business was launched in 1999 when National Power plc (the then parent company of Npower Limited) acquired the electricity supply business of Midlands Electricity plc and the gas supply business of Calortex Limited. In 2000, National Power plc was de-merged to form innogy Holdings plc and International Power plc. innogy Holdings plc later acquired the supply businesses of Yorkshire Electricity and Northern Electric. In 2002, innogy Holdings plc was purchased by RWE AG and renamed RWE npower Holdings plc in 2004. Since April 2016, npower has been part of the innogy Group which was formed when RWE AG combined its renewables, retail and grid and infrastructure businesses. innogy SE became a separate listed company on 7 October 2016 through an IPO and entry on the MDAX (Frankfurt Stock Exchange) in December 2016.

On 12 March 2018, RWE announced that it had concluded an agreement with E.ON on the sale of RWE's 76.8 per cent. stake in innogy. If the E.ON/RWE Transaction completes, E.ON would therefore become the majority owner and ultimate controller of innogy and, indirectly, innogy's holding in MergeCo should the Transaction complete. One of the conditions of the Contribution Agreement was innogy's supervisory board approval which was obtained in December 2017 and the Contribution Agreement does not include provision relating to change of control. SSE therefore does not believe that its agreement with innogy should be affected by the potential E.ON/RWE Transaction. See "*Merger clearance consents may take longer than expected to obtain and/or may not be granted or may be granted subject to conditions or remedies*" in Part III (Risk Factors) of this Circular.

### **Description of SSE Energy Services**

SSE Energy Services is currently in the top three energy suppliers across Wales, England and Scotland with over 12 per cent. of market share (according to Cornwall Insight). Its brands include SSE and SSE Southern Electric in England, SSE SWALEC in Wales and SSE Scottish Hydro in Scotland. SSE Energy Services also provides other essential services through its home and essential services and metering businesses.

## Key Financial and Performance Indicators

The following table sets forth the key financial and performance indicators for SSE Energy Services.

	Year ended 31 March		
	2016	2017	2018
<b>Energy Supply</b>			
Reported operating profit (£m) <sup>(1)</sup>	148.0	303.0	265.9
Adjusted operating profit (£m) <sup>(1)</sup>	249.1	224.4	260.4
Electricity customer accounts (domestic) (m)	4.16	4.06	3.82
Gas customer accounts (domestic) (m)	2.79	2.70	2.53
Electricity supplied household average (kWh)	3,763	3,793	3,788
Gas supplied household average (th)	426	440	454
Aged debt (£m) <sup>(2)</sup>	95.1	72.8	76.4
Customer complaints to third parties <sup>(3)</sup>	1,416	1,322	1,616
<b>Energy-related Services</b>			
Reported operating profit (£m) <sup>(1)</sup>	18.8	8.1	13.8
Adjusted operating profit (£m) <sup>(1)</sup>	18.8	15.3	13.8
Energy-related Services customer accounts (m)	0.40	0.47	0.45
Smart meters on supply	>180,000	>500,000	>850,000

(1) Prepared in line with the historical financial information in Part A of Part XI (*Historical Financial Information*) of this Circular.

(2) The aged debt key performance indicator represents debt over six months past due but not individually impaired.

(3) Source: Ombudsman: Energy Services and Citizens Advice

### Energy Supply

SSE Energy Services supplies energy to 6.3 million accounts (approximately 60 per cent. of which are electricity accounts and 40 per cent. are gas accounts) and serves around four million individual residential customers, as at 31 March 2018. Despite industry leading customer churn rates (14.3 per cent. vs. an industry average of 18.0 per cent. in 2017, according to the Department for Business, Energy and Industrial Strategy), account numbers in the year ended 31 March 2018 declined by six per cent, primarily as result of intensifying price-driven competition.

While 71 per cent. of SSE Energy Services' credit customers are on SVTs (as at September 2017), it continues to attract and retain customers via a range of fixed tariffs and is publicly committed to proactively shifting customers away from SVTs. In particular, in November 2017 SSE wrote a public letter to the UK Secretary of State for Business, Energy and Industrial Strategy to outline the steps it will take to reduce the number of customers on SVTs.

### Energy-related Services

#### Home and Essential Services

SSE Energy Services provides to its residential customers telephone and broadband services as well as boiler and heating insurance and other auxiliary products. As at 31 March 2018, SSE Energy Services had around 447,000 customer accounts across its home and essential services product lines, broadly four per cent. less than in the prior year.

#### Metering

SSE Energy Services' metering business is undergoing a transformation through the smart meter rollout, but still undertakes metering operations on legacy meters, including installation, maintenance and operation of such legacy meters. SSE supports the view that there is potential for the smart meters to transform the relationship between customers, their energy usage and their supplier. It is therefore committed to delivering its rollout in a way that is both cost-effective and customer-centric, with the primary objective of maximising the net benefits to customers. SSE Energy Services reached 11.9 per cent. penetration of its electricity customer base and 13.4 per cent. penetration of its gas customer base by December 2017, as reported to Ofgem. At 31 March 2018, SSE had installed over 850,000 smart meters on supply in customers' homes and is committed to reaching smart meter penetration of 22 per cent. for electricity meters and 25 per cent. of gas meters by the end of 2018. The MergeCo Group has a regulatory obligation to take all reasonable steps to roll out smart meters to all of its household and small business customers by the end of 2020 and must submit and achieve annual milestones for household customers.

## Environment

Managing the issues of climate change, resource use and waste is important for SSE Energy Services due to the interest of stakeholders and the impacts to business performance and long-term viability. Energy efficiency is the most sustainable way to help customers to keep energy bills lower and reduce the environmental impact of energy use. Therefore, SSE Energy Services is committed to engaging its customers on energy efficiency via providing advice, the installation of efficiency measures in customers' homes through government mandated schemes such as Energy Company Obligation, and the roll out of smart meters.

SSE Energy Services is subject to regulation under various local, national and international laws on the environment, including responsibilities for its energy and resource use, discharges to air, land and water, the management and disposal of hazardous substances and waste and pollution prevention. It is also committed to providing information about where the electricity it purchases for its customers comes from. These different fuels such as coal, gas, nuclear and renewable resources (sun, wind, water) combine to make up the fuel mix for SSE Energy Services. This information has historically been reported annually in SSE Energy Services' Standard Fuel Mix disclosure.

SSE Energy Services manages its responsibilities to the environment through a Safety, Health and Environment Management System and has a dedicated Retail Safety, Health and Environment Committee reporting to the Retail Management Committee of the SSE Executive Committee. Managing its environmental impacts is part of a wider approach to sustainability in which SSE Energy Services assesses and manages environmental, social and economic impacts, consistent with directors' statutory duties.

## Intellectual Property

Prior to Completion, SSE Energy Services owns, or will license from the SSE Group, the material intellectual property rights required for its business. This intellectual property includes trade mark rights to 'SSE', 'SSE PROUD TO MAKE A DIFFERENCE' and the SSE "swoosh" logo, as well as ownership of 'SOUTHERN ENERGY', 'SOUTHERN ELECTRIC', 'SWALEC' and 'SCOTTISH HYDRO'. For more detail on the treatment of these trade marks pursuant to the Transaction, see "*What arrangements are planned in terms of brands?*" in Part II (*Some questions and answers on the Transaction*) of this Circular.

The SSE Retained Group and SSE Energy Services also rely on proprietary IT systems relating to customer service including registration, deregistration, metering, billing, payments and collections. For more detail on the treatment of the CS Systems pursuant to the Transaction, see "*Will there be any ongoing relationship between SSE or innogy and SSE Energy Services?*" in Part II (*Some questions and answers on the Transaction*) of this Circular.

## Employees

The following table sets forth the numbers of SSE Energy Services' employees by function.

	As at 31 March		
	2016	2017	2018
Customer service (including sales) . . . . .	4,514	4,902	4,543
Metering . . . . .	2,098	2,547	2,928
Home and essential services . . . . .	601	521	514
Support services . . . . .	634	558	551
Retail transformation project . . . . .	175	155	115
Management centre . . . . .	147	150	136
<b>Total</b> . . . . .	<b>8,169</b>	<b>8,833</b>	<b>8,787</b>

The following table sets forth the numbers of SSE Energy Services' employees by location.

	As at 31 March		
	2016	2017	2018
England . . . . .	3,647	4,001	4,080
Scotland . . . . .	3,189	3,293	3,233
Wales . . . . .	1,333	1,539	1,474
<b>Total</b> . . . . .	<b>8,169</b>	<b>8,833</b>	<b>8,787</b>



## Description of the npower Group

npower is one of Britain's largest energy companies with nearly nine per cent. share of the household market as at 31 January 2018 (according to Cornwall Insight). It supplied electricity and gas services to 4.6 million UK household accounts as at 31 December 2017. npower is also a key player in the business-to-business market and as at 31 October 2017 supplied c.33TWh of energy to over 390,000 customer accounts.

## Key Financial and Performance Indicators

The following table sets forth the key financial and performance indicators for npower Group.

	Year ended 31 December		
	2015	2016	2017
<b>npower</b>			
Reported operating (loss) / profit (£m) . . . . .	(253.5)	185.8	(46.9)
Adjusted operating loss (£m) <sup>(1)</sup> . . . . .	(99.0)	(89.4)	(55.3)
Customer complaints to third parties <sup>(2)</sup> . . . . .	12,937	8,303	6,285
Smart meters installed . . . . .	62,601	106,797	266,321
<b>Domestic</b>			
Adjusted operating loss (£m) <sup>(1)</sup> . . . . .	(116.4)	(89.0)	(55.8)
Electricity customer accounts (m) <sup>(3)</sup> . . . . .	2.80	2.75	2.67
Gas customer accounts (m) <sup>(3)</sup> . . . . .	1.97	1.96	1.89
Electricity supplied household average (kWh) <sup>(4)</sup> . . . . .	3,672	3,582	3,606
Gas supplied household average (th) <sup>(4)</sup> . . . . .	488	486	494
Bad debt expense (£m) <sup>(5)</sup> . . . . .	66	62	52
<b>npower Business</b>			
Adjusted operating loss (£m) <sup>(1)</sup> . . . . .	(21.4)	(22.7)	(40.9)
Electricity customer accounts (m) <sup>(3)</sup> . . . . .	0.16	0.14	0.13
Gas customer accounts (m) <sup>(3)</sup> . . . . .	0.04	0.04	0.03
Electricity supplied customer account average (kWh) <sup>(4)</sup> . . . . .	15,823	14,730	12,316
Gas supplied customer account average (th) <sup>(4)</sup> . . . . .	1,449	1,525	1,499
Bad debt expense (£m) <sup>(5)</sup> . . . . .	38	25	22
<b>Business Solutions</b>			
Adjusted operating profit (£m) <sup>(1)</sup> . . . . .	38.8	22.3	41.4
Electricity customer accounts (m) <sup>(3)</sup> . . . . .	0.22	0.22	0.22
Gas customer accounts (m) <sup>(3)</sup> . . . . .	0.01	0.01	0.01
Electricity supplied customer account average (kWh) <sup>(4)</sup> . . . . .	138,079	126,899	120,503
Gas supplied customer account average (th) <sup>(4)</sup> . . . . .	11,615	16,344	17,518
Bad debt expense (£m) <sup>(5)</sup> . . . . .	6	5	5

(1) Adjusted operating loss is calculated as the reported operating loss or profit less exceptional items and certain re-measurements. Values may differ from those reported in the innogy SE annual report.

(2) Source: Ombudsman: Energy Services and Citizens Advice

(3) End of year customer meter points

(4) Calculation: Total annual volume divided by end of year customer meter points

(5) Calculation: Bad debt write off + provision movements + credit releases

## Business Overview

As at 31 December 2017 npower supplied energy to 4.6 million UK domestic accounts (approximately 60 per cent. of which were electricity accounts and 40 per cent. were gas accounts).

Additionally, npower is a key player in the business-to-business market and as at 31 October 2017 supplied c.33TWh of energy to over 390,000 customer accounts. The Telecom Plus Group is a key business-to-business customer of npower under a long-term supply agreement for the supply of electricity and gas to Utility Warehouse (its wholly-owned subsidiary). As at 1 April 2018, Utility Warehouse supplied electricity and gas to around 540,000 small business and household energy customers with around 970,000 energy accounts under its multi-utility customer offerings.

Following a reduction in profitability in 2015 and costs incurred relating to Ofgem penalties resulting from a standards of conduct investigation linked to issues with the SAP domestic billing platform, innogy introduced a new npower executive team in 2015 with a focus on improving financial performance through a 'Recovery Programme'. The programme aims to deliver savings and improve performance by:

- enhancing operational and financial performance;
- enhancing IT capabilities; and
- improving customer service processes.

### ***Energy-related Services***

#### *Powershop*

PS Energy UK Limited, trading as Powershop, is a wholly owned subsidiary of npower and was established as a commercial vehicle to explore strategic options for new products and new value streams for its UK retail utilising a bespoke UK instance of the Flux Federation operational platform. Powershop is operated under brand and software licences from the UK subsidiary of Flux Federation Ltd. Flux Federation is ultimately owned by Meridian Energy, a major New Zealand Energy Company.

In 2017, Powershop launched its domestic electricity proposition to market via a web and smart phone based product, which offers customers an innovative ability to 'shop' for their energy requirements via 'Power Packs'. Subsequently, in April 2018 a full domestic market dual fuel offer was launched, so now allowing Powershop access to the wider dual fuel customer market.

In addition to retailing Powershop branded products and aligned to the company's wider commercial strategy, the business is also actively progressing partner branded "white label" affinity arrangements with third parties. Deals with two prominent professional rugby clubs launched in April 2018, using both clubs' and npower branding operating from the Powershop UK platform.

#### *Boiler / Central heating care*

npower currently maintains a partnership with Allianz Global Assistance for the provision of home service products relating to boiler and central heating care. Npower Northern Limited holds the status of an Introducer Appointed Representative of Allianz Global Assistance, undertaking marketing efforts and generating leads for the relevant products, with Allianz Global Assistance handling payments and sale of the products. In 2018 npower is focusing on developing its customer offer pricing, and OnDemand Repairs and OnDemand Boiler Services, and Boiler Cover for Landlords. The five year partnership commenced in 2017 and customer numbers are projected to grow substantially from 2018 onwards.

#### *Electric Vehicles*

npower is currently supplying hardware and software services to the B2B market, with ambitions to become a major player in the market by offering end-to-end customer capabilities. This is an early stage exploratory investment.

#### *Energy Services*

npower's Energy Services segment is an internal service provider delivering metering services and ECO (Energy Company Obligation) related services for the supply business.

The ECO services are delivered through a combination of managing agents and npower generated leads which are fulfilled by external contractors. npower is well on track to deliver its current ECO targets.

The metering services are provided by a combination of internal and external capabilities and cover both smart meter rollout installation and operation; as well as traditional metering—installation, maintenance, operation and data retrieval (reading). npower is fully committed to the rollout of smart meters and the benefits they will bring to customers. npower delivered (in the case of gas, within agreed tolerances) on its Ofgem commitments in 2017. At the end of December 2017 npower has 545,000 smart and advance meters installed. During 2018 the focus is on transitioning to SMETS2 meters which enable full industrywide connectivity to maximise the benefits of Smart to customers and a significant increase in the number of meters deployed.

Npower Energy Services has been gradually increasing the rate of delivery and installation of smart meters and has recorded 96 per cent. for its customer satisfaction with the installation experience. In 2017, npower Energy

Services delivered on its Ofgem relevant meter commitment for penetration of its customer base (in the case of its gas customer base, within agreed tolerances).

As of 31 March 2018, npower Energy Services had 467,111 smart meters on supply and is committed to reaching 19.6 per cent. penetration by the end of 2018. The MergeCo Group has a regulatory obligation to take all reasonable steps to install smart meters for all of its household and small business customers by the end of 2020 and must submit and achieve annual milestones for household customers.

### ***Environment***

npower takes seriously its responsibility to manage the environmental impacts of its business operations and buildings as well as helping its customers to do the same.

npower's environmental focus is structured around three core areas:

- Carbon emission reductions
- Effective resource management
- Energy efficiency advice and solutions for customers

npower is focussed on continuing to reduce carbon emissions associated with its business operations through effective operation and management of its buildings, a move to agile working, utilisation of energy efficient technologies and through business and commuter miles reductions. As a further commitment to reducing its environmental impact, npower aims to match the electricity used in its offices by Renewable Electricity Guarantees of Origin, guaranteeing that its own energy consumption is matched by grid-supplied renewable energy.

### ***Intellectual Property***

Prior to Completion, npower Group will either own or have a right to use all the material intellectual property rights required for its business (for example its principal brands, trade marks and domain names, the "Powershop" brand and its SAP system software).

### ***Employees***

The following table sets forth the numbers of npower's employees by function.

	<b>As at 31 December</b>		
	<b>2015</b>	<b>2016</b>	<b>2017</b>
Customer service <sup>(1)</sup>	2,173	2,035	2,075
Metering <sup>(1)</sup>	1,319	1,314	1,338
Home and essential services	695	293	311
Support services, sales and marketing	1,170	1,196	1,257
Retail transformation project	175	200	218
Management centre	81	71	63
B2B	1,590	1,563	1,673
<b>Total</b>	<b>7,203</b>	<b>6,672</b>	<b>6,935</b>

(1) A significant portion of npower's customer service and metering functions are outsourced, and such outsourced workforce is not included in these figures.

The following table sets forth the numbers of npower's employees by location.

	<b>As at 31 December</b>		
	<b>2015</b>	<b>2016</b>	<b>2017</b>
England	7,184	6,652	6,915
Republic of Ireland	19	20	20
<b>Total</b>	<b>7,203</b>	<b>6,672</b>	<b>6,935</b>

### **Regulatory Environment**

The electricity industry in Great Britain is regulated by the Authority, which is the governing body of Ofgem. The principal objective of the Authority, as set out under the Electricity Act 1989, is to protect the interests of

existing and future consumers in relation to electricity conveyed by distribution or transmission systems; wherever appropriate by promoting effective competition. Ofgem provides the staff who support the role of the Authority and carry out the day to day activities of the statutory body. The Authority's duties include ensuring that licence holders are able to finance their statutory and licence obligations, and that they operate their business with regard to the effect on the environment.

SSE Energy Services and npower operate under licences issued under the Electricity Act 1989 and the Gas Act 1986. The provisions of such licences are regulated by the Authority. While SSE Energy Services and npower operate under licence, the supply of electricity and gas in Great Britain is a competitive activity and is currently only subject to price caps in certain areas, namely: (i) PPM, as discussed below and (ii) Warm Home Discount customers (who are customers meeting certain low-income thresholds) on their supplier's default tariff. Ofgem consulted on widening the eligibility of the price cap applicable to Warm Home Discount customers to an additional two million customers.

On 27 March 2014, Ofgem published its state of the market assessment report setting out its findings in relation to competition in the energy market. The report concluded that despite the reforms introduced by Ofgem, there continued to be significant consumer and public concern regarding the energy market. The report specifically highlighted concerns around: weak customer response; evidence of incumbency advantages; evidence of possible tacit coordination; vertical integrations and barriers to entry; and increased supplier profits. As a result, Ofgem made a reference to the CMA to investigate the supply and acquisition of energy in Great Britain.

The CMA's Final Report establishes that:

- wholesale gas markets are liquid and transparent and do not act as a barrier to entry or lead to other market inefficiencies;
- vertical integration does not give companies an unfair advantage;
- there is no unilateral market power in generation; and
- there is no coordination, tacit or otherwise, between household energy suppliers.

The CMA's Final Orders, published in late 2016, sought to address a perceived problem of weak customer response and the CMA's conclusion that the customer detriment due to shortcomings in competition in retail energy is a headline figure of £1.4 billion/year. Technically, this figure was a measure of the gains from switching and SSE argued strongly in its submissions that the CMA was wrong to consider this a measure of detriment.

Key remedies proposed in the CMA's Final Orders representing risks to the MergeCo Group are:

- the **PPM price cap**, which will be transitional and is in force from 2017–2020. It applies to all PPM customers with either 'dumb' meters or SMETS1. The CMA accepted that the price cap should not apply to customers with SMETS 2 smart meters. See below for further detail;
- the **Disengaged Customer Database** will store information on customers who have been on a standard variable tariff with the same supplier for three years or more. By late 2018, it is proposed that suppliers will be able to access the database of disengaged domestic customers who have not opted out;
- on **locational pricing of transmission losses** the CMA ordered National Grid, supported by industry, to implement a solution based on full marginal pricing;
- on **financial reporting** Ofgem consulted on changes to the requirements for the consolidated segmental statements, to include provision of separate balance sheets for generation and supply as well as disaggregated wholesale energy costs;
- the CMA introduced a new licence condition giving Ofgem the power, if necessary, to compel suppliers to participate in **trials of customer communications**; and
- on **restricted hours meters** suppliers must ensure that new and existing customers with restricted hours meters (except Economy 7 Smart and Prepayment) can choose an unrestricted (single-rate) tariff without requiring a meter exchange. SSE already did this for a small number of existing customers (via manual workarounds) but making this available for all customers in this group has required process and system changes. Suppliers must also provide a range of information to customers with restricted meters and to the applicable Citizens Advice body.

The other remedies, including those for microbusiness, softening of the Retail Market Review rules, and the recommendations to the Department of Energy and Climate Change (now the Department for Business, Energy and Industrial Strategy) and Ofgem on improved governance are also in the package but represent lower levels of risk.

Significant resource and investment has been deployed to implement the proposed remedies within the necessary timeframes and to customers' satisfaction. There is an unprecedented pipeline of technological change placing real constraints on licensed suppliers' IT systems, including:

- the smart meter rollout;
- the faster switching programme, which aims to reduce significantly the time it takes customers to switch supplier and make the process more reliable;
- the midata programme, which enables customers to request data about their usage and other information from their supplier, and to give permission for this to be shared with intermediaries such as internet comparison websites to help them find a better deal; and
- Project Nexus, which was the project for the replacement of the UK Link system (operated by Xoserve) which carries out energy settlements, point administration and other functions in the British gas market.

Overall, Ofgem is introducing a new approach to regulation that will be reliant on principles, rather than prescriptive rules. This piece of work, referred to as the "Future of Retail Regulation" project, will examine the current rulebook with a view to introducing additional overarching principles whilst removing areas of unnecessary prescription. Ofgem hopes that this approach will safeguard the interests of customers, whilst at the same time ensuring that regulation does not stand in the way of innovation. As part of this workstream, Ofgem consulted on a number of licence changes in 2017, which included new principles governing sales and marketing, whilst at the same time removing some of the prescriptive requirements in this area. In addition, Ofgem amended the existing Standards of Conduct, which is designed to widen the scope of the principles, and introduced a new principle regarding the treatment of vulnerable customers. Further refinement to Ofgem's approach to principles-based regulation is expected through the course of 2018 and 2019.

In October 2017 the Department for Business, Energy and Industrial Strategy proposed legislation to allow Ofgem to set an absolute cap for SVT customers in Great Britain. On 26 February 2018 the UK government introduced the Domestic Gas and Electricity (Tariff Cap) Bill into Parliament and stated its intention that Ofgem should implement the tariff cap by the end of the year. The proposed legislation would allow Ofgem to set a temporary price cap for SVT and certain other default tariff customers in Great Britain and would last until 2020, with a maximum of three one-year possible extensions if Ofgem recommends to the Secretary of State that conditions are not yet in place for effective competition. The SVT/default price cap must end by the end of 2023.

## PART VI INDUSTRY OVERVIEW

### *Energy sector overview*

Within the electricity and gas utilities industry in Great Britain, the standard value chain generally covers the following segments: (i) generation or production (conversion of fuel into energy, generating energy from renewable sources or sourcing of gas); (ii) transmission (transportation of electricity through high voltage network lines and of gas through the high-pressure network); (iii) distribution through electrical networks or gas pipes; and (iv) supply of electricity and gas to industrial and commercial (including the public sector) customers or household energy consumers.

Following the privatisation of the electricity and gas utilities industry in the United Kingdom in the 1990s, there was separation of this value chain, introducing competition into both the generation and supply activities followed by vertical integration by a number of companies. Today, these segments are highly competitive. The companies that were privatised originally have all undergone significant structural change, with none remaining in their original form, and the companies that have emerged from that process share the market with a large range of competitors. The MergeCo Group will operate in the latter part of the value chain, supplying energy to business and public sector and residential customers, which is a continuation of the operations currently undertaken by SSE Energy Services and npower.

### *Energy supply*

Retail energy supply involves the sale of electricity and/or gas to end customers. Retailers can be generators who sell their generated electricity, or suppliers without generation activities who either procure electricity from wholesale markets or source it directly from generators via short-term or medium-to-long term contracts. MergeCo will not have any material interests in any electricity- or gas-producing plants.

Suppliers sell electricity to homes, businesses and public sector customers while relying on transmission system operators or distribution system operators to transport or distribute the electricity to the final point of consumption. The volumes consumed are measured and provided to the relevant market participants. Suppliers generally offer a range of different products, such as fixed rate electricity and gas contracts or electricity produced exclusively from renewable sources, for example.

The energy supply market in Great Britain can be described along three segments: industrial and commercial (including public sector), small and medium-sized enterprise (**SME**), and residential or retail customers. I&C typically comprises large commercial and industrial users with heavy usage (more than 20 GWh electricity per year). Residential or retail customers represent the largest segment of the market by number of customers, with SSE estimating that such customers make up 80 per cent. of the market based on data from Cornwall Insight and House of Commons Business Statistics. Although I&C and SME represent a smaller number of customers, together they accounted for approximately 50 per cent. of the electricity and gas demand in 2017, according to National Grid's "Future Energy Scenarios" report published in July 2017.

For 2017, consumption of electricity in the British market was estimated at 299 TWh (113 TWh residential and 186 TWh business), compared with 301 TWh in 2015 (114 TWh residential and 187 TWh business), according to National Grid. Total British gas demand in 2017 was estimated at 566 TWh (329 TWh residential and 237 TWh business), compared with 557 TWh in 2015 (327 TWh residential and 230 TWh business), according to National Grid.

### *Energy supply market*

The market at the end of 2017 accounted for 28.0 million residential electricity and 23.1 million residential gas consumers (meter points) across Great Britain, according to Cornwall Insight.

As of May 2018, the Directors are aware that there are more than 80 active suppliers (including White Labels) in the British household energy supply market, the vast majority of which provide both gas and electricity. The market share of small and medium suppliers was 23.2 per cent. as of April 2018, according to Cornwall Insight.

At the start of financial year 2016/17, there were 65 suppliers in the I&C and SME energy supply market, with 26 providing both gas and electricity; 21 providing gas only; and 18 providing electricity only. Following Completion, MergeCo and SSE will both be competing in the I&C and SME markets.

Energy supply customers' bills are made up of seven main elements: wholesale energy costs; transmission and distribution costs; environmental and social obligations costs; operating costs; other direct costs; VAT; and any

pre-tax margin. Based on typical household consumption values, household tariffs as of April 2018 ranged from £788 to £1,138.

The key competitive parameter in the market is price. The range and quality of products and services provided are also important parameters. Each energy supplier is free to set its own retail prices, with the exception of prices to customers with pre-payment meters and those on their supplier's default tariff who are in receipt of the Warm Home Discount. In addition, SVT tariffs may become subject to price regulation, pending introduction of the Ofgem Default Tariff Cap (see "Regulatory Environment" in Part V (*MergeCo Group Business Overview*)).

#### *Energy supply regulation and politics*

The market, albeit liberalised, remains overseen by Ofgem, the UK Government's electricity and gas regulator, formed in the early 2000s to regulate both the gas and electricity supply markets. In July 2016, the Government formed the Department of Business, Energy and Industrial Strategy, replacing the Department of Energy and Climate Change, as the government department responsible for energy markets amongst other duties.

#### *Current and future change within energy supply*

Energy supply has been undergoing a gradual transformation driven, in part, by technological change, regulatory interventions and intensifying competition. Digitalisation, including a shift to internet-based customer engagement, growth of data analytics and automation of back-office and customer facing processes, is enabling suppliers to offer enhanced and more cost-effective customer experience as well as propositions tailored to customer needs. This trend towards digitally-enabled personalised engagement is further supported by the smart meter rollout. Although still at a relatively early stage, the rollout is well underway and all licensed suppliers are mandated by the UK Government to take all reasonable steps to roll out smart meters to all of their household and small business customers by the end of 2020. In the longer-term horizon, the operating model of energy providers is likely to evolve further with growing opportunities for customers to generate, store and trade energy themselves.

Alongside these technology trends, the market is also evolving in response to increased government and regulatory intervention. Recent policies relating to the energy retail market in Great Britain have centred on efforts to increase competition by driving customer engagement with the market and have included:

- the faster switching programme, which aims to reduce significantly the time it takes customers to switch supplier and make the process more reliable;
- enabling customers to request data about their usage and other information from their supplier, and to give permission for this to be shared with intermediaries such as internet comparison websites to help them find a better deal;
- efforts to simplify and standardise the way in which suppliers provide key information, such as bills and annual statements, to customers; and
- exemption of suppliers with fewer than 250,000 customer accounts from participation in government mandated social schemes such as the Warm Home Discount and the Energy Company Obligation, to reduce barriers to entry.

These measures have contributed to intensifying competition in the market. This is evidenced by the increasing switching rates with a record 9.3 million customer accounts, or one in six, switching supplier in 2017, according to the UK Department for Business, Energy & Industrial Strategy; the surge in new market entrants taking the number of suppliers from six to more than 80 (including White Labels); and their collective market share from less than five per cent in 2013 to 23.2 per cent. as at 31 March 2018, according to Cornwall Insight.

In response to the regulatory changes and increased market pressure, suppliers have also introduced a number of voluntary initiatives to drive customer engagement. Such initiatives have included communication campaigns, reward programmes and, most recently, commitments to roll customers whose fixed-term contract is ending on to another fixed-term contract with no exit fees, priced at or below their SVT. These measures together with innovation in propositions contributed to increasing fragmentation of the residential energy market with some competitors seeking differentiation via focusing on specific customer segments (e.g. renters) and meeting distinct preferences (e.g. green offering, multi-product bundles). This dual trend towards increased competition and market fragmentation is likely to continue as more players continue to enter the market and the smart meter rollout and digitalisation further spur innovation.

The Directors note that, according to Ofgem, National Grid and the Department for Business, Energy and Industrial Strategy, there are a number of potential scenarios for future household energy demand with increased efficiencies, smart meters and distributed generation exerting downward pressure on energy consumption. However, for electricity in particular, forecast scenarios indicate that these effects may be partly, fully or more than offset by growth in the number of accounts due to increasing population, economic growth and volume growth through the electrification in transport.

#### *Energy-related and other essential services*

As suppliers have sought to add value to customers and differentiate themselves in an increasingly competitive sector, many have diversified to offer other essential services for the home. They include primarily heating, boiler and electrical cover (referred to below as “home services”) and phone and broadband services.

SSE estimates the home services market in 2017 covered around 13 million maintenance accounts and five million on-demand repairs across a range of products, based on analysis of estimates by third-party consultants. This implies an average market penetration of approximately 45 per cent., but it is likely that the majority of customers hold more than one product. The competition in this sector is highly diverse, with SSE estimating that British Gas holds almost 50 per cent. market share, and being challenged by other energy suppliers (such as SSE, Ovo and Scottish Power), specialists (such as HomeServe), home and appliance insurers (such as Aviva) as well as local providers. Overall, home services is an area of growth, with further potential to increase market penetration of the product, increasing scope for product innovation and emergence of new business models (such as platforms connecting customer, local tradesmen and suppliers).

In phone and broadband services, the UK market is almost fully saturated with around 33 million fixed lines and 25 million broadband connections at the end of 2016, according to Ofcom, the United Kingdom’s communications regulator. While the market is being led by large providers such as BT, Virgin, TalkTalk and Sky, holding jointly around 90 per cent. market share (according to Ofcom), there is growing scope for challengers to leverage their customer relationships from other sectors to cross-sell telecommunications propositions to their customer base.



## PART VII MERGECO DIRECTORS AND CORPORATE GOVERNANCE

### Proposed MergeCo Directors

The following table lists the names and positions of certain proposed directors of MergeCo following Completion of the Transaction (*MergeCo Directors*):

<u>Name</u>	<u>Designated position</u>
Katie Bickerstaffe . . . . .	Chief Executive
Gordon Boyd . . . . .	Chief Financial Officer

#### ***Katie Bickerstaffe (Chief Executive Designate)***

Katie Bickerstaffe will take up her appointment on 24 September 2018. Katie served as a non-executive director of SSE from 2011 until April 2018 when she was appointed as Chief Executive Designate of MergeCo. Katie has experience in a variety of roles in different customer-facing retailers and fast-changing markets, including roles in human resources, marketing and other business areas. She has been an Executive Director of Dixons Carphone plc since it was formed in 2014 and has been Chief Executive, UK and Ireland for the business since 2015, having joined Dixons in 2008 and been a member of its Board since 2012. She has other substantive and diverse retail experience gained with Kwik Save, Somerfield, Dyson, PepsiCo and Unilever. Katie will bring extensive experience of organisational change and recent insight derived from merging two companies into one as well as experience of the growing digitalisation of retail markets. Katie is also a non-executive director of Marks and Spencer Group plc.

#### ***Gordon Boyd (Chief Financial Officer Designate)***

Gordon Boyd will take up his appointment on 4 July 2018. Gordon has significant experience both in the energy sector and in major listed companies, acquired over more than 30 years. He originally joined the energy sector in 1989 and went on to hold a variety of senior finance leadership positions in this sector including British Energy and EDF Energy, as well as overseeing the initial public offerings of both Drax and Infinis. Gordon also has highly relevant experience of mergers and business transformation.

### MergeCo Corporate Governance

It is intended that the composition of the MergeCo Board will comply with the provisions of the UK Corporate Governance Code. The UK Corporate Governance Code states, in part, that at least half of a board of directors, excluding the chairperson, should comprise independent non-executive directors. SSE notes that the Financial Reporting Council is consulting on changes to the board composition provisions of the UK Corporate Governance Code, and any such changes will be considered by MergeCo. As described in “*Relationship Agreement with innogy*” below, innogy will be able to appoint two non-executive directors to the MergeCo Board for so long as it and its associates hold at least 20 per cent. of the ordinary shares in MergeCo. innogy will be able to appoint one non-executive director to the MergeCo Board for so long as it and its associates hold at least ten per cent. but less than 20 per cent. of the ordinary shares in MergeCo.

#### ***Relationship Agreement with innogy***

Immediately following Admission, it is envisaged that innogy will exercise or control on its own or together with any person with whom it is acting in concert, more than 30 per cent. of the votes to be cast on all or substantially all matters at general meetings of MergeCo. On Completion, MergeCo and innogy will enter into the Relationship Agreement which will, following Admission, regulate the on-going relationship between MergeCo and innogy.

The principal purpose of the Relationship Agreement is to ensure that MergeCo can carry on an independent business as its main activity as required by the Listing Rules. The Relationship Agreement contains, among others, undertakings from innogy that it will (and will procure that its associates will): (i) conduct all transactions and arrangements with any member of the MergeCo group at arm’s length and on normal commercial terms; (ii) not take any action that would have the effect of preventing MergeCo from complying with its obligations under the Listing Rules; and (iii) not propose or procure the proposal of a shareholder resolution of MergeCo which is intended or appears to be intended to circumvent the proper application of the Listing Rules. The Relationship Agreement also provides that innogy will (and will procure that its associates will) not take any action which would preclude MergeCo or any of its associates from carrying on its business independently of innogy and its associates. Furthermore, innogy undertakes to MergeCo that it will (and will procure that its associates will) not exercise any of its voting or other rights and powers as a shareholder of

MergeCo to procure any amendments to the articles of association of MergeCo which are inconsistent with, or undermine, any provision of the Relationship Agreement, including the provisions designed to safeguard MergeCo's independence.

Pursuant to the Relationship Agreement, innogy will be able to appoint two non-executive directors to the MergeCo Board for so long as it and its associates hold at least 20 per cent. of the ordinary shares in MergeCo. innogy will be able to appoint one non-executive director to the MergeCo Board for so long as it and its associates hold at least ten per cent. but less than 20 per cent. of the ordinary shares in MergeCo.

Pursuant to the Relationship Agreement, innogy will be subject to certain transfer restrictions in respect of its shares in MergeCo for a lock-up period of six months following Completion. Furthermore, MergeCo will be subject to certain restrictions on its ability to make share buy-backs and secondary issues of shares which would trigger an obligation on innogy to make a mandatory general offer for MergeCo pursuant to Rule 9 of the City Code. For more information, see paragraph 7 of Part XII (*Further details of the Transaction*) of this Circular.

The Relationship Agreement will continue until the earlier of (a) the date on which MergeCo Shares cease to be admitted to the premium listing segment of the Official List or (b) the date on which innogy, together with its associates, ceases to hold shares which in aggregate confer ten per cent. or more of the total voting rights in MergeCo.

## PART VIII TAXATION

### United Kingdom Taxation

The following statements are intended only as a general guide to certain UK tax considerations and do not purport to be a complete analysis of all potential UK tax consequences of the Transaction. They are based on current UK law and what is understood to be the current practice of HMRC as at the date of this Circular, both of which may change, possibly with retroactive effect. They apply only to SSE Shareholders and SSE ADR holders who are resident and, in the case of individuals, domiciled, for tax purposes in (and only in) the United Kingdom (except insofar as express reference is made to the treatment of non-UK residents), who hold their SSE Shares, MergeCo Shares and ADRs as an investment (other than in an individual savings account or pension arrangement) and who are the absolute beneficial owner of both their SSE Shares and MergeCo Shares and any dividends paid on them. In practice, HMRC will regard holders of ADRs as the beneficial owners of the ordinary shares represented by those ADRs, although case law has cast some doubt on this. The discussion below assumes that HMRC's position is followed. The tax position of certain categories of SSE Shareholders or SSE ADR holders who are subject to special rules (such as persons acquiring their SSE Shares, MergeCo Shares or ADRs in connection with employment, dealers in securities, insurance companies and collective investment schemes) is not considered.

**SSE Shareholders or SSE ADR holders who are in any doubt as to their tax position or who may be subject to tax in a jurisdiction other than the United Kingdom are strongly recommended to consult their own professional advisers.**

### *Demerger*

#### *Income*

SSE has received clearance under section 1091 of the Corporation Tax Act 2010 (**CTA 2010**) confirming that the distribution of the entire issued share capital of MergeCo to the SSE Shareholders will qualify as an “exempt distribution” within the meaning of section 1075 CTA 2010.

As a result, a SSE Shareholder who is resident in the United Kingdom for UK tax purposes should not incur any liability to tax on income in respect of the receipt of their MergeCo Shares.

#### *Chargeable gains*

SSE Shareholders who are resident in the United Kingdom for UK tax purposes should not be treated, by virtue of the receipt of MergeCo Shares under the Demerger, as making a disposal or part disposal of their SSE Shares for the purposes of the taxation of chargeable gains.

The MergeCo Shares distributed to SSE Shareholders pursuant to the Demerger should be treated as the same asset, and as having been acquired at the same time, as the SSE Shares already held by SSE Shareholders. The aggregate base cost of the SSE Shares and MergeCo Shares immediately after the Demerger should be the same as the base cost of the SSE Shares immediately before the Demerger. Such base cost should be apportioned between the SSE Shares and the MergeCo Shares by reference to their respective market values on the first day on which the market values or prices are quoted or published for such shares.

SSE Shareholders who hold more than five per cent. of the SSE Shares should note that clearance has been obtained from HMRC that section 137(1) of the Taxation of Chargeable Gains Act 1992 should not have effect in respect of the Demerger.

#### *Stamp duty and stamp duty reserve tax*

No stamp duty or stamp duty reserve tax should be incurred by the SSE Shareholders as a result of the distribution to them of the MergeCo Shares pursuant to the Demerger. This statement does not relate to persons such as dealers, intermediaries and persons connected with depositary arrangements and clearance services to whom special rules apply.

### *Receipt of cash from the sale of MergeCo Shares*

MergeCo Shares issued to certain SSE Shareholders pursuant to the Demerger, including SSE Shareholders that hold Ineligible Shares and SSE ADRs, will be sold, and net proceeds from the sales will be distributed to the relevant SSE Shareholders (see “Overseas Shareholders” and “ADR Holders” in Part IV (*Summary of the Principal Terms and Conditions of the Transaction*)). Such SSE Shareholders will be treated as having received

and disposed of the MergeCo Shares sold. See “*Taxation of disposals*” and “*Stamp Duty and Stamp Duty Reserve Tax (SDRT)*” below for a description of the consequences of a disposal of the MergeCo Shares.

### ***Ownership of the MergeCo Shares***

#### ***(a) Taxation of dividends***

MergeCo is not required to withhold tax when paying a dividend. Liability to tax on dividends will depend upon the individual circumstances of a SSE Shareholder.

##### ***(i) UK resident individual SSE Shareholders***

Under current UK tax rules specific rates of tax apply to dividend income. These include a nil rate of tax (the nil rate band) for the first £2,000 of dividend income in any tax year and different rates of tax for dividend income that exceeds the nil rate band. No tax credit attaches to dividend income. For these purposes “dividend income” includes UK and non UK source dividends and certain other distributions in respect of shares.

An individual SSE Shareholder who is resident for tax purposes in the UK and who receives a dividend from MergeCo will not be liable to UK tax on the dividend to the extent that (taking account of any other dividend income received by the SSE Shareholder in the same tax year) that dividend falls within the nil rate band.

To the extent that (taking account of any other dividend income received by the SSE Shareholder in the same tax year) the dividend exceeds the nil rate band, it will be subject to income tax at 7.5 per cent. to the extent that it falls below the threshold for higher rate income tax. To the extent that (taking account of other dividend income received in the same tax year) it falls above the threshold for higher rate income tax then the dividend will be taxed at 32.5 per cent. to the extent that it is within the higher rate band, or 38.1 per cent. to the extent that it is within the additional rate band. For the purposes of determining which of the taxable bands dividend income falls into, dividend income is treated as the highest part of a SSE Shareholder’s income. In addition, dividends within the nil rate band which would (if there was no nil rate band) have fallen within the basic or higher rate bands will use up those bands respectively for the purposes of determining whether the threshold for higher rate or additional rate income tax is exceeded.

##### ***(ii) UK resident corporate SSE Shareholders***

It is likely that most dividends paid on the MergeCo Shares to UK resident corporate shareholders would fall within one or more of the classes of dividend qualifying for exemption from corporation tax. However, it should be noted that the exemptions are not comprehensive and are also subject to anti-avoidance rules.

##### ***(iii) UK resident exempt SSE Shareholders***

UK resident SSE Shareholders who are not liable to UK tax on dividends, including exempt pension funds and charities, are not entitled to any tax credit in respect of dividends paid by MergeCo.

##### ***(iv) Non-UK resident SSE Shareholders***

No tax credit will attach to any dividend paid by MergeCo. A SSE Shareholder resident outside the UK may also be subject to non-UK taxation on dividend income under local law. A SSE Shareholder who is resident outside the UK for tax purposes should consult his or her own tax adviser concerning his or her tax position on dividends received from MergeCo.

#### ***(b) Taxation of disposals***

A disposal or deemed disposal of MergeCo Shares by a SSE Shareholder who is resident in the UK for tax purposes may, depending upon the SSE Shareholder’s circumstances and subject to any available exemption or relief (such as the annual exempt amount for individuals), give rise to a chargeable gain or an allowable loss for the purposes of UK taxation of capital gains. For discussion of SSE Shareholders’ base cost in MergeCo Shares immediately after the Demerger, see above in relation to the chargeable gains consequences of the Demerger.

SSE Shareholders who are not resident in the UK will not generally be subject to UK taxation of capital gains on the disposal or deemed disposal of MergeCo Shares unless they are carrying on a trade, profession or vocation in the UK through a branch or agency (or, in the case of a corporate SSE Shareholder, a permanent establishment) in connection with which the MergeCo Shares are used, held or acquired. Non-UK tax resident SSE Shareholders may be subject to non-UK taxation on any gain under local law.

An individual SSE Shareholder who has been resident for tax purposes in the UK but who ceases to be so resident or becomes treated as resident outside the UK for the purposes of a double tax treaty (***Treaty non-resident***) for a period of five years or less and who disposes of all or part of his or her MergeCo Shares during that period may be liable to capital gains tax on his or her return to the UK, subject to any available exemptions or reliefs.

*(c) Stamp Duty and Stamp Duty Reserve Tax (SDRT)*

*(i) Subsequent transfers of MergeCo Shares*

Stamp duty at the rate of 0.5 per cent. (rounded up to the next multiple of £5) of the amount or value of the consideration given is generally payable on an instrument transferring MergeCo Shares. A charge to SDRT will also arise on an unconditional agreement to transfer MergeCo Shares (at the rate of 0.5 per cent. of the amount or value of the consideration payable). However, if within six years of the date of the agreement becoming unconditional an instrument of transfer is executed pursuant to the agreement, and stamp duty is paid on that instrument, any SDRT already paid will be refunded (generally, but not necessarily, with interest) provided that a claim for repayment is made, and any outstanding liability to SDRT will be cancelled. The liability to pay stamp duty or SDRT is generally satisfied by the purchaser or transferee. An exemption from stamp duty is available on an instrument transferring MergeCo Shares where the amount or value of the consideration is £1,000 or less, and it is certified on the instrument that the transaction effected by the instrument does not form part of a larger transaction or series of transactions for which the aggregate consideration exceeds £1,000.

*(ii) MergeCo Shares transferred through paperless means including CREST*

Paperless transfers of MergeCo Shares, such as those occurring within CREST, are generally liable to SDRT, rather than stamp duty, at the rate of 0.5 per cent. of the amount or value of the consideration. CREST is obliged to collect SDRT on relevant transactions settled within the system. The charge is generally borne by the purchaser. Under the CREST system, no stamp duty or SDRT will arise on a transfer of MergeCo Shares into the system unless such a transfer is made for a consideration in money or money's worth, in which case a liability to SDRT (usually at a rate of 0.5 per cent.) will arise.

*(iii) MergeCo Shares held through Clearance Systems or Depositary Receipt Arrangements*

Special rules apply where MergeCo Shares are issued or transferred to, or to a nominee or agent for, either a person whose business is or includes issuing depositary receipts or a person providing a clearance service, under which SDRT or stamp duty may be charged at a rate of 1.5 per cent., with subsequent transfers within the clearance service or transfers of depositary receipts then being free from SDRT or stamp duty. HMRC accept that this charge is in breach of EU law so far as it applies to new issues of shares or transfers that are an integral part of a share issue, and it was confirmed in the Autumn 2017 Budget that the Government intend to continue this approach following Brexit. HMRC's published view is that the 1.5 per cent. SDRT or stamp duty charge continues to apply to other transfers of shares into a clearance service or depositary receipt arrangement, although this has been disputed. Further litigation indicates that certain transfers of legal title to clearance services in connection with listing, but not integral to a new issue, are also not chargeable. **In view of the continuing uncertainty, specific professional advice should be sought before incurring a 1.5 per cent. stamp duty or stamp duty reserve tax charge in any circumstances.**

**The statements in this paragraph (c) apply to any holders of MergeCo Shares irrespective of their residence, summarise the current position and are intended as a general guide only. Special rules apply to agreements made by, amongst others, intermediaries.**

*(d) Inheritance Tax*

The MergeCo Shares will be assets situated in the UK for the purposes of UK inheritance tax. A gift of such assets by, or the death of, an individual holder of such assets may (subject to certain exemptions and reliefs) give rise to a liability to UK inheritance tax even if the holder is neither domiciled in the UK nor deemed to be domiciled there under certain rules relating to long residence or previous domicile. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and particular rules apply to gifts where the donor reserves or retains some benefit.

Special rules also apply to close companies and to trustees of settlements who hold MergeCo Shares, bringing them within the charge to inheritance tax. SSE Shareholders should consult an appropriate tax adviser if they make a gift or transfer at less than market value or intend to hold any MergeCo Shares through trust arrangements.

## Certain United States Federal Income Tax Considerations

The following discussion is a summary of certain US federal income tax considerations under present law of the receipt of the MergeCo Shares under the Demerger and the ownership and disposition of MergeCo Shares, in each case, by a US Holder (as defined below). This summary deals only with US Holders receiving MergeCo Shares under the Demerger (or receiving cash proceeds from the sale of MergeCo Shares) that use the US dollar as their functional currency and that hold SSE Shares or ADRs, and will hold MergeCo Shares received under the Demerger, as capital assets. The following discussion is a general summary; it is not a substitute for tax advice.

This summary does not address tax considerations applicable to US Holders subject to special rules, such as banks or other financial institutions, insurance companies, tax exempt entities, dealers, traders in securities that elect to mark to market, regulated investment companies, real estate investment trusts, US expatriates, persons that that will own immediately after the Demerger directly, indirectly or constructively five per cent. or more by vote or value of MergeCo's equity interests, persons holding their SSE Shares, ADRs or MergeCo Shares as part of a hedge, straddle, conversion, constructive sale or other integrated transaction or who received their SSE Shares or ADRs as remuneration for services. It also does not address US federal taxes other than the income tax (such as the alternative minimum tax and estate or gift taxes) or US state and local, or non US tax considerations.

As used in this summary, **US Holder** means a beneficial owner of SSE Shares or ADRs and, following the Demerger, MergeCo Shares that is, for US federal income tax purposes, (i) a citizen or individual resident of the United States, (ii) a corporation or entity treated as such created or organised under the laws of the United States, any State thereof, or the District of Columbia, (iii) a trust subject to the control of a US person and the primary supervision of a US court or (iv) an estate the income of which is subject to US federal income tax without regard to its source.

The tax consequences to a partner in a partnership (or other entity treated as a partnership for US federal income tax purposes) receiving, holding or disposing of MergeCo Shares generally will depend on the status of the partner and the activities of the partnership. Partnerships holding SSE Shares or ADRs should consult their own tax advisers about the US federal income tax consequences to their partners of receiving MergeCo Shares under the Demerger and of owning and disposing of MergeCo Shares.

US Holders of the ADRs generally will be treated for US federal income tax purposes as owners of the SSE Shares represented by the ADRs.

MergeCo believes that neither it, nor SSE will be a passive foreign investment company (**PFIC**) for the current year, and this discussion assumes that MergeCo will not be a PFIC in the current year or future years.

### *The Receipt of MergeCo Shares under the Demerger*

SSE believes that the distribution of MergeCo Shares under the Demerger should qualify as a reorganization within the meaning of Sections 368(a)(1)(D) and 355 of the US Internal Revenue Code of 1986, as amended (the **Revenue Code**) and as a tax-free distribution under Section 355 of the Revenue Code. Assuming the distribution of MergeCo Shares under the Demerger so qualifies, a US Holder receiving MergeCo Shares (i) should not recognise any income, gain or loss upon the receipt of MergeCo Shares, (ii) should apportion its adjusted tax basis in its SSE Shares or ADRs between such SSE Shares or ADRs and the MergeCo Shares received under the Demerger in proportion to the relative fair market value of the SSE Shares or ADRs and the MergeCo Shares on the date that includes the Demerger Effective Time, and (iii) should have a holding period for the MergeCo Shares that includes the period during which the US Holder held the SSE Shares or ADRs in respect of which the distribution is made. A US Holder that acquired SSE Shares or ADRs at different times and at different prices will be required to calculate a separate tax basis and holding period for each block of SSE Shares or ADRs and then allocate that basis separately to the corresponding number of MergeCo Shares received under the Demerger. US federal income tax laws do not specifically identify how to determine the fair market values of the SSE Shares or ADRs and the MergeCo Shares. However, one approach is to use the average of the high and low trading prices for the SSE Shares and the MergeCo Shares on the first trading day after the Demerger Effective Time.

Neither MergeCo nor SSE has either requested or received an opinion of US federal income tax counsel that the Demerger qualifies under Section 355 and no ruling has been sought or obtained from the US Internal Revenue Service (**IRS**). Accordingly, there can be no assurance the IRS will not take a position that the Demerger does not qualify as a tax-free distribution under Section 355 of the Revenue Code, or that such position would not be sustained if challenged. If such a position were taken and were sustained, then US

Holders generally would be required to treat the receipt of MergeCo Shares pursuant to the Demerger as a dividend in a US dollar amount equal to the fair market value of the MergeCo Shares received on the date of receipt, would take tax basis in the MergeCo Shares equal to the US dollar amount included in income as a dividend and would have a holding period in the MergeCo Shares that begins on the day after the Demerger Effective Time. The dividend generally would be treated as from sources outside the United States for foreign tax credit purposes. Any amount included as a dividend would be taxed at the preferential rates applicable to qualified dividend income provided that SSE qualifies for the benefits of the income tax treaty between the United States and the United Kingdom (the *US-UK Treaty*), which SSE believes it does, and such amount were treated as a dividend paid on SSE Shares or ADRs that have been held by such US Holder for at least 61 days during the 121 day period beginning 60 days before the Demerger Record Time.

### ***Receipt of Cash from the Sale of MergeCo Shares***

MergeCo Shares issued to certain US Holders pursuant to the Demerger, including US Holders that hold Ineligible Shares and ADRs, will be sold, and net proceeds from the sales will be distributed to the relevant US Holders (see “Overseas Shareholders” and “ADR Holders” in Part IV (*Summary of the Principal Terms and Conditions of the Transaction*)). Such US Holders will be treated as having received and disposed of the MergeCo Shares sold. See “Sale or Other Disposition of the MergeCo Shares” below for a description of the consequences of a disposition of the MergeCo Shares.

### ***Ownership of the MergeCo Shares***

#### ***Distributions on the MergeCo Shares***

The gross amount of any distribution of cash or property with respect to the MergeCo Shares (other than certain distributions, if any, of the MergeCo Shares distributed pro rata to all shareholders) generally will be included in a US Holder’s gross income as ordinary income to the extent of MergeCo’s current and accumulated earnings and profits as determined under US federal income tax laws. MergeCo does not expect to maintain calculations of its earnings and profits for US federal income tax purposes. Therefore, a US Holder should expect that such distribution will generally be treated as a dividend from foreign sources when received. The dividends will not be eligible for the dividends-received deduction generally available to US corporations.

Dividends received by eligible non-corporate US Holders should be taxed at the preferential rates applicable to qualified dividend income provided that MergeCo qualifies for the benefits of the US-UK Treaty, which MergeCo believes it will, and such dividend is paid on the MergeCo Shares that have been held by such US holder for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date.

Dividends paid in pounds sterling will be included in income in a US dollar amount based on the exchange rate in effect on the date of receipt, whether or not the pounds sterling are converted into US dollars at that time. A US Holder’s tax basis in the pounds sterling will equal the US dollar amount included in income. Any currency gain or loss realised on a subsequent conversion or other disposition of the pounds sterling for a different US dollar amount generally will be US source ordinary income or loss. If dividends paid in pounds sterling are converted into US dollars on the day they are received, a US Holder generally will not be required to recognise currency gain or loss in respect of the dividend income.

Dividends received by certain non-corporate US Holders will generally be includible in net investment income for purposes of the Medicare contribution tax on net investment income.

#### ***Sale or Other Disposition of the MergeCo Shares***

A US Holder generally will recognise capital gain or loss on the sale or other disposition of MergeCo Shares equal to the difference between the US dollar value of the amount realised and the US Holder’s tax basis in the MergeCo Shares. Any gain or loss generally will be treated as arising from US sources. The gain or loss will be long term capital gain or loss if the US Holder’s holding period exceeds one year. Any loss will also be long term to the extent the US Holder previously received qualified dividends in excess of ten per cent. of the US Holder’s adjusted tax basis in the MergeCo Shares. Long term capital gains of non-corporate US Holders are subject to preferential tax rates. Deductions for capital loss are subject to significant limitations.

As described above, if the Demerger qualifies as a tax-free distribution under Section 355 of the Revenue Code, a US Holder’s initial tax basis in the MergeCo Shares will be determined by apportioning such US Holder’s tax basis in its SSE Shares or ADRs between such SSE Shares or ADRs and the MergeCo Shares received under the Demerger in proportion to the relative fair market value of the SSE Shares or ADRs and the

MergeCo Shares on the date on which the MergeCo Shares are issued. A US Holder's holding period for the MergeCo Shares will include the period during which the US Holder held its SSE Shares or ADRs.

A US Holder that receives pounds sterling on the sale or other disposition of MergeCo Shares will realise an amount equal to the US dollar value of the pounds sterling at the spot rate of exchange on the date of sale or other disposition (or, if the MergeCo Shares are traded on an established securities market, in the case of a cash basis or electing accrual basis US Holder, the settlement date). A US Holder will recognise currency gain or loss if the US dollar value of the pounds sterling received at the spot rate of exchange on the settlement date differs from the amount realised. A US Holder will have a tax basis in the pounds sterling received equal to its US dollar value at the spot rate on the settlement date. Any currency gain or loss realised on the settlement date or on a subsequent conversion of the pounds sterling into US dollars will be US source ordinary income or loss.

Capital gains from the sale or other disposition of the MergeCo Shares received by certain non-corporate US Holders will generally be includible in net investment income for purposes of the Medicare contribution tax.

#### *Backup Withholding and Information Reporting*

Dividends on MergeCo Shares and proceeds from the sale or other disposition of MergeCo Shares may be reported to the IRS unless the holder establishes a basis for exemption. Backup withholding tax may apply to amounts subject to reporting. Any amount withheld may be credited against the holder's US federal income tax liability subject to certain rules and limitations. US Holders should consult with their own tax advisers regarding the application of the US information reporting and backup withholding rules.

Certain non-corporate US Holders are required to report information with respect to investments in MergeCo Shares not held through an account with a domestic financial institution. US Holders that fail to report required information could become subject to substantial penalties. SSE Shareholders are encouraged to consult with their own tax advisers about these and any other reporting obligations arising from their ownership of MergeCo Shares.

**THE DISCUSSION ABOVE IS A GENERAL SUMMARY. IT DOES NOT COVER ALL TAX MATTERS THAT MAY BE OF IMPORTANCE TO A PARTICULAR INVESTOR. EACH PROSPECTIVE INVESTOR IS URGED TO CONSULT ITS OWN TAX ADVISER ABOUT THE TAX CONSEQUENCES TO IT OF THE DEMERGER, THE RECEIPT OF MERGECO SHARES UNDER THE DEMERGER, AND THE OWNERSHIP AND DISPOSITION OF THE MERGECO SHARES IN LIGHT OF THE INVESTOR'S OWN CIRCUMSTANCES.**



## **PART IX UNAUDITED PRO FORMA FINANCIAL INFORMATION FOR THE SSE RETAINED GROUP**

The unaudited pro forma financial information set out below has been prepared to illustrate the impact of the Demerger on the consolidated net assets of SSE plc as if the Demerger had taken place on 31 March 2018 and on the consolidated income statement of SSE plc as if the Demerger had taken place on 1 April 2017. The unaudited pro forma financial information has been prepared on the basis of, and should be read in conjunction with, the notes set out below.

The unaudited pro forma statement of net assets is based on the consolidated net assets of SSE plc at 31 March 2018 and has been prepared on the basis that the Demerger took place on 31 March 2018. The unaudited pro forma statement of net assets is compiled on the basis set out in the notes below and in accordance with the accounting policies of SSE plc for the year ending 31 March 2018.

The unaudited pro forma income statement is based on the consolidated profits of SSE plc for the year ended 31 March 2018 on the basis that the Demerger took place on 1 April 2017. The unaudited pro forma income statement is compiled on the basis set out in the notes below and in accordance with the accounting policies of SSE plc for the year ending 31 March 2018.

Because of its nature the unaudited pro forma information addresses a hypothetical situation and does not, therefore, represent SSE's actual financial position or results. It may not, therefore give a true picture of SSE's financial position or results nor is it indicative of the results that may, or may not, be expected to be achieved in the future. The pro forma information has been prepared for illustrative purposes only.

**Unaudited pro forma statement of net assets of SSE plc as at 31 March 2018**

	Consolidated net assets of SSE plc at 31 March 2018	SSE Energy Services at 31 March 2018	Disposal Adjustments	Tax Impact of Disposal Adjustments	Pro forma
	Note 1	Note 2	Note 3	Note 4	Note 5
	£m	£m	£m	£m	£m
<b>Assets</b>					
Property, plant and equipment . . . . .	13,121.7	(144.9)	(34.1)	—	12,942.7
Goodwill and other intangible assets	707.7	(623.6)	—	—	84.1
Equity investments in JVs and associates . . . . .	977.0	—	—	—	977.0
Loans to joint ventures and associates . . . . .	781.0	—	—	—	781.0
Other investments . . . . .	4.8	—	—	—	4.8
Deferred tax assets . . . . .	294.7	(4.0)	—	9.7	300.4
Derivative financial assets . . . . .	336.4	(9.1)	—	—	327.3
Retirement benefit assets . . . . .	572.1	—	—	—	572.1
<b>Non-current assets</b> . . . . .	<b>16,795.4</b>	<b>(781.6)</b>	<b>(34.1)</b>	<b>9.7</b>	<b>15,989.4</b>
Intangible assets . . . . .	712.5	—	—	—	712.5
Inventories . . . . .	225.9	(1.0)	—	—	224.9
Trade and other receivables . . . . .	4,071.7	(1,119.5)	—	—	2,952.2
Cash and cash equivalents . . . . .	232.2	(80.6)	(88.2)	—	63.4
Derivative financial assets . . . . .	1,060.1	(60.9)	—	—	999.2
Current assets held for sale . . . . .	117.2	—	—	—	117.2
<b>Current Assets</b> . . . . .	<b>6,419.6</b>	<b>(1,262.0)</b>	<b>(88.2)</b>	<b>—</b>	<b>5,069.4</b>
<b>Total assets</b> . . . . .	<b>23,215.0</b>	<b>(2,043.6)</b>	<b>(122.3)</b>	<b>9.7</b>	<b>21,058.8</b>
<b>Liabilities</b>					
Loans and other borrowings . . . . .	650.3	—	—	—	650.3
Trade and other payables . . . . .	4,977.6	(1,408.7)	—	—	3,568.9
Current tax liabilities . . . . .	117.9	(55.2)	—	—	62.7
Provisions . . . . .	20.6	—	—	—	20.6
Derivative financial liabilities . . . . .	1,253.1	(46.1)	57.2	—	1,264.2
<b>Current liabilities</b> . . . . .	<b>7,019.5</b>	<b>(1,510.0)</b>	<b>57.2</b>	<b>—</b>	<b>5,566.7</b>
Loans and other borrowings . . . . .	7,960.2	—	—	—	7,960.2
Deferred tax liabilities . . . . .	1,002.8	(21.5)	—	—	981.3
Trade and other payables . . . . .	385.3	—	—	—	385.3
Provisions . . . . .	812.5	(5.1)	—	—	807.4
Retirement benefit obligations . . . . .	237.6	—	—	—	237.6
Derivative financial liabilities . . . . .	566.9	(13.3)	—	—	553.6
<b>Non-current liabilities</b> . . . . .	<b>10,965.3</b>	<b>(39.9)</b>	<b>—</b>	<b>—</b>	<b>10,925.4</b>
<b>Total liabilities</b> . . . . .	<b>17,984.8</b>	<b>(1,549.9)</b>	<b>57.2</b>	<b>—</b>	<b>16,492.1</b>
<b>Net assets</b> . . . . .	<b>5,230.2</b>	<b>(493.7)</b>	<b>(179.5)</b>	<b>9.7</b>	<b>4,566.7</b>

Notes

- (1) The assets and liabilities of SSE plc at 31 March 2018 have been extracted without material adjustment from SSE's 2018 Annual Report and Accounts.
- (2) The adjustment in Note 2 represents the assets and liabilities of SSE Energy Services at 31 March 2018 extracted without material adjustment from Part A of Part XI (*Historical Financial Information*) of this Circular.
- (3) Disposal adjustments in relation to the Transaction comprise (i) adjustment to property, plant and equipment representing total estimated Impairment costs in relation to three properties which will form part of the MergeCo Group's assets (ii) reduction to cash representing estimated transaction costs not yet incurred of £88.2 million (transaction costs are subject to a number of variables including timing of Completion, and the actual total costs incurred by SSE related to the Transaction may therefore differ) (iii) increase in derivative financial liabilities representing total estimated IAS deconsolidation charges of £57.2 million in relation to derivatives currently consolidated at a group level.
- (4) An adjustment of £9.7 million in relation to derivative financial liabilities has also been presented as an increase to deferred tax assets, based on the applicable rate of deferred tax of 17 per cent.
- (5) No adjustment has been made to reflect the consolidated trading results of SSE plc or SSE Energy Services since 31 March 2018 or of any other change in their financial positions in that period.

# Unaudited pro forma income statement of SSE plc for the year ended 31 March 2018

	SSE PLC 12 months to 31 March 2018	SSE Energy Services 12 months to 31 March 2018	Disposal adjustments	Tax impact of disposal adjustments	Pro forma
	Note 1	Note 2	Note 3	Note 4	Note 5
	£m	£m	£m	£m	£m
<b>Revenue</b> . . . . .	<b>31,226.4</b>	<b>(3,984.4)</b>	—	—	<b>27,242.0</b>
Cost of sales . . . . .	(28,043.4)	3,232.9	(78.6)	—	(24,889.1)
<b>Gross profit</b> . . . . .	<b>3,183.0</b>	<b>(751.5)</b>	<b>(78.6)</b>	—	<b>2,352.9</b>
Operating Costs . . . . .	(1,988.0)	471.8	(122.3)	—	(1,638.5)
Operating Income . . . . .	38.0	—	—	—	38.0
<b>Operating profit before JVs and associates</b> . . . . .	<b>1,233.0</b>	<b>(279.7)</b>	<b>(200.9)</b>	—	<b>752.4</b>
Share of profit on JVs and associates	146.2	—	—	—	146.2
<b>Operating profit</b> . . . . .	<b>1,379.2</b>	<b>(279.7)</b>	<b>(200.9)</b>	—	<b>898.6</b>
Finance income . . . . .	102.1	—	—	—	102.1
Finance costs . . . . .	(395.1)	—	—	—	(395.1)
<b>Profit/(loss) before taxation</b> . . . . .	<b>1,086.2</b>	<b>(279.7)</b>	<b>(200.9)</b>	—	<b>605.6</b>
Taxation . . . . .	(166.1)	49.1	—	13.3	(103.7)
<b>Profit/(loss) for the year</b> . . . . .	<b>920.1</b>	<b>(230.6)</b>	<b>(200.9)</b>	<b>13.3</b>	<b>501.9</b>

## Notes

- (1) The profit on ordinary activities after taxation of SSE plc for the 12 months to 31 March 2018 has been extracted without material adjustment from SSE's 2018 Annual Report and Accounts.
- (2) The adjustment in Note 2 represents the income and expenses of SSE Energy Services for the 12 months to 31 March 2018 extracted without material adjustment from Part A of Part XI (*Historical Financial Information*) of this Circular.
- (3) Disposal adjustments in relation to the Transaction comprise (i) adjustment to cost of sales relating to total estimated IAS deconsolidation charges of £78.6 million arising in relation to derivatives currently consolidated at a Group level (ii) adjustment to operating costs of £122.3 million comprising:
  - total estimated transaction costs still to be incurred of £88.2 million (transaction costs are subject to a number of variables including timing of Completion, and the actual total costs incurred by SSE related to the Transaction may therefore differ); and
  - impairment costs of £34.1 million in relation to three properties which will form part of the MergeCo Group's assets will crystallise as a result of the Transaction.
- (4) The adjustment in Note 4 represents the deferred tax impact of the disposal adjustments in Note 3 based on the applicable rate of deferred tax for SSE plc of 17.0 per cent.
- (5) No adjustment has been made to reflect the consolidated trading results of SSE plc or SSE Energy Services since 31 March 2018 or of any other change in their financial positions in that period.

## **PART X UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE MERGECO GROUP**

The unaudited pro forma financial information set out below has been prepared to illustrate the impact of the Transaction on the consolidated net assets of MergeCo as if the Transaction had taken place on 31 March 2018 and on the consolidated income statement of MergeCo as if the Transaction had taken place on 1 April 2017. The unaudited pro forma financial information has been prepared on the basis of, and should be read in conjunction with, the notes set out below.

The unaudited pro forma statement of net assets is based on the assumption that MergeCo had nil balances at 31 March 2018 and has been prepared on the basis that the Transaction took place on 31 March 2018. The unaudited pro forma statement of net assets is compiled on the basis set out in the notes below and in accordance with the accounting policies of SSE Energy Services for the year ending 31 March 2018.

The unaudited pro forma statement of income statement is based on the assumption that MergeCo had consolidated profits/losses of nil pounds sterling for the year ended 31 March 2018 and has been prepared on the basis that the Transaction took place on 1 April 2017. The unaudited pro forma income statement is compiled on the basis set out in the notes below and in accordance with the accounting policies of SSE Energy Services for the year ending 31 March 2018.

Because of its nature the unaudited pro forma financial information addresses a hypothetical situation and does not, therefore, represent MergeCo's actual financial position or results. The pro forma net asset statement does not currently take into account the effect of financing arrangements, pension adjustments or certain other combination adjustments on financial position as these are currently uncertain. It may not, therefore give a true picture of MergeCo's financial position or results nor is it indicative of the results that may, or may not, be expected to be achieved in the future. The pro forma information has been prepared for illustrative purposes only.

# Unaudited pro forma statement of net assets of MergeCo as at 31 March 2018

	SSE Energy Services as at 31 March 2018	npower as at 31 December 2017	Accounting policy alignment	Tax impact of accounting policy alignment	Pro forma
	Note 1	Note 2	Notes 3	Notes 4 and 5	Notes 6 and 7
	£m	£m	£m	£m	£m
<b>Assets</b>					
Property, plant and equipment . . . . .	144.9	22.5	—	—	167.4
Goodwill and other intangible assets . . .	623.6	763.0	55.8	—	1,442.4
Deferred tax assets . . . . .	4.0	108.3	—	—	112.3
Derivative financial assets . . . . .	9.1	41.5	—	—	50.6
Available for sale financial assets . . . .	—	5.1	—	—	5.1
<b>Non-current assets</b> . . . . .	<b>781.6</b>	<b>940.4</b>	<b>55.8</b>	<b>—</b>	<b>1,777.8</b>
Intangibles . . . . .	—	—	285.2	—	285.2
Inventories . . . . .	1.0	3.1	—	—	4.1
Trade and other receivables . . . . .	1,119.5	1,703.3	(285.2)	—	2,537.6
Current tax assets . . . . .	—	5.8	—	(4.4)	1.4
Cash and cash equivalents . . . . .	80.6	3.6	—	—	84.2
Derivative financial assets . . . . .	60.9	89.2	—	—	150.1
<b>Current assets</b> . . . . .	<b>1,262.0</b>	<b>1,805.0</b>	<b>—</b>	<b>—</b>	<b>3,062.6</b>
<b>Total assets</b> . . . . .	<b>2,043.6</b>	<b>2,745.4</b>	<b>55.8</b>	<b>(4.4)</b>	<b>4,840.4</b>
<b>Liabilities</b>					
Loans and other borrowings . . . . .	—	787.7	—	—	787.7
Trade and other payables . . . . .	1,408.7	1,821.0	—	—	3,229.7
Current tax liabilities . . . . .	55.2	—	—	—	55.2
Provisions for liabilities and charges . . .	—	23.3	—	—	23.3
Derivative financial liabilities . . . . .	46.1	65.5	—	—	111.6
<b>Current liabilities</b> . . . . .	<b>1,510.0</b>	<b>2,697.5</b>	<b>—</b>	<b>—</b>	<b>4,207.5</b>
Deferred tax liabilities . . . . .	21.5	9.5	—	—	31.0
Provisions for liabilities and charges . . .	5.1	2.3	—	—	7.4
Retirement benefit obligations . . . . .	—	16.1	—	—	16.1
Derivative financial liabilities . . . . .	13.3	11.1	—	—	24.4
<b>Non-current liabilities</b> . . . . .	<b>39.9</b>	<b>39.0</b>	<b>—</b>	<b>—</b>	<b>78.9</b>
<b>Total liabilities</b> . . . . .	<b>1,549.9</b>	<b>2,736.5</b>	<b>—</b>	<b>—</b>	<b>4,286.4</b>
<b>Net assets</b> . . . . .	<b>493.7</b>	<b>8.9</b>	<b>55.8</b>	<b>(4.4)</b>	<b>554.0</b>

## Notes

- (1) The adjustment in Note 1 represents the assets and liabilities of SSE Energy Services at 31 March 2018 extracted without material adjustment from Part A of Part XI (*Historical Financial Information*) of this Circular.
- (2) The adjustment in Note 2 represents the assets and liabilities of npower at 31 December 2017 extracted without material adjustment from Part B of Part XI (*Historical Financial Information*) of this Circular.
- (3) The adjustment in Note 3 represents adjustments to align npower's accounting policies with SSE Energy Services' accounting policies. The identified differences are in relation to (i) the treatment of certain costs relating to the smart meter infrastructure programme, which are capitalised by SSE Energy Services, but expensed by npower, and (ii) the presentation of Renewable Obligation Certificates ('ROCS'), which SSE Energy Services present as Intangible Assets and npower present as Other Receivables. Final policies to be adopted by MergeCo will be selected by the MergeCo Board following appointment.
- (4) The adjustment in Note 4 represents the tax impact of the accounting policy alignment adjustments in Note 3 based on the applicable rate of corporation tax for npower of 19.25 per cent.
- (5) If the group were to adopt npower's accounting policies £86.6 million of costs relating to the smart meter infrastructure programme, which are currently capitalised by SSE Energy Services, would be expensed. SSE has estimated the tax benefit of this to be £16.5 million, based on the applicable rate of corporation tax for SSE Energy Services of 19.0 per cent.
- (6) No adjustment has been made to reflect goodwill or other purchase price adjustments which may arise on Completion of the Transaction. The nature and amount of any such adjustments will be determined based on the final value of the consideration and the fair value of the assets and liabilities of both entities at Completion of the Transaction.
- (7) No adjustment has been made to reflect the consolidated trading results of MergeCo and SSE Energy Services since 31 March 2018 and npower since 31 December 2017 or of any other change in their financial positions in that period.

# Unaudited pro forma income statement of MergeCo for the year ended 31 March 2018

	SSE Energy Services 12 months to 31 March 2018	npower 12 months to 31 December 2017	Accounting policy alignment	Tax impact of accounting policy alignment	Pro forma
	Note 1	Note 2	Notes 3	Notes 4 and 5	Notes 6 and 7
	£m	£m	£m	£m	£m
<b>Revenue</b> . . . . .	3,984.4	6,014.6	—	—	9,999.0
Cost of sales . . . . .	(3,232.9)	(5,261.9)	—	—	(8,494.8)
<b>Gross profit</b> . . . . .	<b>751.5</b>	<b>752.7</b>	<b>—</b>	<b>—</b>	<b>1,504.2</b>
Administrative expenses . . . . .	(471.8)	(799.6)	23.1	—	(1,248.3)
<b>Operating profit/(loss)</b> . . . . .	<b>279.7</b>	<b>(46.9)</b>	<b>23.1</b>	<b>—</b>	<b>255.9</b>
Finance income . . . . .	—	1.4	—	—	1.4
Finance costs . . . . .	—	(345.6)	—	—	(345.6)
<b>Profit/(loss) before taxation</b> . . . . .	<b>279.7</b>	<b>(391.1)</b>	<b>23.1</b>	<b>—</b>	<b>(88.3)</b>
Taxation . . . . .	(49.1)	19.3	—	(4.4)	(34.2)
<b>Profit/(loss) for the year</b> . . . . .	<b>230.6</b>	<b>(371.8)</b>	<b>23.1</b>	<b>(4.4)</b>	<b>(122.5)</b>

## Notes

- (1) The adjustment in Note 1 represents the income and expenses of SSE Energy Services for the 12 months to 31 March 2018 extracted without material adjustment from Part A of Part XI (*Historical Financial Information*) of this Circular.
- (2) The adjustment in Note 2 represents the income and expenses of npower for the 12 months to 31 December 2017 extracted without material adjustment from Part B of Part XI (*Historical Financial Information*) of this Circular. This includes a £272.8 million prepayment penalty expense resulting from a npower group reconstruction during 2017.
- (3) The adjustment in Note 3 represents adjustment to align npower's accounting policies with SSE Energy Services' accounting policies in relation to the treatment of certain costs relating to the smart meter infrastructure programme, which are capitalised by SSE Energy Services, but expensed by npower. Final policies to be adopted by MergeCo will be selected by the MergeCo Board following appointment.
- (4) The adjustment in Note 4 represents the tax impact of the accounting policy alignment based on the applicable rate of corporation tax of 19.25 per cent.
- (5) If the group were to adopt npower's accounting policies £32.2 million of smart DCC meter costs, which are currently capitalised by SSE Energy Services, would be expensed. SSE has estimated the tax benefit of this to be £6.1 million, based on the applicable rate of corporation tax of 19 per cent.
- (6) No adjustment has been made to reflect goodwill or other purchase price adjustments which may arise on Completion of the Transaction. The nature and amount of any such adjustments will be determined based on the final value of the consideration and the fair value of the assets and liabilities of both entities at Completion of the Transaction.
- (7) No adjustment has been made to reflect the consolidated trading results of MergeCo and SSE Energy Services since 31 March 2018 and npower since 31 December 2017 or of any other change in their financial positions in that period.

## **PART XI HISTORICAL FINANCIAL INFORMATION**

### **Part A SSE Energy Services carve out financials for the three financial years ended 31 March 2016, 2017 and 2018**

The Directors  
SSE plc  
Inveralmond House  
200 Dunkeld Road  
Perth PH1 3AQ

27 June 2018

Ladies and Gentlemen

#### **SSE plc**

We report on the combined and carved out financial information relating to SSE Energy Services for the three years ended 31 March 2016, 2017 and 2018 (“the Historical Financial Information”). The Historical Financial Information has been prepared for inclusion in the circular dated 27 June 2018 of SSE plc, relating to the proposed demerger of SSE Energy Services to ShiftMCo123 Ltd and combination with Npower Group Limited, on the basis of the accounting policies of SSE plc as set out in note 1. This report has been commissioned by the Directors of SSE plc pursuant to paragraph LR 13.3.1(3) of the Listing Rules and is given for the purpose of complying with that paragraph and for no other purpose.

#### **Responsibilities**

The Directors of SSE plc are responsible for preparing the Historical Financial Information on the basis of preparation set out in note 1.1 to the financial information.

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Save for any responsibility we may have to those persons to whom this report is addressed and which we may have to shareholders of the Company as a result of the inclusion of this report in the circular, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report.

#### **Basis of Opinion**

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of the significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity’s circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

#### **Opinion on financial information**

In our opinion, the Historical Financial Information gives, for the purposes of the circular dated 27 June 2018, a true and fair view of the state of affairs of SSE Energy Services as at 31 March 2016, 2017 and 2018, and of its profits, cash flows and changes in equity for the three years ended 31 March 2016, 2017 and 2018 in accordance with the basis of preparation set out in note 1.1.

Yours faithfully

KPMG LLP

**SSE Energy Services**  
**Combined and carved out income statement**  
**for the three years ended 31 March 2016, 31 March 2017 and 31 March 2018**

		Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements (Note 6)	Total	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements (Note 6)	Total	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements (Note 6)	Total
	Note	2016	2016	2016	2017	2017	2017	2018	2018	2018
		£m	£m	£m	£m	£m	£m	£m	£m	£m
Revenue . . . . .	3	4,140.4	—	4,140.4	3,939.0	—	3,939.0	3,984.4	—	3,984.4
Cost of sales . . . . .		(3,424.2)	(89.9)	(3,514.1)	(3,247.5)	166.8	(3,080.7)	(3,267.7)	34.8	(3,232.9)
<b>Gross profit . . . . .</b>		<b>716.2</b>	<b>(89.9)</b>	<b>626.3</b>	<b>691.5</b>	<b>166.8</b>	<b>858.3</b>	<b>716.7</b>	<b>34.8</b>	<b>751.5</b>
Administration costs . . . . .		(448.3)	(11.2)	(459.5)	(451.8)	(95.4)	(547.2)	(442.5)	(29.3)	(471.8)
<b>Operating profit . . . . .</b>	4	<b>267.9</b>	<b>(101.1)</b>	<b>166.8</b>	<b>239.7</b>	<b>71.4</b>	<b>311.1</b>	<b>274.2</b>	<b>5.5</b>	<b>279.7</b>
Finance income . . . . .		—	—	—	—	—	—	—	—	—
Finance costs . . . . .		—	—	—	—	—	—	—	—	—
<b>Profit before taxation . . . . .</b>		<b>267.9</b>	<b>(101.1)</b>	<b>166.8</b>	<b>239.7</b>	<b>71.4</b>	<b>311.1</b>	<b>274.2</b>	<b>5.5</b>	<b>279.7</b>
Taxation . . . . .	7	(47.8)	(16.4)	(31.4)	(45.6)	(11.0)	(56.6)	(47.4)	(1.7)	(49.1)
<b>Profit for the year . . . . .</b>		<b>220.1</b>	<b>(84.7)</b>	<b>135.4</b>	<b>194.1</b>	<b>60.4</b>	<b>254.5</b>	<b>226.8</b>	<b>3.8</b>	<b>230.6</b>



**SSE Energy Services**  
**Combined and carved out statement of other comprehensive income**  
**for the three years ended 31 March 2016, 31 March 2017 and 31 March 2018**

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Profit for the financial year</b> . . . . .	135.4	254.5	<b>230.6</b>
Other comprehensive income . . . . .	<u>—</u>	<u>—</u>	<u>—</u>
<b>Total comprehensive income for the year</b> . . . . .	<u><u>135.4</u></u>	<u><u>254.5</u></u>	<u><u>230.6</u></u>

**SSE Energy Services**  
**Combined and carved out balance sheet**  
**for the three years ended 31 March 2016, 31 March 2017 and 31 March 2018**

	<u>Note</u>	<u>2016</u> £m	<u>2017</u> £m	<u>2018</u> £m
<b>Assets</b>				
Property, plant & equipment . . . . .	8	149.3	173.9	144.9
Goodwill and other intangible assets . . . . .	9	468.1	542.9	623.6
Deferred tax assets . . . . .	17	39.8	7.8	4.0
Derivative financial assets . . . . .	15	15.9	14.4	9.1
<b>Non-current assets</b> . . . . .		<b><u>673.1</u></b>	<b><u>739.0</u></b>	<b><u>781.6</u></b>
Inventories . . . . .	11	0.3	0.7	1.0
Trade and other receivables . . . . .	12	981.0	930.3	1,119.5
Cash and cash equivalents . . . . .		79.8	69.1	80.6
Derivative financial assets . . . . .	15	99.8	46.0	60.9
Current assets held for sale . . . . .	14	27.9	—	—
<b>Current assets</b> . . . . .		<b><u>1,188.8</u></b>	<b><u>1,046.1</u></b>	<b><u>1,262.0</u></b>
<b>Total assets</b> . . . . .		<b><u>1,861.9</u></b>	<b><u>1,785.1</u></b>	<b><u>2,043.6</u></b>
<b>Liabilities</b>				
Trade and other payables . . . . .	13	1,466.1	1,345.8	1,408.7
Current tax liabilities . . . . .		47.6	27.4	55.2
Derivative financial liabilities . . . . .	15	241.5	67.7	46.1
<b>Current Liabilities</b> . . . . .		<b><u>1,755.2</u></b>	<b><u>1,440.9</u></b>	<b><u>1,510.0</u></b>
Deferred tax liabilities . . . . .	17	21.5	19.5	21.5
Provisions for liabilities and charges . . . . .	16	10.7	9.0	5.1
Derivative financial liabilities . . . . .	15	65.2	16.9	13.3
<b>Non-current Liabilities</b> . . . . .		<b><u>97.4</u></b>	<b><u>45.4</u></b>	<b><u>39.9</u></b>
<b>Total liabilities</b> . . . . .		<b><u>1,852.6</u></b>	<b><u>1,486.3</u></b>	<b><u>1,549.9</u></b>
<b>Net assets</b> . . . . .		<b><u>9.3</u></b>	<b><u>298.8</u></b>	<b><u>493.7</u></b>
<b>Equity attributable to owners</b>				
Invested capital attributable to equity owners . . . . .		9.3	298.8	493.7
<b>Total capital</b> . . . . .		<b>9.3</b>	<b>298.8</b>	<b>493.7</b>

**SSE Energy Services**  
**Combined and carved out statement of changes in equity**  
**for the three years ended 31 March 2016, 31 March 2017 and 31 March 2018**

	<u>Invested capital</u>
	<u>£m</u>
<b>Balance at 1 April 2015</b> . . . . .	(137.9)
Profit for the financial year . . . . .	135.4
Other comprehensive income . . . . .	—
Net transfers (to) / from SSE . . . . .	<u>11.8</u>
<b>Balance at 31 March 2016</b> . . . . .	<u><b>9.3</b></u>
<b>Balance at 1 April 2016</b> . . . . .	<u><b>9.3</b></u>
Profit for the financial year . . . . .	254.5
Other comprehensive income . . . . .	—
Net transfers (to) / from SSE . . . . .	<u>35.0</u>
<b>Balance at 31 March 2017</b> . . . . .	<u><b>298.8</b></u>
<b>Balance at 1 April 2017</b> . . . . .	<u><b>298.8</b></u>
Profit for the financial year . . . . .	230.6
Other comprehensive income . . . . .	—
Net transfers (to) / from SSE . . . . .	<u>(35.7)</u>
<b>Balance at 31 March 2018</b> . . . . .	<u><b>493.7</b></u>

**SSE Energy Services**  
**Combined and carved out cash flow statement**  
**for the three years ended 31 March 2016, 31 March 2017 and 31 March 2018**

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Operating profit</b> . . . . .	<b>166.8</b>	<b>311.1</b>	<b>279.7</b>
Movement on operating derivatives . . . . .	89.9	(166.8)	(34.8)
Depreciation, amortisation, write downs and impairments . . . . .	33.0	117.8	90.2
(Profit)/loss on disposal of assets and liabilities . . . . .	1.0	—	—
Release of provisions . . . . .	(0.3)	(0.5)	(6.0)
<b>Cash generated from operations before working capital movements</b> . . . . .	<b><u>290.4</u></b>	<b><u>261.6</u></b>	<b><u>329.1</u></b>
Decrease/(increase) in inventories . . . . .	3.6	(0.4)	(0.3)
Decrease/(increase) in receivables . . . . .	173.4	50.7	(189.2)
(Decrease)/increase in payables . . . . .	51.1	(120.3)	62.9
(Decrease)/increase in provisions . . . . .	(3.0)	(1.2)	2.1
<b>Cash generated from/(absorbed by) operations</b> . . . . .	<b><u>515.5</u></b>	<b><u>190.4</u></b>	<b><u>204.6</u></b>
Taxes paid . . . . .	(33.8)	(55.4)	(45.6)
<b>Net cash from operating activities</b> . . . . .	<b><u>481.7</u></b>	<b><u>135.0</u></b>	<b><u>159.0</u></b>
Purchase of property, plant and equipment . . . . .	(69.9)	(61.2)	(41.5)
Purchase of other intangible assets . . . . .	(125.9)	(171.6)	(99.8)
Proceeds from disposals . . . . .	—	43.5	—
<b>Net cash from investing activities</b> . . . . .	<b><u>(195.8)</u></b>	<b><u>(189.3)</u></b>	<b><u>(141.3)</u></b>
Net transfers (to)/from parent . . . . .	(277.7)	43.6	(6.2)
<b>Net cash from financing activities</b> . . . . .	<b><u>(277.7)</u></b>	<b><u>43.6</u></b>	<b><u>(6.2)</u></b>
<b>Net increase/(decrease) in cash and cash equivalents</b> . . . . .	<b><u>8.2</u></b>	<b><u>(10.7)</u></b>	<b><u>11.5</u></b>
Cash and cash equivalents at the start of the year . . . . .	71.6	79.8	69.1
Net increase/(decrease) in cash and cash equivalents . . . . .	8.2	(10.7)	11.5
<b>Cash and cash equivalents at the end of the year</b> . . . . .	<b><u>79.8</u></b>	<b><u>69.1</u></b>	<b><u>80.6</u></b>

## NOTES TO THE COMBINED AND CARVED OUT FINANCIAL INFORMATION

### 1 Basis of preparation and significant accounting policies

#### 1.1 Basis of preparation

Combined and carved out financial information relating to SSE's household energy supply and energy related services business in Great Britain ("SSE Energy Services") has been prepared by the directors of SSE plc ("Parent") for the purposes of presenting financial information of the businesses that are subject to the proposed demerger and combination with Innogy SE's subsidiary Npower Group Limited ("npower") to form a new independent UK incorporated company ("MergeCo") to be held by SSE shareholders (immediately following the Demerger) and with minority participation by innogy SE.

The combined and carved out financial information (the "HFI") has been prepared on a "carve out" basis from the Parent's consolidated financial information by combining the historical results, assets and liabilities attributable to the relevant operations of SSE Energy Services. The HFI has been prepared using the accounting policies adopted in the Parent's latest annual accounts. The accounting policies of MergeCo are yet to be determined and could differ from the accounting policies adopted within the HFI.

The separate legal entities and businesses carved out from other legal entities that constitute SSE Energy Services did not constitute a separate legal entity and did not have a common parent company other than their ultimate parent, SSE plc, during the periods presented in this HFI. The HFI includes the energy related services business specific legal entities as listed below:

- SSE Home Services Ltd
- SSE Energy Solutions Ltd
- SSE Metering Ltd

It also includes certain assets, liabilities, results and cash flows pertaining to the GB household energy supply business carved out from other SSE legal entities as listed below:

- SSE Energy Supply Ltd
- Southern Electric Gas Ltd
- SSE Services plc
- SSE plc

This basis of preparation describes how the HFI has been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations as adopted by the European Union as at 31 March 2018, except as described below.

IFRS as adopted by the European Union does not provide for the preparation of carve-out HFI, or for the specific accounting treatments set out below. Accordingly, in preparing the carve-out HFI, certain accounting conventions commonly used for the preparation of carve-out HFI for inclusion in investment circulars as described in the Annexure to SIR 2000 (Investment Reporting Standard applicable to public reporting engagements on historical financial information) issued by the UK Auditing Practices Board have been applied. The application of these conventions results in the following material departure from IFRS as adopted by the European Union; in all other respects, IFRS as adopted by the European Union has been applied and the financial information relating to SSE Energy Services has been prepared in a form that is consistent with the accounting policies adopted in the Parent's latest annual accounts.

- As explained above, the HFI is not prepared on a consolidated basis and therefore does not comply with the requirements of IFRS 10 "Consolidated Financial Statements". However, the HFI has been prepared on a combined and carved out basis applying the principles underlying the consolidations procedures of IFRS 10.
- The reporting entity is not a first time adopter of IFRS as SSE Energy Services has previously reported financial information to its parent prepared on the same basis as this financial information. In that financial information, IFRS 1 was applied by analogy. In particular, it applied the exemption for a subsidiary that becomes a first time adopter later than its Parent, and accordingly the assets and liabilities were measured at the carrying amounts that would be included in SSE plc's consolidated financial statements, based on the parent's date of transition to IFRSs.

- Invested capital attributable to equity owners represents a combination of intercompany balances created through the cash pooling arrangement, receivables and payables with Parent, funding balances with Parent and equity investment by Parent, except as explained below in respect of cash in transit and the liability for operating expenses procured from the Parent Group. This presentation reflects that historic debt and equity funding positions with the Parent—including those within the legal entities SSE Home Services Ltd, SSE Energy Solutions Ltd and SSE Metering Ltd—do not represent a debt and equity structure of an independent entity. This treatment of intercompany balances, including any interest charged thereon, represents a departure from IFRS.
- Goodwill in relation to the acquisition of the SWALEC electricity and gas supply business in 2000, has been included within the HFI and represents a departure from IFRS given the Parent (and not any entity within SSE Energy Services) acquired that business. Goodwill would not be present in the IFRS consolidated financial statements for SSE Energy Services given this fact pattern. Goodwill is being allocated to the carve out based on SIR 2000 guidance, on the basis that it is directly attributable to the Energy Services business.

### **Basis of carve-out**

The following principles have been applied in preparing the HFI:

- Any net funding requirements, equity investments or equity returns are charged or credited by way of intercompany transactions and is presented as invested capital attributable to equity owners. The balances created from transfers to and from Parent are recorded at a legal entity level and cannot be separately identified or allocated to the household energy and services business throughout the three years ended 31 March 2016, 2017 and 2018. Given the overall amount of future debt or equity financing, and the terms on which that financing is received, are yet to be agreed, the invested capital attributable to equity holders is unlikely to represent the future debt or equity position of SSE Energy Services as an independent entity.
- The legal entities within SSE Energy Services participate in a Parent Group-wide centralised treasury and cash pooling system. Under these arrangements, after receipt in each company bank account, these cash balances are remitted at the end of each working day into a central bank account. Trading balances are accrued and settled on the last working day of the month following the transactions, these include items such as corporate recharges or payment for tax related group relief are charged or credited by way of intercompany transactions. The liability for operating expenses procured from entities in Parent Group have been included in trade payables and other payables for one month from the date of supply, after which the amount is assumed to have been settled and the balance is subsumed within invested capital attributable to equity owners.
- Given the cash pooling arrangement, overall receivables and payables with Parent and funding balances with Parent are presented within invested capital, no interest has been charged on intercompany loans or trading balances. This is not representative of interest income and expenses that would have been reported had SSE Energy Services been an independent entity, nor is it representative of the interest income and expense that may arise in the future.
- Transactions and balances between separate entities included within the HFI have been eliminated. Transactions and balances with other entities within the Parent Group but outside SSE Energy Services are shown as external transactions and balances and are disclosed as related party transactions and balances. The total net effect of the settlement of these intercompany transactions with the Parent Group is reflected in the combined and carved out cash flow statement within financing activities and within invested capital attributable to equity owners on the combined and carved out balance sheet.
- Dividends and other equity transactions made by legal entities from which certain assets, liabilities, results and cash flows have been carved out have not been included within the HFI, as there is no rational or consistent basis to apportion those equity transactions to the household energy and services business.
- The HFI is not intended to present the results of SSE Energy Services as if it had operated as an independent entity during the periods presented. The HFI has been prepared for SSE Energy Services, based on how it was historically managed by Parent and reflects recharges of certain costs related to the operations of SSE Energy Services as historically charged by Parent. These costs relate to certain services that are provided on a centralised basis. As certain expenses reflected in the HFI are allocated, the historical financial information may not be indicative of the financial position, results of operations and cash flows that would have been presented if SSE Energy Services had been an independent entity.

- The HFI includes certain assets previously recorded elsewhere in the Parent Group. These include IT assets, brands and goodwill in relation to the acquisition of the SWALEC electricity and gas supply business in 2000. These assets are clearly attributable to, and therefore have been recorded in the HFI as if they had always been part of, SSE Energy Services.
- The combined and carved out income statement includes corporate cost allocations for certain functions, including Finance, Human Resources, IT, Procurement & Logistic, Corporate Business Services, Corporate Affairs, Health & Safety and Property & FM expenses. Corporate cost allocations relating to Property & FM expenses include re-charges for leasing of offices and related buildings and property depreciation costs. Costs have been allocated to SSE Energy Services through a corporate recharge model which apportions central costs through appropriate, proportional and objective measures such as headcount, number of service users and floor space occupied. These have been allocated consistently in all periods presented in the HFI and total £123.0m for the year ended 31 March 2018 (2017 £95.1m, 2016 £83.3m). These amounts are not necessarily representative of the amounts that would have been incurred by the SSE Energy Services as an independent entity however, as further described in paragraph 3 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of the Circular, there will be a minimum period of up to five years where Parent and SSE Energy Services will share certain IT systems and ongoing service arrangements.
- No adjustments have been made for shared corporate head costs of the Parent that may be attributable to SSE Energy Services beyond those reported in the HFI for the years ended 31 March 2018, 2017 and 2016.
- Cash and cash equivalents comprises cash in transit due from household energy supply customers of Southern Electric Gas Ltd (“SEGL”) and SSE Energy Supply Ltd (“SSEESL”). The bank account for SEGL sits within SSE Energy Services and the cash in transit balance has been included in this HFI. Whilst the bank account of SSEESL sits outside SSE Energy Services, the cash in transit relating to household energy supply customers has been carved out and included in this HFI on the basis that it is directly attributable to the Energy Services business.
- The provision for income taxes is calculated as if each entity within SSE Energy Services completed separate tax returns. The tax charges recorded in the combined and carved out income statement and combined and carved out statement of comprehensive income are not necessarily representative of the tax charges that would have been reported had the SSE Energy Services been an independent entity throughout the period presented. They are not necessarily representative of the tax charges that may arise in the future.
- Where entire legal entities are included within the HFI, current and deferred tax balances have been aggregated from the underlying statutory books and records for the period in question. For legal entities that have had assets and liabilities carved out, current and deferred tax balances have been recalculated based on the carved out income statement and balance sheet for that entity. Tax balances have also been provided on combination items, where appropriate. There is no tax impact assumed for invested capital balances.
- There is no analysis of invested capital into the components of equity as SSE Energy Services does not consist of a single or group of legal entities. The disclosure requirements of IAS 33 “Earnings Per Share” have not been followed as the disclosures will not provide meaningful information.
- Some of the SSE Energy Services’ employees are members of SSE defined benefit pension schemes. As a result of the proposed demerger and combination, a transfer of assets and past service pension liabilities from the SSE schemes into new defined benefit arrangements operated by MergeCo will occur in respect of some or all of those members. Given these transfers have not yet occurred, and final transfer values therefore not yet calculated and agreed, the scheme assets and liabilities attributable to those members have not been recorded within the HFI.
- Post balance sheet events have been considered for the most recent balance sheet date 31 March 2018. The HFI is presented in Sterling (£) and all values are rounded to the nearest million (£m) except when otherwise indicated.
- Capital commitments, guarantees and indemnities have been included to the extent that they directly relate to the businesses or legal entities that comprise SSE Energy Services.

## **Adjusted measures**

SSE Energy Services applies the use of Adjusted Performance Measures throughout the HFI. These measures enable the directors to present the underlying performance of SSE Energy Services and its segments to the users of the statements in a consistent and meaningful manner.

The performance of SSE Energy Services and its operating segments is reported based on Adjusted profit before interest and tax ('Adjusted operating profit'). This is reconciled to Reported profit before interest and tax ('Reported operating profit') by adding back exceptional items and certain re-measurements (see Note 3(ii) and below).

Certain re-measurements are re-measurements arising on certain commodity contracts which are accounted for as held for trading in accordance with the policy for such financial instruments. The amounts shown in the 'before exceptional items and certain re-measurements' results for these contracts is the amount settled in the year as disclosed in Note 15. This excludes commodity contracts not treated as financial instruments under IAS 39 where held for SSE Energy Services' own use requirements which are not recorded until the underlying commodity is delivered.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

## **Going concern**

The HFI has been prepared on a going concern basis. In arriving at that assumption, the directors have considered two scenarios:

### ***If the proposed demerger and combination with npower completes***

Funding currently comprises intercompany funding received from the Parent by access to their group financing arrangements. The intention is that any intercompany loans in respect of SSE Energy Services will be capitalised or repaid prior to or immediately following Completion. At this point, the newly formed merged group will have been required to obtain external finance in order to meet its short-term cash liquidity requirements and to be able to satisfy its financial obligations as they fall due.

### ***If, for any reason, the proposed demerger and combination does not complete and SSE Energy Services remains a part of the Parent***

If, for any reason, the proposed merger does not complete, then SSE Energy Services will remain a part of the Parent Group, with continued access to the Parent Group financing arrangements and delivering continued profitability and positive cash flows.

As such, the directors expect that SSE Energy Services will continue operating and will continue to be able to meet its liabilities as they fall due.

## **Use of estimates and judgements**

The preparation of financial statements conforming with adopted IFRS requires the use of certain accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. A summary of estimates and judgements applied in the preparation of these carve-outs is included in Note 2.

## **1.2 Significant accounting policies**

### **Revenue**

#### ***Energy supply***

Revenue on the supply of energy comprises sales to household end-user customers based on actual energy consumption and agreed tariff rates, including an estimate of the volume of electricity and gas supplied to customers between the date of the last meter reading and the year end. Details of the estimation process for the value of electricity and gas supplied to customers is given within Note 2.

#### ***Energy-related services***

The provision of energy-related goods and services to customers includes a range of services from meter reading and installation, boiler maintenance and installation, installing energy saving measures such as external wall insulation in household properties and residential telecoms and broadband services.



Where SSE Energy Services has an ongoing obligation to provide contracted services, revenues are recognised as the service is performed with amounts billed in advance or arrears treated as either deferred income or accrued income and excluded from current revenue. Revenue from fixed-fee service contracts is recognised over the life of the contract, in relation to the benefit received by the customer.

### **Cost of sales**

Cost of sales mainly comprises energy commodity costs, renewable obligation costs, use of system charges and the costs of metering services (where not provided within SSE Energy Services).

### ***Capacity market***

The capacity market charge is a levy paid by Suppliers to an independent Settlement Body to ensure sufficient reliable electricity capacity is available throughout the year. This charge is based on the Suppliers forecast Customer energy demands between November and February, and is charged over the course of the delivery year.

In accordance with IFRIC 21 “Levies”, a liability for the full year charge is recognised progressively between November and February. Given this is a regulatory operating cost to the business, the charge is recognised over the course of the year. Any difference between the liability and charge is recognised as a prepaid asset.

### **Administration costs**

Administration costs comprises all other operating charged not included within cost of sales, including employee benefit costs, depreciation and amortisation charges and changes in allowance for impairment of trade receivables.

### **Cash and cash equivalents**

Cash and cash equivalents comprise cash in transit due from customers.

### **Invested capital attributable to equity owners**

Net transfers to and from Parent are included within invested capital attributable to equity owners. The components of net transfers to Parent are included within the combined and carved out statement of changes in equity.

Invested capital attributable to equity owners in the combined and carved out statement of financial position and statement of changes in equity represents Parent’s historical investment in SSE Energy Services, the net effect of transactions with allocation from Parent and SSE Energy Services accumulated earnings. See Note 5 for further information about transactions between SSE Energy Services and Parent.

### **Employee benefits**

#### ***Equity and equity-related compensation benefits***

The Parent operates a number of All Employee Share Schemes as described in the Remuneration Report of the Parent. These schemes enable employees to acquire shares of the ultimate parent company. The employees of SSE Energy Services are entitled, where applicable, to participate in these schemes. SSE Energy Services has not been charged with the cash cost of acquiring shares on behalf of its employees, this cost is borne by Parent. Where the fair value of the options granted has been measured, SSE Energy Services has recognised the expense as if the share based payments related to the Parent’s own shares.

The exercise prices of the sharesave scheme are set at a discount to market price at the date of the grant. The fair value of the sharesave scheme option granted is measured at the grant date by use of an option pricing model. The fair value of the options granted is recognised as an expense on a straight-line basis over the period that the scheme vests. Estimates are updated at each balance sheet date with any adjustment in respect of the current and prior years being recognised in the combined and carved out income statement.

The costs associated with the other main employee schemes, the share incentive plan and the deferred bonus scheme, are recognised in the combined and carved out income statement with the credit entry being presented within net transfers to Parent in invested capital.

The disclosure on equity and equity related compensation benefits have been removed on the grounds of materiality.

## Exceptional Items

Exceptional items are those charges or credits that are considered unusual by nature and scale and of such significance that separate disclosure is required for the HFI to be properly understood. The trigger points for exceptional items will tend to be nonrecurring although exceptional charges may impact the same asset class or segment over time. Examples of items that may be considered exceptional include material asset or business impairment charges, business restructuring costs, significant gains or losses on disposal and contractual settlements following significant disputes and claims.

## Certain re-measurements

SSE Energy Services enters into forward commodity purchase (and sale) contracts to meet the future demand requirements of its Energy Supply business. Certain of these contracts are determined to be derivative financial instruments under IAS 39 and as such are required to be recorded at their fair value. Changes in the fair value of those commodity contracts designated as IAS 39 financial instruments are reflected in the combined and carved out income statement (as part of 'certain re-measurements'). SSE Energy Services shows the change in the fair value of these forward contracts separately as this mark-to-market movement is not relevant to the underlying performance of its operating segments. SSE Energy Services will recognise the underlying value of these contracts as the relevant commodity is delivered, which will predominately be within the subsequent 12 to 36 months. Conversely, commodity contracts that are not financial instruments under IAS 39 are accounted for as 'own use' contracts. The re-measurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of SSE Energy Services.

## Taxation

The charge for taxation is based on the profit or loss for the year and takes into account deferred taxation.

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted, or substantially enacted, by the balance sheet date.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

## Property, plant and equipment

Items of property, plant and equipment relate to metering vehicles and equipment and are stated at cost less accumulated depreciation and impairments. Where an item of property, plant and equipment comprises major components having different useful lives, the components are accounted for as separate items of property, plant and equipment, and depreciated accordingly.

## Subsequent expenditure

Expenditure incurred to replace a component of a tangible fixed asset that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the tangible fixed asset to which it relates.

## Depreciation

Depreciation is provided on tangible fixed assets to write off cost, less residual values, on a straight-line basis over their estimated operational lives. The estimated operational lives are as follows:

	<u>Years</u>
Meter assets and miscellaneous equipment . . . . .	5 to 10 years
IT infrastructure . . . . .	5 to 15 years

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

**Intangible assets**

**Goodwill**

Goodwill arising on a business combination represents the excess of the cost of acquisition over the interest in the fair value of the identifiable assets, liabilities and contingent liabilities of a subsidiary, associate or joint venture at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment at least on an annual basis.

For the purpose of impairment testing, goodwill is allocated on initial recognition to those cash-generating units (CGUs) expected to benefit from the combination’s synergies. The cash-generating units used for goodwill impairment testing purposes will represent how goodwill was attributed but may not represent reportable business segments.

**Other intangible assets**

Intangible assets that are acquired by SSE Energy Services are stated at cost less accumulated amortisation and less accumulated impairment losses. Expenditure on internally generated brands is expensed as incurred.

***Development assets***

Expenditure on research activities is recognised as an expense in the period in which it is incurred. An internally-generated intangible asset arising from development (or from the development phase of an internal project) is recognised if, and only if, a number of conditions have been demonstrated including technical and financial feasibility, intention to complete, ability to use or sell and the future economic benefits expected.

The amount initially recognised for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognised, development expenditure is recognised in profit or loss in the period in which it is incurred.

Development assets relate to intangible assets under construction and principally comprise costs incurred on developing new software for the Retail Transformation Project and costs incurred in relation to SMART infrastructure assets. As development assets are completed, they are transferred to the appropriate asset category with depreciation commencing thereafter.

***Software***

Software assets include the costs of developing and installing products for use within the business. Software is amortised once the development of the software is complete and has been implemented. The useful life of the asset is assessed on the basis of the nature of the asset and an expected useful life is applied accordingly.

***Amortisation***

Amortisation is charged to the profit and loss account on a straight-line basis over the estimated useful life of these other intangible assets.

	<u>Years</u>
Software . . . . .	10 years

**Impairment review**

The carrying amounts of PP&E and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For PP&E assets that have previously been identified as exhibiting indications of impairment, the review of impairment will be performed annually until there is sufficient evidence to confirm that any potential impairment loss has been appropriately recognised. For goodwill and other intangible assets with an indefinite life or which are not yet ready for use, the test for impairment is carried out annually. In addition, financial assets measured at amortised cost are also reviewed for impairment annually.

For assets subject to impairment testing, the asset’s carrying value is compared to the asset’s recoverable amount. The recoverable amount is determined to be the higher of the fair value less costs to sell (FVLCS) and the value-in-use (VIU) of the asset. For financial assets measured at amortised cost the impairment is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows discounted at the financial asset’s original effective interest rate.

If the carrying amount of the asset or CGU exceeds its recoverable amount, an impairment charge will be recognised immediately in the combined and carved out income statement and, in relation to the impairment of goodwill, will not be subsequently reversed.

Value in use (VIU) calculations require the estimation of future cash flows to be derived from the respective assets (or CGUs) and the selection of an appropriate discount rate to calculate their present value. The VIU methodology is consistent with the approach taken by management to evaluate economic value and is deemed to be the most appropriate for reviews of PP&E asset and the identified goodwill-related CGUs. The methodology is based on the pre-tax cash flows arising from the specific assets, underlying assets or CGUs, and discounted using a pre-tax discount rate based on Parent's cost of funding and adjusted for any specific risks. The estimation of the timing and value of underlying projected cash flows and the selection of appropriate discount rates involves management judgement. Subsequent changes to these estimates or judgements may impact the carrying value of the assets.

The fair value less costs to sell methodology also uses a present value technique, unless there is a quoted price in an active market for that asset. The methodology is based on the post-tax cash flows arising from the specific assets, underlying assets or CGUs, and discounted using a post-tax discount rate determined in the same manner as the rates used in the VIU calculations, adjusted for the relevant taxation rate.

For goodwill, the impairment charge will initially be adjusted against the goodwill allocated to the cash-generating unit. Thereafter, the remaining assets of the cash-generating unit will be written-down proportionately. Impairments of other intangible or PP&E assets will only be reversed if there has been a significant increase in the recoverable amount associated with the asset. Impairments of Goodwill are not written back.

### **Inventories**

Inventories relate to raw materials and consumables for the energy-related services business and are valued at the lower of cost and net realisable value.

### **Trade Receivables**

Trade receivables do not carry any interest and are measured at cost less an appropriate provision for irrecoverable receivables.

SSE Energy Services' exposure to credit risk, and therefore the basis of determining the provisions for bad and doubtful debts, is based on assumptions derived from experience and industry knowledge. While the provisions are considered to be appropriate, changes in estimation basis or in economic conditions could lead to a change in the level of provisions recorded and consequently on the charge or credit to the income statement. The analysis of the ageing of trade receivables is used as the basis for the movement in the provision for bad and doubtful debts, and the net trade receivables is expected to be recoverable.

### **Held for sale**

Assets are classified as held for sale if their recoverable value is likely to be recovered via a sale opposed to continued use by SSE Energy Services. In order to be classified as assets held for sale, assets must meet all of the following conditions; sale highly probable, available for immediate sale, being actively marketed and the sale is likely to occur within one year.

Assets determined as held for sale are measured at the lower of carrying value and fair value less costs to sell, no depreciation is charged in respect of these assets after classification.

### **Derivative financial instruments**

Within its regular course of business, SSE Energy Services routinely enters into sale and purchase derivative contracts for commodities such as electricity and gas. On 1 April 2015, the beneficial interest in all energy portfolio management activities for the Parent Group previously transacted by SSE Energy Supply Limited were transferred to SSE EPM Limited ("EPM"), a fellow Parent Group company through a trust agreement. EPM, through the trust agreement with SSE Energy Supply Limited, therefore enters into all external trades on behalf of SSE Energy Services. Where the contract was entered into and continues to be held for the purpose of receipt or delivery in accordance with SSE Energy Services' expected sale, purchase or usage requirements, the contracts are designated as 'own use' contracts and are measured at cost. These contracts are not within the scope of IAS 39.

Derivative commodity contracts which are not designated as own use contracts are accounted for as trading derivatives and are recognised in the combined and carved out balance sheet at fair value. Where a hedge accounting relationship is designated, the portion of gains or losses on the derivative which are deemed to be effective are recognised directly in equity in the hedge reserve. Any ineffective portion of the gains or losses is recognised in the combined and carved out income statement. There are currently no designated hedge relationships in relation to commodity contracts.

Other commodity contracts, where own use is not established and a hedge accounting relationship is not designated, are measured at fair value with gains and losses on re-measurement being recognised in the combined and carved out income statement in cost of sales.

### **Provisions**

A provision is recognised in the combined and carved out balance sheet when SSE Energy Services has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

### **Pensions**

Contributions to pension schemes on behalf of the employees of SSE Energy Services are charged to the combined and carved out income statement in accordance with the contributions incurred in the year.

Some of SSE Energy Services' employees are members of a Parent Group wide defined benefit pension plan. As there is no contractual agreement or stated policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the plan is recognised fully by the sponsoring employer, which is another member of the Parent Group. SSE Energy Services recognises a cost equal to its contribution payable for the period based on the number of employees in the scheme. Obligations for contributions to defined contribution pension plans are recognised as an expense in the combined and carved out income statement in the periods during which services are rendered by employees.

### **New accounting policies and reporting changes**

All issued standards, amendments and interpretations of adopted IFRS, mandatory for the year ended 31 March 2018 and not early adopted, have been applied by SSE Energy Services in the current and preceding years and have not had a material impact on the financial statements. A number of standards have been issued but not yet adopted by SSE Energy Services within these financial statements, because application is not yet mandatory or because adoption by the EU remains outstanding at this point in time:

#### ***IFRS 9 'Financial instruments' which has been endorsed by the European Union (EU) and will be effective from 1 January 2018 (and thus 1 April 2018 for SSE Energy Services);***

This standard replaces IAS 39 'Financial Instruments: Recognition and Measurement' and sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. The impact of adopting this standard can be summarised with reference to the three project phases:

##### **i. Classification and measurement**

The standard adopts a principles based approach to classify financial assets on the basis of the business model within which they are held and their contractual cash flow characteristics. Following this approach, financial assets will be classified as measured at amortised cost, fair value through profit and loss or fair value through other comprehensive income. For financial liabilities, the classification and measurement requirements under IAS 39 have been carried forward essentially unchanged, with the majority of financial liabilities being classified as measured at amortised cost.

Whilst financial assets and liabilities will be classified into the categories required by IFRS 9, there is not expected to be any resulting measurement impact.

##### **ii. Impairment**

The standard includes the requirement that impairment models also consider the expected credit losses on an entity's financial assets held at amortised cost and commitments to extend credit. As a result of this forward

looking model—which removes the requirement for a “trigger event” to have occurred—earlier recognition of credit losses may occur.

Existing impairment models—principally provision matrix models applied to Energy Supply Trade Receivables—have been reviewed, including the credit risk management processes described in Note 15. Given the short term nature of the majority of affected financial assets, and the focus on mitigating significant credit risk through regular monitoring and securitisation, the inclusion of forward looking information within these models is expected to reduce Reported Profit by less than 1%.

### iii. Hedge accounting

The standard does not materially change the amounts recognised in relation to existing hedging arrangements but does simplify the requirements for measuring hedge effectiveness, and thus the eligibility conditions for hedge accounting. The new hedge accounting model is intended to enable companies to reflect better their risk management activities in the financial statements.

SSE Energy Services’ review of the IFRS 9 hedge accounting model concluded that whilst adoption would not change the treatment of existing hedging arrangements, the changes made would not result in any additional hedge designations either. As such, the existing hedge accounting model under IAS 39 appropriately reflects SSE Energy Services’ risk management activities in the financial statements. Therefore, as permitted by IFRS 9, SSE Energy Services has elected to continue to apply the hedge accounting requirements of IAS 39. This policy choice will be periodically reviewed to consider any changes in our risk management activities.

Upon adoption of IFRS 9, SSE Energy Services intends to apply the exemption from the requirement to restate comparative information about classification and measurement, including impairment. The opening retained earnings will be adjusted for any difference between financial instrument carrying amounts before and after adoption of IFRS 9, which is expected to be less than 1% of Reported Profit.

### ***IFRS 15 ‘Revenue from contracts with customers’ which has been endorsed by the EU and will be effective from 1 January 2018 (and thus 1 April 2018 for SSE Energy Services);***

This standard replaces IAS 11 ‘Construction contracts’, IAS 18 ‘Revenue’, IFRIC 18 ‘Transfers of Assets from Customers’ and a number of other revenue related interpretations previously adopted. The core principle of IFRS 15 is that an entity recognises revenue that reflects the expected consideration for goods or services provided to a customer under contract, over the performance obligations they are being provided. The standard has introduced a five-step model as the framework for applying that core principle.

SSE Energy Services’ assessment of changes to the current revenue recognition policy can be summarised as follows:

The clarifications on assessing principal versus agent relationships will result in revenue and costs relating to customer support schemes (such as the Warm Home Discount), being offset within the Income Statement, rather than recognised gross as currently applied.

For certain equipment provided to customers on inception of a contract—for example, internet routers delivered to a customer on inception of a Broadband contract—IFRS 15 requires recognition of revenue when the equipment is delivered rather than over the contract period as currently applied.

Applying the IFRS 15 revenue recognition policy changes noted above to SSE Energy Services for the year ended 31 March 2018 would have resulted in a less than 1% change in Revenue, less than 1% change in Reported Profit and less than 1% change in Net Assets. Adoption of IFRS 15 will not affect the cashflows generated by SSE Energy Services. The full impact of adopting IFRS 15 on the HFI for the year ended 31 March 2019 will depend on the contractual arrangements entered into during the forthcoming financial year, however, it is SSE Energy Services’ expectation that the impact will be broadly equivalent.

SSE Energy Services will apply the “Modified Retrospective” approach, with the cumulative effect of initially applying IFRS 15 recognised at the date of initial application as allowed by the standard. SSE Energy Services has also elected to take advantage of the practical expedient whereby contracts that have been completed under the current accounting policies at the beginning of the earliest period are not restated.

### ***IFRS 16 ‘Leases’ which has been endorsed by the EU and will be effective from 1 January 2019 (and thus 1 April 2019 for SSE Energy Services).***

This standard replaces IAS 17 ‘Leases’ and sets out the principles for the recognition, measurement, presentation and disclosure of leases. The principal change from the previous standard is the introduction of a

single lessee accounting model which requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.

SSE Energy Services commenced its project on adoption of this standard during the year, with current activity still focussed on data collection and analysis of contracts for lease features. SSE Energy Services continues to anticipate that the impact from adopting the standard can be summarised in two areas:

i. Identification of a lease

The standard introduces a distinction between a lease and a service contract on the basis of whether a customer is able to control an identifiable asset. SSE Energy Services anticipates some existing service contracts may now meet this definition, and therefore would be treated as leases. However, it is not anticipated that this will have a material impact on the results, given the low number of affected contracts identified to date.

ii. Recognition of right-of-use assets and lease liabilities for existing operating leases

The standard removes the previous distinction between operating leases and finance leases and requires that, where a lease is identified in a contract, a right-of-use asset and lease liability are recognised. Whilst SSE Energy Services does not currently account for any arrangements as operating leases, it anticipates that adoption is likely to result in any service contracts that meet the definition of leases being recognised on the combined and carved out balance sheet as right-of-use assets and lease liabilities.

The project will be completed during the forthcoming financial year and, given the number of service contracts in place, the data capture requirements and the variety of transition approaches available on adoption, the full implementation effect of the standard will only be determined once the project has completed.

However, SSE Energy Services has concluded that the arrangements for Smart Meter contracts—as described in Accounting Judgement Note 2—do not contain a lease under IFRS 16, given SSE Energy Services' inability to direct the use of the asset.

***IFRS 17 'Insurance Contracts' is effective from 1 January 2021 (and thus 1 April 2021 for SSE Energy Services), and is subject to EU endorsement.***

IFRS 17 'Insurance contracts' was issued in May 2017, replaces IFRS 4 'Insurance Contracts' and sets out the requirements that a company should apply in reporting information about insurance contracts it issues and reinsurance contracts it holds.

Given SSE Energy Services does not issue insurance based products, with only financial guarantee contracts to guarantee indebtedness of the other Parent Group undertakings considered to be insurance arrangements, it is not expected that adoption of this standard will have a significant impact on the HFI.

***Other interpretations and amendments***

In addition to these issued standards, there are a number of other interpretations, amendments and annual improvement project recommendations that have been issued but not yet adopted because application is not yet mandatory or because adoption by the EU remains outstanding at this point in time. These are not anticipated to have a material impact on the HFI.

**2 Accounting estimates and judgements**

The preparation of the HFI requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. It should be noted that the impact of variation in some assumptions, judgements and estimates can have a particularly material impact on the reported results.

**Revenue recognition—estimated energy consumption—Estimation Uncertainty**

Revenue from Retail energy supply activities includes an estimate of the value of electricity or gas supplied to customers between the date of the last meter reading and the year end. This estimation will comprise of values for i) billed revenue in relation to consumption from unread meters based on estimated consumption taking account of various factors including usage patterns and weather trends (disclosed as trade receivables) and ii) unbilled revenue calculated by assessing a number of factors such as externally notified aggregated volumes supplied to customers from national settlements bodies, amounts billed to customers and other adjustments (disclosed as accrued income).

Given the non-routine process, number of differing inputs and the extent of management judgement as noted below, the unbilled revenue estimate is considered a significant estimate made by management in preparing the financial statements.

Unbilled revenue is calculated by applying the tariffs applicable to customers to the calculated estimated volume of electricity or gas consumed. This estimation methodology is subject to an internal corroboration process that provides support for the judgements made by management. This corroboration process requires the comparison of calculated unbilled volumes to a 'benchmark' measure of unbilled volumes (in GWh and millions of therms) which is derived from historical weather-adjusted consumption patterns and aggregated, independently validated but unreconciled, metering data that is used in industry reconciliation processes for total consumption by supplier. This comparison of the estimated supplied quantity of electricity or gas that is deemed to have been delivered to customers against the aggregate supplied quantity of electricity or gas applicable to SSE Energy Services' customers that is measured by industry system operators, is a key judgement. The estimation of electricity unbilled revenue is further influenced by the impact on estimated electricity or gas supplied of national settlements data or, for electricity only, feed-in-tariff supported volumes and spill from solar PV generation.

SSE Energy Services' policy is to recognise unbilled revenue only where the economic benefits are expected to flow to it. As a result, the judgements applied, and the assumptions underpinning the judgements, are considered to be appropriate. Change in these assumptions would have an impact on the amount of revenue recognised in any given period. In the year to 31 March 2018, judgements applied for household electricity, SSE Energy Services' confidence in the quality of grid supply point metering and national settlements data it uses as part of its estimation process has improved which has enabled an additional revenue amount of £21m (2017 £30m, 2016 £nil) to be recognised. The unbilled gas revenue estimation process has required SSE Energy Services to take account of industry estimated supplied quantities of gas consumed have historically been higher than actual metered supply. To address this, SSE Energy Services has applied a further judgement, being a percentage reduction to unbilled consumption volume, to the measurement of its unbilled revenue in the financial statements. While it is expected that this judgement will become less critical as the industry transitions to smart meter technology, the percentage reduction applied has been increased in the year following the entering into operation of the new national settlements system, Nexus, and data issues associated with that; the impact of this change in estimation is c. £12m reduction in revenue. The sensitivity associated with this judgement factor is disclosed at Note 12.

#### **Valuation of trade receivables—Estimation Uncertainty**

SSE Energy Services' exposure to credit risk, and therefore the basis of determining the provisions for bad and doubtful debts, is based on assumptions derived from experience and industry knowledge. While the provisions are considered to be appropriate, changes in estimation basis or in economic conditions could lead to a change in the level of provisions recorded and consequently on the charge or credit to the combined and carved out income statement.

Exposure to credit risk in the retail supply of electricity and gas to end user customers arises from the potential of a customer defaulting on their invoiced payables. Household customers' creditworthiness is reviewed from a variety of internal and external information.

The analysis of the ageing of trade receivables, movement in the provision for bad and doubtful debts and the net trade receivables expected to be recoverable is detailed within Note 15.

#### **Lease classification for Smart Meter contracts—Accounting Judgement**

Following the disposal of smart meter assets to Meter Fit 10 Limited in 2017 (see Note 14), SSE Energy Services entered into an agreement for the provision of meter asset provider (MAP) services with that company. During 2017, SSE Energy Services also entered into a framework agreement with a Parent joint venture company, Maple Topco Limited, to provide MAP services for further tranches of smart meter deployment.

SSE Energy Services has assessed that both arrangements, in common with all similar arrangements, do not contain leases of the smart meters owned by the MAP due to other parties taking a significant amount of the output from the meters and due to SSE Energy Services being unable to control either the operation or the physical access to the meters. The IFRS 16 "Leases" implementation project has concluded that this assessment will not change upon adoption of that standard.



### Accounting for costs of the smart meter infrastructure programme—Accounting Judgement

Through its participation in the UK smart metering programme, SSE Energy Services is required to make payments to the Data Communications Company (“DCC”) as it develops infrastructure to support the UK smart meter roll-out. SSE Energy Services has assessed that the DCC costs incurred are capital in nature as they will provide future economic benefit and SSE Energy Services has the power to control certain assets through the terms of the Smart Meter Code. These assets relate to the centralised infrastructure costs of the UK’s smart meter programme. At 31 March 2018 the costs capitalised to date total £86.6m (2017: £54.4m). SSE Energy Services is aware that other market participants have elected to expense these costs as incurred, however, given that it has been assessed that control exists over these assets, they have been capitalised.

### Recognition of Capacity Market levy—Accounting Judgement

As disclosed in Note 1, the capacity market charge is a levy paid by Suppliers to an independent Settlement Body to ensure sufficient reliable electricity capacity is available throughout the year. This charge is based on the Suppliers forecast Customer energy demands between November and February, and is charged over the course of the delivery year.

In accordance with IFRIC 21 “Levies”, a liability for the full year charge is recognised progressively between November and February. Given this is a regulatory operating cost to the business, the charge is recognised over the course of the year. Any difference between the liability and charge is recognised as a prepaid asset.

SSE Energy Services considers that recognition of the charge over the course of the year with a corresponding prepaid asset, rather than over the 4 month period in line with recognition of the liability under IFRIC 21 to be a key Accounting Judgement in preparation of the Financial Statements.

### 3 Segmental information

The Parent Group’s operating segments are those used internally by the Directors to run the Parent business and make strategic decisions. On 8 November 2017, SSE announced its intention to dispose of its GB household supply and energy related services business in a demerger with nPower. Following this announcement the presentation of financial information to the Board changed, resulting in a change of the operating segments.

The operating segments within the HFI have been identified based on the internal reporting information and management structures within SSE Energy Services at 31 March 2018. A segmental analysis was prepared for the carve-out business to reflect the segments which the carve-out business has decided to adopt. The main operating and reported segments in SSE Energy Services are Energy Supply and Energy-related Services.

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

<u>Reported Segments</u>	<u>Description</u>
Energy Supply . . . . .	The supply of electricity and gas to household customers in GB
Energy-related Services . . . .	The provision of energy related goods and services to household customers in GB including meter reading and installation, boiler maintenance and installation and residential telecoms and broadband services

The internal measure of profit used by the Directors is ‘adjusted profit before interest and tax’ or ‘adjusted operating profit’ which is arrived at before exceptional items and the impact of financial instruments measured under IAS 39.

Analysis of revenue, operating profit and other items by segment is provided below. All revenue and profit before taxation arise from operations within the United Kingdom.

### i) Revenue by segment

	External revenue 2016	Intra-segment revenue <sup>(i)</sup> 2016	Total revenue 2016	External revenue 2017	Intra-segment revenue (I) 2017	Total revenue 2017	External revenue 2018	Intra-segment revenue, restated (I) 2018	Total revenue, restated 2018
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Retail</b>									
Energy Supply . . .	4,015.8	—	4,015.8	3,797.1	—	3,797.1	3,850.6	—	3,850.6
Energy-related Services . . . . .	124.6	103.4	228.0	141.9	123.6	265.5	133.8	161.6	295.4
<b>Total . . . . .</b>	<b>4,140.4</b>	<b>103.4</b>	<b>4,243.8</b>	<b>3,939.0</b>	<b>123.6</b>	<b>4,062.6</b>	<b>3,984.4</b>	<b>161.6</b>	<b>4,146.0</b>

(i) Intra-segment revenue is derived from Energy-related Services providing metering and other services to other SSE Energy Services companies. All are provided at arm's length basis.

### ii) Operating profit by segment

	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements (Note 6)	Total
	£m	£m	£m
<b>2016</b>			
Energy Supply . . . . .	249.1	(101.1)	148.0
Energy-related Services . . . . .	18.8	—	18.8
<b>Total . . . . .</b>	<b>267.9</b>	<b>(101.1)</b>	<b>166.8</b>

	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements (Note 6)	Total
	£m	£m	£m
<b>2017</b>			
Energy Supply . . . . .	224.4	78.6	303.0
Energy-related Services . . . . .	15.3	(7.2)	8.1
<b>Total . . . . .</b>	<b>239.7</b>	<b>71.4</b>	<b>311.1</b>

	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements	Total
	£m	£m	£m
<b>2018</b>			
Energy Supply . . . . .	260.4	5.5	265.9
Energy-related Services . . . . .	13.8	—	13.8
<b>Total . . . . .</b>	<b>274.2</b>	<b>5.5</b>	<b>279.7</b>

### iii) Capital Expenditure by Segment

	Capital additions to intangible assets (Note 9) 2016	Capital additions to property, plant & equipment (Note 8) 2016	Capital additions to intangible assets (Note 9) 2017	Capital additions to property, plant & equipment (Note 8) 2017	Capital additions to intangible assets (Note 9) 2018	Capital additions to property, plant & equipment (Note 8) 2018
	£m	£m	£m	£m	£m	£m
<b>Retail</b>						
Energy Supply . . . . .	125.9	31.5	171.6	34.1	99.8	31.3
Energy-related Services . . . . .	—	38.4	—	27.1	—	10.2
<b>Total . . . . .</b>	<b>125.9</b>	<b>69.9</b>	<b>171.6</b>	<b>61.2</b>	<b>99.8</b>	<b>41.5</b>

#### 4 Operating profit

Operating profit is arrived at after charging:

	2016	2017	2018
	£m	£m	£m
Depreciation of tangible fixed assets . . . . .	12.1	12.6	16.1
Amortisation of intangible fixed assets . . . . .	9.7	9.8	44.8
Other exceptional charges (Note 6) . . . . .	11.2	95.4	29.3
Loss on disposals . . . . .	1.0	—	—

#### 5 Related party transactions

##### Trading with SSE

As part of the normal course of business, SSE Energy Services has business relationships and transactions with numerous related party companies, including the Parent company, as well as any subsidiaries, joint ventures or associates of the Parent Company. Income principally relates to meter reading related activities for the SSE Networks segment under an annual agreement, with Expenses principally relating to derivative contracts for commodities such as the purchase or supply of electricity, gas and ROCs with SSE EPM Limited ('EPM') and use of system charges levied by various companies within the SSE Networks segment for transmission and distribution of electricity. All transactions were completed at arm's length conditions. A summary of these transactions by period is given below.

	2016	2017	2018
	£m	£m	£m
Income . . . . .	9.5	8.3	11.6
Expenses . . . . .	(2,023.9)	(1,688.3)	(1,645.7)
Receivables . . . . .	—	—	—
Liabilities . . . . .	(225.8)	(178.0)	(233.9)

In addition to these transactions, committed sale and purchase derivative contracts are in place with EPM at the end of each period. EPM, through a trust agreement with SSE Energy Supply Limited, enters into all external commodity trades on behalf of SSE Energy Services, therefore details of the carrying values, contractual cashflows, contractual maturities and sensitivities to these contracts are given in Note 15.

The HFI includes the historical financial information in respect of three energy related services business specific legal entities as described in Note 1.1. The intercompany receivables/(payables) between these legal entities and the Parent Group—which comprise either funding or net cash pooling balances, included within invested capital as described in Note 1.1—are stated below:

	Funding 2016	Net cash pooling 2016	Funding 2017	Net cash pooling 2017	Funding 2018	Net cash pooling 2018
	£m	£m	£m	£m	£m	£m
SSE Home Services Ltd . . . . .	—	(78.4)	—	(83.1)	(12.0)	4.2
SSE Energy Solutions Ltd . . . . .	—	(5.2)	—	5.0	—	—
SSE Metering Ltd . . . . .	—	(66.9)	—	(22.1)	—	(9.9)
	<u>—</u>	<u>(150.5)</u>	<u>—</u>	<u>(100.2)</u>	<u>(12.0)</u>	<u>(5.7)</u>

##### Corporate cost allocations

The combined and carved out income statement includes corporate cost allocations for certain functions, including Finance, Human Resources, IT, Procurement & Logistic, Corporate Business Services, Corporate Affairs, Health & Safety and Property & FM expenses. Corporate cost allocations relating to Property & FM expenses include re-charges for leasing of offices and related buildings and property depreciation costs. Corporate cost allocations relating to Property & FM expenses include re-charges for leasing of offices and related buildings and property depreciation costs. Costs have been allocated to SSE Energy Services through a corporate recharge model which apportions central costs through appropriate, proportional and objective measures such as headcount, number of service users and floor space occupied. These have been allocated consistently in all periods presented in the HFI and total £123.0m for the year ended 31 March 2018 (2017 £95.1m, 2016 £83.3m). These amounts are not necessarily representative of the amounts that would have been incurred by the SSE Energy Services as a separate entity.

## Invested capital attributable to equity owners

Net transfers (to)/from Parent as disclosed within the Cash Flow Statement are included with invested capital attributable to equity owners and consist of corporate allocations, dividends, cash pooling and general financing activities. These total £(6.2)m for the year ended 31 March 2018 (2017 £43.6m, 2016 £(277.7)m).

The legal entities within SSE Energy Services participate in a Parent Group-wide centralised treasury and cash pooling system. Under these arrangements, after receipt in each company bank account, these cash balances are remitted at the end of each working day into a central bank account. Trading balances are accrued and settled on the last working day of the month following the transactions, these include items such as corporate recharges or payment for tax related group relief are charged or credited by way of intercompany transactions. The liability for operating expenses procured from entities in the Parent Group have been included in trade payables and other payables for one month from the date of supply, after which the amount is assumed to have been settled and the balance is subsumed within invested capital attributable to equity owners.

Likewise, any funding requirements, equity investments or equity returns are charged or credited by way of intercompany transactions. The balances created from transfers to and from Parent are recorded at a legal entity level and cannot be separately identified or allocated to the household energy and services business throughout the three years ended 31 March 2016, 2017 and 2018. Invested capital attributable to equity owners represents a combination of the balances created through the cash pooling arrangement, overall receivables and payables with Parent, funding balances with Parent and equity investment by Parent, except as explained in Note 1.1 in respect of cash in transit and the liability for operating expenses procured from the Parent Group.

The total net effect of the settlement of these intercompany transactions is reflected in the combined and carved out cash flow statement within financing activities and within invested capital attributable to equity owners on the balance sheet.

Given that the cash pooling arrangement, overall receivables and payables with Parent and funding balances with Parent are presented within Invested capital, no interest has been charged on intercompany loans or trading balances. This is not representative of interest income and expenses that would have been reported had SSE Energy Services been an independent entity, nor is it representative of the interest income and expense that may arise in the future.

## Remuneration of key management personnel

Key management personnel are responsible for planning, directing and controlling the operations of SSE Energy Services. The remuneration of the key management personnel is set out below in aggregate.

	2016	2017	2018
	£m	£m	£m
Salaries and short-term employee benefits . . . . .	1.8	2.1	2.2
Social security costs . . . . .	0.2	0.3	0.4
Post employment benefits . . . . .	0.2	0.2	0.1
Share-based benefits . . . . .	0.1	0.1	0.1
<b>Total</b> . . . . .	<b>2.3</b>	<b>2.7</b>	<b>2.8</b>

## 6 Exceptional items and certain re-measurements

	2016	2017	2018
	£m	£m	£m
Exceptional items:			
Property, plant and equipment impairments (Note 8) . . . . .	—	(7.2)	—
Intangible asset impairments (Note 9) . . . . .	(11.2)	(88.2)	(28.7)
Related development charges . . . . .	—	—	(0.6)
Total exceptional items . . . . .	(11.2)	(95.4)	(29.3)
Certain re-measurements:			
Movement on operating derivatives (Note 15) . . . . .	(89.9)	166.8	34.8
Total certain re-measurements . . . . .	(89.9)	166.8	34.8
Exceptional items after certain re-measurements and before taxation: . . . . .	(101.1)	71.4	5.5
Taxation . . . . .	16.4	(11.0)	(1.7)
Exceptional items after certain re-measurements . . . . .	<u>(84.7)</u>	<u>60.4</u>	<u>3.8</u>

## Exceptional items

### 2018

During the year, SSE Energy Services decided to discontinue the development of its Connected Homes and In-House Experience programmes, along with projects relating to Metering Reporting and Smart Enhancements. As there was no enduring value to spend incurred this has been recognised as an exceptional charge of £29.3m, comprising an impairment of £28.7m in respect of intangible assets (Note 9) and £0.6m of related charges.

### 2017

During the year ended 31 March 2017 SSE Energy Services decided to cease the development of its replacement customer service and billing system. As a result of this strategic decision, all amounts capitalised in relation to the development of the system and related software and hardware have been impaired with the resulting impact being recognised as an exceptional impairment charge of £88.2m against intangible assets.

Other exceptional charges relate to a review of the IT projects conducted in SSE Metering in March 2017 which highlighted four SMART Projects with no future operational value. These had a carrying value of £7.2m which was recognised as an exceptional charge during the year.

### 2016

During the year ended 31 March 2016 an exceptional impairment of £11.2m was recognised against intangible assets in relation to software development.

## Certain re-measurements

SSE Energy Services enters into forward commodity purchase (and sales) contracts to meet the future demand requirements of its Energy Supply business. Certain of these contracts are determined to be derivative financial instruments under IAS 39 and as such are required to be recorded at their fair value. Changes in the fair value of those commodity contracts designated as IAS 39 financial instruments are reflected in the combined and carved out income statement (as part of 'certain re-measurements'). SSE Energy Services shows the change in the fair value of these forward contracts separately as this mark-to-market movement is not relevant to the underlying performance of its operating segments. SSE Energy Services will recognise the underlying value of these contracts as the relevant commodity is delivered, which will predominately be within the subsequent 12 to 36 months. Conversely, commodity contracts that are not financial instruments under IAS 39 are accounted for as 'own use' contracts. The re-measurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of SSE Energy Services.

## 7 Taxation

	2016 £m	2017 £m	2018 £m
UK corporation tax			
Current tax on income for the period	49.2	28.0	46.6
Adjustment in respect of prior periods	(9.1)	(1.4)	(3.3)
<b>Total current tax charge</b>	<b>40.1</b>	<b>26.6</b>	<b>43.3</b>
Deferred tax (see note 17):			
Origination and reversal of timing differences	(14.7)	34.8	6.6
Change in applicable tax rate	2.7	(5.0)	—
Adjustment in respect of prior periods	3.3	0.2	(0.8)
<b>Total deferred tax</b>	<b>(8.7)</b>	<b>30.0</b>	<b>5.8</b>
<b>Total taxation charge</b>	<b>31.4</b>	<b>56.6</b>	<b>49.1</b>

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Profit before taxation . . . . .	<u>166.8</u>	<u>311.1</u>	<u>279.7</u>
Tax on profit at standard UK corporation tax rate of 19% (2017: 20%; 2016: 20%)	<u>33.3</u>	<u>62.3</u>	<u>53.1</u>
	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Effects of:			
Expenses not deductible for tax purposes . . . . .	1.2	0.5	0.1
Effect of rate change . . . . .	2.7	(5.0)	—
Corporation tax adjustment in respect of previous periods . . . . .	(9.1)	(1.4)	(3.3)
Deferred tax adjustment in respect of previous periods . . . . .	<u>3.3</u>	<u>0.2</u>	<u>(0.8)</u>
<b>Total tax charge for year . . . . .</b>	<b><u>31.4</u></b>	<b><u>56.6</u></b>	<b><u>49.1</u></b>

Legislation to reduce the corporation tax rate from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020 was substantively enacted on 26 October 2015. As these changes were substantively enacted at 31 March 2016, deferred tax at that date was calculated accordingly. Legislation was substantively enacted on 15 September 2016 to further reduce the corporation tax rate to 17% from 1 April 2020. As this change was substantively enacted at 31 March 2017, deferred tax at that date was calculated accordingly.

## 8 Property, plant & equipment

	Vehicles and miscellaneous equipment £m	Assets under construction £m	Total £m
<b>Cost:</b>			
At 1 April 2015	141.9	62.9	204.8
Additions	7.3	62.6	69.9
Disposals	—	(1.0)	(1.0)
Transfers to held for sale	—	(27.9)	(27.9)
Transfers from AUC to fully commissioned PP&E	0.4	(0.4)	—
<b>At 31 March 2016</b>	<b><u>149.6</u></b>	<b><u>96.2</u></b>	<b><u>245.8</u></b>
Additions	5.8	55.4	61.2
Disposals	(15.6)	—	(15.6)
Transfers from AUC to fully commissioned PP&E	83.9	(83.9)	—
Transfers from AUC to fully commissioned intangible assets	—	(1.2)	(1.2)
<b>At 31 March 2017</b>	<b><u>223.7</u></b>	<b><u>66.5</u></b>	<b><u>290.2</u></b>
Additions	10.7	30.8	41.5
Transfers from AUC to fully commissioned PP&E	0.5	(0.5)	—
Transfers from AUC to fully commissioned intangible assets	—	(54.4)	(54.4)
<b>At 31 March 2018</b>	<b><u>234.9</u></b>	<b><u>42.4</u></b>	<b><u>277.3</u></b>
<b>Accumulated depreciation:</b>			
At 1 April 2015	84.4	—	84.4
Charge for the year	12.1	—	12.1
<b>At 31 March 2016</b>	<b><u>96.5</u></b>	<b><u>—</u></b>	<b><u>96.5</u></b>
Charge for the year	12.6	—	12.6
Impairment charge for the year (Note 6)	7.2	—	7.2
<b>At 31 March 2017</b>	<b><u>116.3</u></b>	<b><u>—</u></b>	<b><u>116.3</u></b>
Charge for the year	16.1	—	16.1
<b>At 31 March 2018</b>	<b><u>132.4</u></b>	<b><u>—</u></b>	<b><u>132.4</u></b>
<b>Net book value:</b>			
<b>At 31 March 2018</b>	<b><u>102.5</u></b>	<b><u>42.4</u></b>	<b><u>144.9</u></b>
At 31 March 2017	<u>107.4</u>	<u>66.5</u>	<u>173.9</u>
At 31 March 2016	<u>53.1</u>	<u>96.2</u>	<u>149.3</u>

## 9 Intangible assets

	Goodwill	Brand Value	Development assets	Software	Total
	£m	£m	£m	£m	£m
<b>Cost:</b>					
At 1 April 2015	186.7	9.0	87.4	136.5	419.6
Additions	—	—	114.9	11.0	125.9
<b>At 31 March 2016</b>	<b>186.7</b>	<b>9.0</b>	<b>202.3</b>	<b>147.5</b>	<b>545.5</b>
Additions	—	—	171.6	—	171.6
Transfers from AUC to fully commissioned intangible assets	—	—	—	1.2	1.2
<b>At 31 March 2017</b>	<b>186.7</b>	<b>9.0</b>	<b>373.9</b>	<b>148.7</b>	<b>718.3</b>
Additions	—	—	99.5	0.3	99.8
Transfers from AUC to fully commissioned PP&E	—	—	—	54.4	54.4
Transfers from AUC to fully commissioned intangible assets	—	—	(102.0)	102.0	—
<b>At 31 March 2018</b>	<b>186.7</b>	<b>9.0</b>	<b>371.4</b>	<b>305.4</b>	<b>872.5</b>
<b>Amortisation and impairment:</b>					
At 1 April 2015	—	9.0	35.4	12.1	56.5
Amortised in the year	—	—	—	9.7	9.7
Impairment charge for the year (Note 6)	—	—	11.2	—	11.2
<b>At 31 March 2016</b>	<b>—</b>	<b>9.0</b>	<b>46.6</b>	<b>21.8</b>	<b>77.4</b>
Amortised in the year	—	—	—	9.8	9.8
Impairment charge for the year (Note 6)	—	—	86.1	2.1	88.2
<b>At 31 March 2017</b>	<b>—</b>	<b>9.0</b>	<b>132.7</b>	<b>33.7</b>	<b>175.4</b>
Amortised in the year	—	—	—	44.8	44.8
Impairment charge for the year (Note 6)	—	—	28.7	—	28.7
<b>At 31 March 2018</b>	<b>—</b>	<b>9.0</b>	<b>161.4</b>	<b>78.5</b>	<b>248.9</b>
<b>Net Book Value:</b>					
<b>At 31 March 2018</b>	<b>186.7</b>	<b>—</b>	<b>210.0</b>	<b>226.9</b>	<b>623.6</b>
At 31 March 2017	186.7	—	241.2	115.0	542.9
At 31 March 2016	186.7	—	155.7	125.7	468.1

### Goodwill

Goodwill is carried in relation to the acquisition of the SWALEC energy supply business following its acquisition for £210m in August 2000 and is attributed to the Energy Supply CGU.

### Brand value

This historic cost represents the Atlantic brand, acquired on the acquisition of Atlantic Electric and Gas Limited during the year ended 31 March 2005. SSE Energy Services has assessed the economic life, and therefore amortisation period, of the Atlantic brand to be nil years. The brand is now fully amortised.

Other retail brands held by SSE Energy Services were internally developed and therefore do not have any historical cost attributed to them.

### Development Assets

Development expenditure relates to intangible assets under construction and includes costs incurred on developing new software for the Retail Transformation Project.

### Software

Represents software developed and currently in use as part of the Retail Transformation Project. A useful life of between 4 and 10 years has been determined for the assets.



## 10 Impairment testing

SSE Energy Services reviews the carrying amounts of its property, plant and equipment (“PP&E”), goodwill and other intangible assets annually, or more frequently if events or changes in circumstances indicate that the recoverable amounts may be lower than their carrying amounts or where other indicators of impairment are deemed to have arisen.

### 10.1 Goodwill impairment review—CGUs testing

The recoverable amount of the Energy Supply CGU is determined by reference to value-in-use (‘VIU’) calculations. The VIU calculations use, as a starting point, pre-tax cash flow projections based on the Parent Group’s five year Corporate Model as approved by the Parent’s Board. The Parent Group’s Corporate Model is based on past experience adjusted to reflect the Parent Group’s forward view of markets, prices, risks and its strategic objectives. Commodity prices used are based on observable market data and, where this is not available, on internal estimates.

### 10.2 PP&E and other intangibles impairment review—asset testing

The recoverable amounts of SSE Energy Services PP&E and other intangible assets are determined by reference to VIU calculations. Aligned with the Goodwill impairment review noted above, the calculations use, as their starting point, pre-tax cash flow projections based on the Parent Group’s five year Corporate Model as approved by the Parent Board. The Parent Group’s Corporate Model is based on past experience adjusted to reflect the Parent Group’s forward view of markets, prices, risks and its strategic objectives. Commodity prices used are based on observable market data and, where this is not available, on internal estimates.

### 10.3 Impairment reviews

The key operating and valuation assumptions, specific considerations and outcome tests for all impairment reviews are noted in the following table. The discount rates used are pre-tax real, and reflect specific risks attributable to the relevant CGUs or operating segments. The discount rates used have been benchmarked against externally published rates used by comparable quoted companies operating in the respective market sectors. The discount rates applied in 2018, 2017 and 2016 remain consistent, reflecting SSE Energy Services’ view of cost of capital and risk. The recoverable amounts derived from the VIU calculations are compared to the carrying amount of each asset or CGU to determine whether an impairment charge requires to be recognised. The review for 2018 was carried out in the fourth quarter of the year, which is consistent with previous reviews. Note that the actual outcomes may differ from the assumptions included in the assessments at the balance sheet date.

Assets/ CGUs	Cash flow period assumption	Operating and other valuation assumptions	Commentary and impairment conclusions
Goodwill / Energy Supply	5 years	<p>The key assumption driving the VIU assessment is the net margin expected to be achieved from current and new Energy Supply customers.</p> <p>The derivation of the net margins applied include assumptions for future power and gas prices, credit losses, acquisition and retention costs, sales and marketing costs, government schemes such as ECO and other impacts of competition and regulation such as Price Caps.</p> <p>The projected cash flows derived are discounted by applying a discount rate of 10.8%, which is consistent with the previous year.</p>	<p>The calculated VIU for the Energy Supply CGU significantly exceeded the carrying values of goodwill, PP&amp;E and other intangibles at the time of the impairment test.</p> <p>While cash flow projections are subject to inherent uncertainty, particularly the impact a Price Cap would have, a reasonable possible reduction in cashflows of 10% would not cause a change to the conclusion reached.</p>
PP&E and other intangibles /	5 years	<p>The key assumption driving the VIU assessment is the net margin expected to be achieved from current and new</p>	<p>The calculated VIU for the Energy Supply &amp; Energy Related Services CGU significantly exceeded the</p>

Assets/ CGUs	Cash flow period assumption	Operating and other valuation assumptions	Commentary and impairment conclusions
Energy Supply & Energy Related Services		<p>Energy Supply and Energy Related Services customers.</p> <p>The derivation of the net margins applied include assumptions for future power and gas prices, credit losses, acquisition and retention costs, sales and marketing costs, government schemes such as ECO and other impacts of competition and regulation such as Price Caps.</p> <p>The projected cash flows derived are discounted by applying a discount rate of 10.9%, which is consistent with the previous year.</p>	<p>carrying values of goodwill, PP&amp;E and other intangibles at the time of the impairment test.</p> <p>While cash flow projections are subject to inherent uncertainty, particularly the impact a Price Cap would have, a reasonable possible reduction in cashflows of 10% would not cause a change to the conclusion reached.</p>

## 11 Inventories

	2016 £m	2017 £m	2018 £m
Raw materials and consumables . . . . .	0.3	0.7	1.0
Less: provisions held . . . . .	—	—	—
	<u>0.3</u>	<u>0.7</u>	<u>1.0</u>

## 12 Trade and other receivables

	2016 £m	2017 £m	2018 £m
Trade receivables . . . . .	315.9	339.7	333.2
Other receivables . . . . .	1.9	11.0	8.7
Prepayments and accrued income:			
Unbilled energy income . . . . .	648.2	564.5	747.5
Other prepayments and accrued income . . . . .	<u>15.0</u>	<u>15.1</u>	<u>30.1</u>
	<u>981.0</u>	<u>930.3</u>	<u>1,119.5</u>

Prepayments and accrued income includes ‘unbilled’ energy income which represents an estimate of the value of electricity or gas supplied to customers between the date of the last meter reading and the year end. Details of the judgements applied in deriving these balances are included at Note 2. SSE Energy Services estimates the value of residual electricity consumption uncertainty at the year end is around £25.0m (2017—£25.0m, 2016—£25.0m). SSE Energy Services also applies a percentage reduction to consumption estimates in relation to gas to take account of inaccuracies in the industry settlement process which have historically allocated more volume than has been recovered through subsequent billings. A 0.5% change in this percentage adjustment would increase or decrease the accrued income recognised by £6.5m in the current year (2017—£6.0m, 2016—£8.0m).

Trade receivables and other financial assets are part of the Group’s financial exposure to credit risk as explained in Note 15.

## 13 Trade and other payables: amounts falling due within one year

	2016 £m	2017 £m	2018 £m
Trade payables . . . . .	107.3	68.5	44.1
Amounts due to related undertakings . . . . .	225.8	178.0	233.9
Other creditors . . . . .	833.1	719.1	677.6
Accruals and deferred income . . . . .	<u>299.9</u>	<u>380.2</u>	<u>453.1</u>
	<u>1,466.1</u>	<u>1,345.8</u>	<u>1,408.7</u>

## 14 Held-for-sale assets

During the year ended 31 March 2016, Parent substantially completed the programme of non-core asset and business disposals that it had announced on 26 March 2014 along with a number of other separately identified assets. As the programme came to an end, some assets remained classified as held-for-sale on the balance sheet as at 31 March 2016. The aggregated pre-tax profit contribution of the held for sale assets and businesses in the year to 31 March 2016 was £nil.

On 26 May 2016 SSE Energy Services disposed of £43.5m (£27.9m held for sale at 31 March 2016 and £15.6m disposed from PP&E, see Note 8) of smart meter assets to Meter Fit 10 Limited for cash consideration equal to book value resulting in £nil gain/(loss) on disposal.

The assets and liabilities classified as held-for-sale, and the comparative balances, are as follows:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Property, plant and equipment . . . . .	<u>27.9</u>	<u>—</u>	<u>—</u>

## 15 Financial risk management

The Board of Parent has overall responsibility for the establishment and oversight of the risk management framework. The Risk Committee in the Retail division reports directly to the Executive Committee to support the Parent's risk management responsibilities by reviewing the strategic, market, credit operational and liquidity risks and exposures that arise from energy supply and treasury operations. The Risk Committees of Retail is designed to ensure strict business separation requirements are maintained.

The Parent's policies for risk management are established to identify the risks faced by the Parent Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. These policies, and the systems used to monitor activities, are reviewed regularly by the Risk Committee in Retail.

The legal entities within SSE Energy Services participate in a Group-wide centralised treasury and cash pooling system which is managed by Parent. EPM enters into forward purchase agreements to manage SSE Energy Supply's exposure to energy commodity price movements and requirement for the delivery of its physical commodity needs as part of its normal course of business. The risk management activity arises from the Parent Group's requirement to source gas, electricity or other commodities such as renewable obligation certificates for energy supply and has been managed centrally during the review period. Financial instruments of SSE Energy Supply comprise cash in transit, receivables, payables arising directly from operations and derivatives to manage commodity risk. Derivative financial instruments relate to operating derivatives for qualifying commodity contracts for electricity and gas.

SSE Energy Services has exposure to the following risks from its use of financial instruments:

- Credit risk;
- Liquidity risk; and
- Commodity risk.

### Credit risk

#### *Treasury-related credit risk*

Credit risk management for SSE Energy Services is exercised and monitored at the Parent Group level.

#### *Commercial related credit risk*

Credit risk is the risk of financial loss if a customer or counterparty fails to meet its contractual obligations. The greatest credit risks exist in the supply of electricity and gas to end user customers through the potential of a customer defaulting on their invoiced payables. Exposure to credit risk is subject to diversification with no exposure to individual customers totalling >10% of trade receivables. Customers' creditworthiness is reviewed from a variety of internal and external information. Trade receivables represent the most significant exposure to credit risk and are stated after an allowance for impairment.

Cash and cash equivalents comprise cash in transit due from customers. These are subject to insignificant risk of change in value or credit risk.

Derivative financial instruments are entered into to cover SSE Energy Services' commodity risks and are consequently covered elsewhere in this note.

### Concentrations of risk

Trade receivables recorded by reportable segment held at the 31 March were:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Energy Supply . . . . .	305.2	332.7	325.9
Energy-related services . . . . .	10.7	7.0	7.3
<b>Total</b> . . . . .	<b><u>315.9</u></b>	<b><u>339.7</u></b>	<b><u>333.2</u></b>

The ageing of trade receivables at the reporting date was:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Not past due . . . . .	183.4	206.3	179.2
<i>Past due but not individually impaired:</i>			
0–30 days . . . . .	64.4	66.7	71.9
31–90 days . . . . .	52.4	48.7	53.4
Over 90 days . . . . .	128.5	102.0	113.4
	428.7	423.7	417.9
Less: allowance for impairment . . . . .	(112.8)	(84.0)	(84.7)
Net Trade receivables . . . . .	<u>315.9</u>	<u>339.7</u>	<u>333.2</u>

SSE Energy Services has past due debt which has not had an impairment allowance set aside to cover potential credit losses. SSE Energy Services has certain procedures to pursue customers in significant arrears and believes its impairment policy in relation to such balances is appropriate. Those debts which are neither past due nor impaired are considered to be good and are expected to be recoverable.

The movement in the allowance for impairment of trade receivables was:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Balance at 1 April . . . . .	123.3	112.8	84.0
Increase in allowance for impairment . . . . .	33.1	13.2	39.5
Impairment losses recognised . . . . .	(43.6)	(42.0)	(38.8)
<b>Balance at 31 March</b> . . . . .	<b><u>112.8</u></b>	<b><u>84.0</u></b>	<b><u>84.7</u></b>

At the end of each reporting period a review of the provision for bad and doubtful debts is performed. It is an assessment of the potential amount of trade receivables which will not be paid by customers after the balance sheet date. This amount is calculated by reference to the age, status and risk of each class of receivable.

### Liquidity risk and Going Concern

Capital and liquidity risk management for SSE Energy Services is performed at the Parent Group level. The Parent manages its capital to ensure that entities in the Parent Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt to equity balance.

The following are the undiscounted contractual maturities of financial liabilities, including interest and excluding the impact of netting agreements:

<u>2016</u>	<u>Carrying Value</u>	<u>Contractual Cash Flows</u>	<u>0–12 months</u>	<u>1–2 years</u>	<u>2–5 years</u>	<u>&gt; 5 years</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Derivative financial instruments <sup>(i)</sup> . . . . .	191.0	(899.2)	(721.4)	(102.2)	(75.6)	—
Trade payables . . . . .	107.3	(107.3)	(107.3)	—	—	—
Amounts due to related undertakings . . . . .	225.8	(225.8)	(225.8)	—	—	—
	<u>524.1</u>	<u>(1,232.3)</u>	<u>(1,054.5)</u>	<u>(102.2)</u>	<u>(75.6)</u>	<u>—</u>

<u>2017</u>	<u>Carrying Value</u>	<u>Contractual Cash Flows</u>	<u>0–12 months</u>	<u>1–2 years</u>	<u>2–5 years</u>	<u>&gt; 5 years</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Derivative financial instruments <sup>(i)</sup> . . . . .	24.2	(490.0)	(447.0)	(52.0)	9.0	—
Trade payables . . . . .	68.5	(68.5)	(68.5)	—	—	—
Amounts due to related undertakings . . . . .	178.0	(178.0)	(178.0)	—	—	—
<b>Net total</b> . . . . .	<b>270.7</b>	<b>(736.5)</b>	<b>(693.5)</b>	<b>(52.0)</b>	<b>9.0</b>	<b>—</b>

<u>2018</u>	<u>Carrying Value</u>	<u>Contractual Cash Flows</u>	<u>0–12 months</u>	<u>1–2 years</u>	<u>2–5 years</u>	<u>&gt; 5 years</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Derivative financial instruments <sup>(i)</sup> . . . . .	(10.6)	(136.8)	(189.6)	27.7	25.1	—
Trade payables . . . . .	44.1	(44.1)	(44.1)	—	—	—
Amounts due to related undertakings . . . . .	233.9	(233.9)	(233.9)	—	—	—
	267.4	(414.8)	(467.6)	27.7	25.1	—

(i) SSE Energy Services believes the liquidity risk associated with out-of-the-money operating derivative contracts needs to be considered in conjunction with the profile of payments or receipts arising from derivative financial assets. It should be noted that cash flows associated with future energy sales and commodity contracts which are not IAS 39 financial instruments are not included in this analysis, which is prepared in accordance with IFRS 7.

### **Commodity risk**

#### **Commodity risk**

The risk management activity arises from the requirement to source gas, electricity or other commodities such as renewable obligation certificates for energy supply and has been managed centrally by the Parent Group during the review period.

Within its regular course of business, SSE Energy Services routinely enters into sale and purchase derivative contracts for commodities such as electricity and gas. All trades have historically been entered into with SSE EPM Limited (“EPM”), a fellow Parent Group company. EPM enters into all external trades on behalf of SSE Energy Services. Where the contract was entered into and continues to be held for the purpose of receipt or delivery in accordance with SSE Energy Services’ expected sale, purchase or usage requirements, the contracts are designated as ‘own use’ contracts and are measured at cost. These contracts are not within the scope of IAS 39.

Within this approach, only certain of the energy commodity contracts are deemed to constitute financial instruments under IAS 39. As a result, while the Parent Group manages the commodity price risk associated with both financial and non-financial commodity contracts, it is only the fair value of IAS 39 financial instruments which represents the exposure of the commodity price risk under IFRS 7. This is a consequence of the accounting policy which stipulates that commodity contracts which are designated as financial instruments under IAS 39 should be accounted for on a fair value basis with changes in fair value reflected in profit or equity. Conversely, commodity contracts that are not designated as financial instruments under IAS 39 will be accounted for as ‘own use’ contracts. As fair value changes in own use contracts are not reflected through profit or equity, these do not represent the IFRS 7 commodity price risk. Therefore, as the overall VaRs associated with commodity risk will be monitored for internal risk management purposes and is outside the scope of IAS 39.

Short-term exposures will arise from the requirement to match volumes of procured gas and electricity with demand for gas and electricity by Energy Supply customers. These requirements can vary from expectations and result in a need to close the contracted positions at unfavourable prices. Longer-term exposures are managed through longer term contracts (including forwards, futures contracts and other financial instruments). These, in turn, are used to reduce short-term market exposures.

SSE Energy Services’ exposure to commodity price risk according to IFRS 7 is measured by reference to the IAS 39 commodity contracts. IFRS 7 requires disclosure of a sensitivity analysis for market risks that is intended to illustrate the sensitivity of the financial position and performance to changes in market variables impacting upon the fair value or cash flows associated with the financial instruments.

Therefore, the sensitivity analysis provided discloses the effect on profit or loss and equity at the balance sheet date assuming that a reasonably possible change in the relevant commodity price had occurred, and been applied to the risk exposures in existence at that date. The reasonably possible changes in commodity prices

used in the sensitivity analysis were determined based on calculated or implied volatilities where available, or historical data.

The sensitivity analysis has been calculated on the basis that the proportion of commodity contracts that are IAS 39 financial instruments remains consistent with those at that point. Excluded from this analysis are all commodity contracts that are not financial instruments under IAS 39.

	2016		2017		2018	
	Base Price	Reasonably possible increase/decrease in variable	Base Price	Reasonably possible increase/decrease in variable	Base Price	Reasonably possible increase/decrease in variable
<b>Commodity prices</b>						
UK gas (p/therm) . . . . .	33	+/-4	43	+/-11	45	+/-11
UK power (£/MWh) . . . . .	33	+/-5	40	+/-10	45	+/-11

(i) The base price represents the average forward market price over the duration of the active market curve used to calculate the sensitivity analysis.

The impacts of reasonably possible changes in commodity prices on profit after taxation based on the rationale described are as follows:

	2016	2017	2018
	Impact on profit and equity £m	Impact on profit and equity £m	Impact on profit and equity £m
<b>Incremental profit/ (loss)</b>			
Commodity prices combined—increase . . . . .	31.1	49.2	10.0
Commodity prices combined—decrease . . . . .	(31.1)	(49.2)	(10.0)

The sensitivity analysis provided is hypothetical and is based on the commodity contracts under IAS 39. This is analysis only and should be used with caution as the impacts disclosed are not necessarily indicative of the actual impacts that would be experienced. It should also be noted that these sensitivities impacts provided are indicative only and are based on calculations which do not consider all interrelationships, consequences and effects of such a change in those prices.

## Fair Value of financial instruments

The fair values of the primary financial assets and liabilities of SSE Energy Services together with their carrying values are as follows:

<b>2016</b>	<b>Amortised cost or other £m</b>	<b>Classified as trading £m</b>	<b>Total carrying value £m</b>	<b>Fair value £m</b>
<b>Financial Assets</b>				
<b>Current</b>				
Trade receivables . . . . .	315.9	—	315.9	315.9
Other receivables . . . . .	1.9	—	1.9	1.9
Cash and cash equivalents . . . . .	79.8	—	79.8	79.8
Derivative financial assets . . . . .	—	99.8	99.8	99.8
	<u>397.6</u>	<u>99.8</u>	<u>497.4</u>	<u>497.4</u>
<b>Non-current</b>				
Derivative financial assets . . . . .	—	15.9	15.9	15.9
	<u>—</u>	<u>15.9</u>	<u>15.9</u>	<u>15.9</u>
	<u>397.6</u>	<u>115.7</u>	<u>513.3</u>	<u>513.3</u>
<b>Financial Liabilities</b>				
<b>Current</b>				
Trade payables . . . . .	(107.3)	—	(107.3)	(107.3)
Derivative financial liabilities . . . . .	—	(241.5)	(241.5)	(241.5)
	<u>(107.3)</u>	<u>(241.5)</u>	<u>(348.8)</u>	<u>(348.8)</u>
<b>Non-current</b>				
Derivative financial liabilities . . . . .	—	(65.2)	(65.2)	(65.2)
	<u>—</u>	<u>(65.2)</u>	<u>(65.2)</u>	<u>(65.2)</u>
	<u>(107.3)</u>	<u>(306.7)</u>	<u>(414.0)</u>	<u>(414.0)</u>
<b>Net financial assets/(liabilities)</b> . . . . .	<u>290.3</u>	<u>(191.0)</u>	<u>99.3</u>	<u>99.3</u>

(i) Recorded at amortised cost or loans and receivables.

(ii) IAS 39 financial instruments.

<b>2017</b>	<b>Amortised cost or other £m</b>	<b>Classified as trading £m</b>	<b>Total carrying value £m</b>	<b>Fair value £m</b>
<b>Financial Assets</b>				
<b>Current</b>				
Trade receivables . . . . .	339.7	—	339.7	339.7
Other receivables . . . . .	11.0	—	11.0	11.0
Cash and cash equivalents . . . . .	69.1	—	69.1	69.1
Derivative financial assets . . . . .	—	46.0	46.0	46.0
	<u>419.8</u>	<u>46.0</u>	<u>465.8</u>	<u>465.8</u>
<b>Non-current</b>				
Derivative financial assets . . . . .	—	14.4	14.4	14.4
	<u>—</u>	<u>14.4</u>	<u>14.4</u>	<u>14.4</u>
	<u>419.8</u>	<u>60.4</u>	<u>480.2</u>	<u>480.2</u>
<b>Financial Liabilities</b>				
<b>Current</b>				
Trade payables . . . . .	(68.5)	—	(68.5)	(68.5)
Derivative financial liabilities . . . . .	—	(67.7)	(67.7)	(67.7)
	<u>(68.5)</u>	<u>(67.7)</u>	<u>136.2</u>	<u>136.2</u>
<b>Non-current</b>				
Derivative financial liabilities . . . . .	—	(16.9)	(16.9)	(16.9)
	<u>—</u>	<u>(16.9)</u>	<u>(16.9)</u>	<u>(16.9)</u>
	<u>(68.5)</u>	<u>(84.6)</u>	<u>(153.1)</u>	<u>(153.1)</u>
<b>Net financial assets/(liabilities)</b>	<b><u>351.3</u></b>	<b><u>(24.2)</u></b>	<b><u>327.1</u></b>	<b><u>327.1</u></b>

(i) Recorded at amortised cost or loans and receivables.

(ii) IAS 39 financial instruments.

<b>2018</b>	<b>Amortised cost or other £m</b>	<b>Classified as trading £m</b>	<b>Total carrying value £m</b>	<b>Fair value £m</b>
<b>Financial Assets</b>				
<b>Current</b>				
Trade receivables . . . . .	333.2	—	333.2	333.2
Other receivables . . . . .	8.7	—	8.7	8.7
Cash and cash equivalents . . . . .	80.6	—	80.6	80.6
Derivative financial assets . . . . .	—	60.9	60.9	60.9
	<u>422.5</u>	<u>60.9</u>	<u>483.4</u>	<u>483.4</u>
<b>Non-current</b>				
Derivative financial assets . . . . .	—	9.1	9.1	9.1
	<u>—</u>	<u>9.1</u>	<u>9.1</u>	<u>9.1</u>
	<u>422.5</u>	<u>70.0</u>	<u>492.5</u>	<u>492.5</u>
<b>Financial Liabilities</b>				
<b>Current</b>				
Trade payables . . . . .	(44.1)	—	(44.1)	(44.1)
Derivative financial liabilities . . . . .	—	(46.1)	(46.1)	(46.1)
	<u>(44.1)</u>	<u>(46.1)</u>	<u>(90.2)</u>	<u>(90.2)</u>
<b>Non-current</b>				
Derivative financial liabilities . . . . .	—	(13.3)	(13.3)	(13.3)
	<u>—</u>	<u>(13.3)</u>	<u>(13.3)</u>	<u>(13.3)</u>
	<u>(44.1)</u>	<u>(59.4)</u>	<u>(103.5)</u>	<u>(103.5)</u>
<b>Net financial assets/(liabilities)</b>	<b><u>378.4</u></b>	<b><u>10.6</u></b>	<b><u>389.0</u></b>	<b><u>389.0</u></b>

(i) Recorded at amortised cost or loans and receivables.

(ii) IAS 39 financial instruments.



## Basis of determining fair value

Certain assets and liabilities designated and carried at amortised cost are receivables. For certain current assets and liabilities their carrying value is equivalent to fair value due to short term maturity.

Assets and liabilities designated at fair value and the fair value of other financial assets and liabilities have been determined by reference to closing rate market values. Commodity contracts fair values are based on published price quotations. The fair values are stated at a specific date and may be different from the amounts which will actually be paid or received on settlement of the instruments. The fair value of items such as property, plant and equipment or internally generated brands are not included as these are not financial instruments.

## Fair value hierarchy

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

Level 1 fair value measurements are those derived from unadjusted quoted market prices for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Financial Instruments</b>				
Energy derivatives . . . . .	—	10.6	—	10.6

There were no significant transfers out of level 1 into level 2 and out of level 2 into level 1 during the year ended 31 March 2018.

## Financial instruments—income statement

Operating derivatives include all qualifying commodity contracts including those for electricity and gas.

<u>Operating Derivatives</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Total result on operating derivatives <sup>(i)</sup> . . . . .	(581.1)	183.8	114.6
Less: Amounts settled <sup>(ii)</sup> . . . . .	491.2	(17.0)	(79.8)
<b>Net income statement impact</b> . . . . .	<b><u>(89.9)</u></b>	<b><u>166.8</u></b>	<b><u>34.8</u></b>

(i) Total result on operating derivatives represents the total amounts (charged) or credited to the combined and carved out income statement in respect of operating derivatives.

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

## Financial instruments—balance sheet

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

<u>Derivative Assets</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Non-current . . . . .	15.9	14.4	9.1
Current . . . . .	99.8	46.0	60.9
<b>Total derivative assets</b> . . . . .	<b><u>115.7</u></b>	<b><u>60.4</u></b>	<b><u>70.0</u></b>
<b>Derivative Liabilities</b>			
Non-current . . . . .	(65.2)	(16.9)	(13.3)
Current . . . . .	(241.5)	(67.7)	(46.1)
<b>Total derivative liabilities</b> . . . . .	<b><u>(306.7)</u></b>	<b><u>(84.6)</u></b>	<b><u>(59.4)</u></b>
<b>Net financial assets/(liabilities)</b> . . . . .	<b><u>(191.0)</u></b>	<b><u>(24.2)</u></b>	<b><u>10.6</u></b>

## 16 Provisions for liabilities and charges

	£m
<b>At 1 April 2015</b>	14.0
Charged in the year	0.1
Released during the year	(0.3)
Utilised during the year	(3.1)
<b>At 31 March 2016</b>	<b>10.7</b>
Released during the year	(0.5)
Utilised during the year	(1.2)
<b>At 31 March 2017</b>	<b>9.0</b>
Charged in the year	5.0
Released during the year	(6.0)
Utilised during the year	(2.9)
<b>At 31 March 2018</b>	<b>5.1</b>

Provisions all relate to specific license condition related obligations.

## 17 Deferred taxation

Deferred tax assets and liabilities are attributable to the following:

	Assets			Liabilities			Net		
	2016	2017	2018	2016	2017	2018	2016	2017	2018
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Tangible fixed assets	—	—	—	(21.5)	(19.5)	(19.5)	(21.5)	(19.5)	(19.5)
Provisions	5.4	3.2	4.0	—	—	—	5.4	3.2	4.0
Financial assets	34.4	4.6	—	—	—	(2.0)	34.4	4.6	(2.0)
Net tax assets	<u>39.8</u>	<u>7.8</u>	<u>4.0</u>	<u>(21.5)</u>	<u>(19.5)</u>	<u>(21.5)</u>	<u>18.3</u>	<u>(11.7)</u>	<u>(17.5)</u>

### Movement in deferred tax

	Tangible fixed assets	Provisions	Financial assets	Total
	£m	£m	£m	£m
<b>At 1 April 2015</b>	(21.3)	10.7	20.2	9.6
Recognised in income	(0.2)	(5.3)	14.2	8.7
Recognised in equity	—	—	—	—
<b>At 31 March 2016</b>	(21.5)	5.4	34.4	18.3
Recognised in income	2.0	(2.2)	(29.8)	(30.0)
Recognised in equity	—	—	—	—
<b>At 31 March 2017</b>	(19.5)	3.2	4.6	11.7
Recognised in income	—	0.8	(6.6)	(5.8)
Recognised in equity	—	—	—	—
<b>At 31 March 2018</b>	<u>(19.5)</u>	<u>4.0</u>	<u>(2.0)</u>	<u>(17.5)</u>

## 18 Pensions

Some of the SSE Energy Services' employees are members of the Scottish Hydro Electric Pension Scheme or Southern Electric Pension Scheme which provides defined benefits based on pensionable pay. As there is no contractual agreement or stated Parent Group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is another member of the Parent Group.

New employees can opt to join a personal pension scheme which is a money purchase scheme with SSE Energy Services matching the members' contributions up to a maximum of 6% of salary. The scheme is managed by Friends Provident.

SSE Energy Services' share of the total contribution payable to the pension schemes during the year was £17.6m (2017: £15.7m, 2016: £17.7m).

## 19 Commitments and contingencies

### Capital commitments

Contracted for but not provided capital commitments include the fixed contracted costs of the SSE Energy Services' major capital projects. In practice, contractual variations may arise on the final settlement of these contractual costs.

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Capital expenditure contracted for but not provided . . . . .	44.7	27.5	7.3

### Guarantees and indemnities

SSE Energy Services has provided guarantees on behalf of other Parent Group undertakings as follows:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Performance of contracts . . . . .	31.0	110.3	83.0
Upward guarantee to SSE . . . . .	1,000.0	1,000.0	—

Where SSE Energy Services enters into financial guarantee contracts to guarantee indebtedness of the other Parent Group undertakings, SSE Energy Services considers these to be insurance arrangements, and accounts for them as such. In this respect, SSE Energy Services treats the guarantee contract as a contingent liability until such time as it becomes probable that SSE Energy Services will be required to make payment under the guarantee.

**Part B Npower Group Limited (formerly Npower Group plc) audited consolidated historical financial information for the years ended 31 December 2015, 2016 and 2017**

The Directors (the “**Directors**”)

SSE plc

Inveralmond House

200 Dunkeld Road

Perth, PH1 3AQ

27 June 2018

Dear Sirs

**Npower Group Limited (formerly Npower Group plc)**

We report on the financial information of Npower Group Limited (formerly Npower Group plc) and its subsidiaries (together, the “**Npower Group**”) for the three years ended 31 December 2017 set out in this Part B of Part XI (*Historical Financial Information*) below (the “**Npower Group Financial Information Table**”). The Npower Group Financial Information Table has been prepared for inclusion in the circular dated 27 June 2018 (the “**Circular**”) of SSE plc (the “**Company**”) on the basis of the accounting policies set out in the accounting policies note to the Npower Group Financial Information Table. This report is provided in connection with the Directors’ responsibilities under item 13.3.1R(3) of the Listing Rules issued by the Financial Conduct Authority (the “**Listing Rules**”) and is given for the purpose of complying with that item and for no other purpose.

**Responsibilities**

The Directors of the Company are responsible for preparing the Npower Group Financial Information Table in accordance with International Financial Reporting Standards as adopted by the European Union.

It is our responsibility to form an opinion as to whether the Npower Group Financial Information Table gives a true and fair view, for the purposes of the Circular and to report our opinion to you.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and which we may have to shareholders of the Company as a result of the inclusion of this report in the Circular, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such person as a result of, arising out of, or in connection with this report.

**Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the Npower Group’s circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

**Opinion**

In our opinion, the Npower Group Financial Information Table gives, for the purposes of the Circular dated 27 June 2018, a true and fair view of the state of affairs of the Npower Group as at the dates stated and of its profits/losses, cash flows, and changes in equity for the periods then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Yours faithfully

PricewaterhouseCoopers LLP  
Chartered Accountants

**Npower Group Limited (formerly Npower Group plc)**

**Consolidated Income Statement for the three years ended 31 December 2015, 31 December 2016 and 31 December 2017**

		2015			2016			2017		
	Note	Before Exceptional operating items and certain re-measurements	Exceptional operating items and certain re-measurements (Note 2)	Total	Before Exceptional operating items and certain re-measurements	Exceptional operating items and certain re-measurements (Note 2)	Total	Before Exceptional operating items and certain re-measurements	Exceptional operating items and certain re-measurements (Note 2)	Total
<b>£m</b>										
Revenue	1	6,690.0	—	6,690.0	6,152.3	—	6,152.3	6,014.6	—	6,014.6
Cost of sales		(5,949.3)	(23.6)	(5,972.9)	(5,384.5)	275.2	(5,109.3)	(5,270.3)	8.4	(5,261.9)
Gross profit		740.7	(23.6)	717.1	767.8	275.2	1,043.0	744.3	8.4	752.7
Administrative expenses	3, 4	(839.7)	(130.9)	(970.6)	(857.2)	—	(857.2)	(799.6)	—	(799.6)
Operating (loss) / profit		(99.0)	(154.5)	(253.5)	(89.4)	275.2	185.8	(55.3)	8.4	(46.9)
Finance income	5			0.9			0.1			1.4
Finance expense	5			(79.5)			(77.0)			(345.6)
<b>(Loss) / Profit before taxation</b>				<b>(332.1)</b>			<b>108.9</b>			<b>(391.1)</b>
Taxation	6			49.9			(29.7)			19.3
<b>(Loss) / Profit for the year</b>				<b>(282.2)</b>			<b>79.2</b>			<b>(371.8)</b>
<b>(Loss) / Earnings per share</b>										
Earnings per share—Basic and diluted (£)	26			(8.5)			2.4			(1.6)

The notes on the following pages are an integral part of these consolidated historical financial information.

**Npower Group Limited (formerly Npower Group plc)**

**Consolidated Statement of Comprehensive Income for the three years ended 31 December 2015,  
31 December 2016 and 31 December 2017**

	<u>Note</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
			<u>£m</u>	
<b>(Loss) / profit for the year</b> . . . . .		<b>(282.2)</b>	<b>79.2</b>	<b>(371.8)</b>
Actuarial (losses) / gains of defined benefit pension plans and similar obligations, net of taxation . . . . .	18	(11.4)	(29.9)	61.0
<b>(Expenses) / income recognised in equity, not to be reclassified through profit or loss</b> . . . . .		<b>(11.4)</b>	<b>(29.9)</b>	<b>61.0</b>
Currency translation differences . . . . .		(0.9)	(1.3)	(1.1)
Change in value of available for sale financial assets, net of taxation . . . .	9	(0.9)	(0.4)	0.1
<b>(Expenses) / income recognised in equity, to be reclassified through profit or loss in the future</b> . . . . .		<b>(1.8)</b>	<b>(1.7)</b>	<b>(1.0)</b>
<b>Other comprehensive (loss) / profit</b> . . . . .		<b>(13.2)</b>	<b>(31.6)</b>	<b>60.0</b>
<b>Total comprehensive (loss) / profit</b> . . . . .		<b>(295.4)</b>	<b>47.6</b>	<b>(311.8)</b>
of which: attributable to Npower Group Limited (formerly Npower Group plc) shareholders . . . . .		<b>(295.4)</b>	<b>47.6</b>	<b>(311.8)</b>

The notes on the following pages are an integral part of these consolidated historical financial information.

**Npower Group Limited (formerly Npower Group plc)**

**Consolidated Balance Sheet as at 31 December 2015, 31 December 2016 and 31 December 2017**

	<u>Note</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
		<u>£m</u>		
<b>Assets</b>				
Property, plant and equipment . . . . .	7	22.1	20.3	22.5
Intangible assets . . . . .	8	808.1	803.0	763.0
Deferred tax assets . . . . .	11	157.7	109.5	108.3
Available for sale financial assets . . . . .	9	4.6	5.0	5.1
Derivative financial instruments . . . . .	10	60.4	66.2	41.5
<b>Non-current assets</b> . . . . .		<b><u>1,052.9</u></b>	<b><u>1,004.0</u></b>	<b><u>940.4</u></b>
Inventories . . . . .	12	0.9	1.6	3.1
Other financial receivables . . . . .	13	—	70.0	—
Trade and other receivables . . . . .	14	1,530.9	1,451.7	1,703.3
Derivative financial instruments . . . . .	10	95.9	107.8	89.2
Income tax assets . . . . .	6	13.9	10.1	5.8
Cash and cash equivalents . . . . .	15	45.0	—	3.6
<b>Current assets</b> . . . . .		<b><u>1,686.6</u></b>	<b><u>1,641.2</u></b>	<b><u>1,805.0</u></b>
<b>Total assets</b> . . . . .		<b><u><u>2,739.5</u></u></b>	<b><u><u>2,645.2</u></u></b>	<b><u><u>2,745.4</u></u></b>
<b>Liabilities</b>				
Other financial liabilities . . . . .	19	(315.8)	(1,160.9)	(787.7)
Trade and other payables . . . . .	20	(1,898.8)	(1,788.5)	(1,821.0)
Provisions for liabilities and charges . . . . .	17	(38.5)	(31.4)	(23.3)
Derivative financial instruments . . . . .	10	(243.8)	(89.9)	(65.5)
<b>Current liabilities</b> . . . . .		<b><u>(2,496.9)</u></b>	<b><u>(3,070.7)</u></b>	<b><u>(2,697.5)</u></b>
Provisions for liabilities and charges . . . . .	17	(0.4)	(1.0)	(2.3)
Other financial liabilities . . . . .	19	(1,515.0)	(915.0)	—
Derivative financial instruments . . . . .	10	(148.7)	(37.4)	(11.1)
Deferred tax liabilities . . . . .	11	—	(8.1)	(9.5)
Provisions for pensions and similar obligations . . . . .	18	(189.2)	(176.1)	(16.1)
<b>Non-current liabilities</b> . . . . .		<b><u>(1,853.3)</u></b>	<b><u>(1,137.6)</u></b>	<b><u>(39.0)</u></b>
<b>Total liabilities</b> . . . . .		<b><u>(4,350.2)</u></b>	<b><u>(4,208.3)</u></b>	<b><u>(2,736.5)</u></b>
<b>Net (liabilities) / assets</b> . . . . .		<b><u><u>(1,610.7)</u></u></b>	<b><u><u>(1,563.1)</u></u></b>	<b><u><u>8.9</u></u></b>
<b>Equity attributable to owners</b>				
Share capital . . . . .	16	33.2	33.2	1,917.0
Available for sale financial assets reserve . . . . .	9	1.9	1.5	1.6
Accumulated deficit . . . . .	16	(1,645.8)	(1,597.8)	(1,909.7)
<b>Total equity</b> . . . . .		<b><u><u>(1,610.7)</u></u></b>	<b><u><u>(1,563.1)</u></u></b>	<b><u><u>8.9</u></u></b>

The notes on the following pages are an integral part of these consolidated historical financial information.

**Npower Group Limited (formerly Npower Group plc)**

**Consolidated Statement of Changes in Equity for the three years ended 31 December 2015, 31 December 2016 and 31 December 2017**

	<u>Note</u>	<u>Share capital of Npower Group Limited (formerly Npower Group plc)</u>	<u>Accumulated deficit</u>	<u>Available for sale financial assets reserve</u>	<u>Total Equity</u>
			<b>£m</b>		
<b>Balance at 1 January 2015</b> . . . . .		<b>33.2</b>	<b>(1,351.3)</b>	<b>2.8</b>	<b>(1,315.3)</b>
(Loss) / Profit for the year . . . . .		—	(282.2)	—	(282.2)
Other comprehensive (loss) / income . . . . .		—	(12.3)	(0.9)	(13.2)
Total comprehensive (loss) / income . . . . .		—	(294.5)	(0.9)	(295.4)
<b>Balance at 31 December 2015</b> . . . . .		<b>33.2</b>	<b>(1,645.8)</b>	<b>1.9</b>	<b>(1,610.7)</b>
(Loss) / Profit for the year . . . . .		—	79.2	—	79.2
Other comprehensive (loss) / income . . . . .		—	(31.2)	(0.4)	(31.6)
Total comprehensive (loss) / income . . . . .		—	48.0	(0.4)	47.6
<b>Balance at 31 December 2016</b> . . . . .		<b>33.2</b>	<b>(1,597.8)</b>	<b>1.5</b>	<b>(1,563.1)</b>
(Loss) / Profit for the year . . . . .		—	(371.8)	—	(371.8)
Other comprehensive (loss) / income . . . . .		—	59.9	0.1	60.0
Total comprehensive (loss) / income . . . . .		—	(311.9)	0.1	(311.8)
Shares issued . . . . .	19	1,883.8	—	—	1,883.8
<b>Balance at 31 December 2017</b> . . . . .		<b>1,917.0</b>	<b>(1,909.7)</b>	<b>1.6</b>	<b>8.9</b>

The notes on the following pages are an integral part of these consolidated historical financial information.



**Npower Group Limited (formerly Npower Group plc)**

**Consolidated Cash Flow Statement for the three years ended 31 December 2015, 31 December 2016 and 31 December 2017**

	<u>Note 28</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
		<u>£m</u>		
(Loss) / profit for the year . . . . .		(282.2)	79.2	(371.8)
Depreciation, amortisation, impairment losses/reversals . . . . .		180.1	80.8	84.3
Changes in provisions . . . . .		32.6	1.7	(2.8)
Movement on operating derivatives . . . . .		40.8	(282.9)	(7.3)
Changes in deferred taxes . . . . .		(55.5)	52.4	(25.3)
Changes in current taxes . . . . .		5.6	(22.7)	6.0
Net finance expense . . . . .		78.6	76.9	344.2
Income from disposal of non-current assets . . . . .		(6.6)	(1.2)	0.9
Interest paid . . . . .		(58.8)	(67.3)	(358.7)
Group tax relief (paid) / received . . . . .		(15.4)	40.1	17.2
Total changes in net working capital . . . . .		<u>146.5</u>	<u>(62.9)</u>	<u>(207.9)</u>
<b>Cash flows from operating activities</b>				
<b>(before initial/ subsequent transfer to pension plans) . . . . .</b>		<b><u>65.7</u></b>	<b><u>(105.9)</u></b>	<b><u>(521.2)</u></b>
Initial / subsequent transfer to pension plans . . . . .		<u>(81.8)</u>	<u>(68.7)</u>	<u>(98.0)</u>
<b>Cash flows from operating activities</b>				
<b>(after initial/ subsequent transfer to pension plans) . . . . .</b>		<b><u>(16.1)</u></b>	<b><u>(174.6)</u></b>	<b><u>(619.2)</u></b>
Purchase of property, plant and equipment and intangible assets . . . . .		(105.8)	(46.6)	(67.1)
Proceeds from disposal of assets . . . . .		32.7	1.3	3.3
Capital expenditure (acquisitions and investments) . . . . .		<u>(5.0)</u>	<u>—</u>	<u>—</u>
<b>Cash flows from investing activities . . . . .</b>		<b><u>(78.1)</u></b>	<b><u>(45.3)</u></b>	<b><u>(63.8)</u></b>
Net change in equity . . . . .		—	—	1,883.8
Issuance of financial debt . . . . .		139.2	167.2	375.5
Repayment of financial debt . . . . .		—	—	(1,565.0)
<b>Cash flows from financing activities . . . . .</b>		<b><u>139.2</u></b>	<b><u>167.2</u></b>	<b><u>694.3</u></b>
<b>Net change in cash and cash equivalents . . . . .</b>		<b><u>45.0</u></b>	<b><u>(52.7)</u></b>	<b><u>11.3</u></b>
Cash and cash equivalents at beginning of the reporting period . . . . .		<u>—</u>	<u>45.0</u>	<u>(7.7)</u>
<b>Cash and cash equivalents at end of the reporting period . . . . .</b>		<b><u>45.0</u></b>	<b><u>(7.7)</u></b>	<b><u>3.6</u></b>

The notes on the following pages are an integral part of these consolidated historical financial information.

## **Notes**

### **General information**

Npower Group Limited (formerly Npower Group plc) and its subsidiaries (together, “npower Retail Group”) supply electricity, gas and energy related services to both residential and business customers in the United Kingdom, with operations additionally located in the Republic of Ireland. The address of the npower Retail Group’s registered office is Windmill Hill Business Park, Whitehill Way, Swindon, SN5 6PB, United Kingdom.

As part of RWE AG’s restructuring in 2016, which combined its Renewables, Retail and Grid and Infrastructure businesses, npower Retail Group’s ownership transferred from RWE AG to innogy SE, a newly formed entity. In December 2016, innogy SE was listed on the MDAX as an independent company.

### **Basis of preparation**

The consolidated historical financial information presents the financial track record of the npower Retail Group for the three years ended 31 December 2017 and was prepared for the purpose of supporting the circular issued by the directors of SSE plc in connection with the demerger of SSE plc’s household energy and services business in Great Britain and the proposed subsequent combination of that business with innogy’s subsidiary npower Group Limited (formerly npower Group plc) to form a new independent UK-based group (the ‘Transaction’). This special purpose consolidated historical financial information was prepared in accordance with International Financial Reporting Standards (IFRS), IFRS Interpretations Committee (IFRS IC) interpretations as adopted by the European Union and the npower Retail Group accounting policies.

The consolidated historical financial information was prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss.

As the consolidated historical financial information has been prepared on a non-statutory basis, the requirements of the Companies Act 2006 have not been applied in the preparation of this consolidated historical financial information.

The circular makes reference to the issuance of a prospectus in connection with the proposed admission of shares of the newly formed merged group to the premium listing segment of the Official List and to the trading on the London Stock Exchange’s main market for listed securities. In this context, we note that the consolidated historical financial information of npower Retail Group will need to be presented on the basis of the accounting policies to be adopted by the newly formed merged group in the first financial statements following publication of the prospectus. This may require certain balances to be restated.

### **Accounting policies**

#### **Summary of significant accounting policies**

The principal accounting policies applied in the preparation of this consolidated historical financial information are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

npower Retail Group applies the use of Adjusted accounting measures throughout the consolidated historical financial statements. These measures enable the directors to present the underlying performance of npower Retail Group and its segments to the users of the statements in a consistent and meaningful manner. The adjusted accounting measures apply the term ‘Adjusted operating profit’ which is not defined under IFRS and is explained in more detail in the Adjusted measures section below.

#### **Adjusted measures**

The directors assess the performance of npower Retail Group and its reportable segments based on ‘Adjusted measures’. These measures are used for internal performance management and are believed to be appropriate for explaining underlying performance to users of the accounts.

The performance of the reportable segments is reported based on Adjusted profit before interest and tax (‘Adjusted operating profit’). This is reconciled to Reported profit before interest and tax by adding back exceptional items and certain re-measurements (see Note 2 below). The performance of npower Retail Group is reported based on Adjusted profit before tax which excludes exceptional items and certain re-measurements (see below).

Certain re-measurements are re-measurements arising on certain commodity contracts which are accounted for as held for trading in accordance with the policy for such financial instruments. The amounts shown in the before exceptional items and certain re-measurements results for these contracts is the amount settled in the year as disclosed in Note 2. This excludes commodity contracts not treated as financial instruments under IAS 39 where held for the npower Retail Group's own use requirements which are not recorded until the underlying commodity is delivered.

### **Going concern**

The consolidated historical financial information of the npower Retail Group covering the period from 1 January 2015 to 31 December 2017 has been prepared on a going concern basis, which assumes that the npower Retail Group will continue to trade for a period of at least twelve months from the date of publication of this consolidated historical financial information. The basis of this assumption is that the npower Retail Group has access to the innogy SE group cash management arrangements which provide adequate liquidity. The purpose of the consolidated historical financial information presented herein is to support the filing requirements in conjunction with the proposed merger of the npower Retail Group and SSE plc's UK Retail Supply activities. On completion of the proposed merger, the npower Retail Group will no longer be included within the innogy SE group, and as such the npower Retail Group will cease to have access to the innogy SE group cash management arrangements. At this point, the newly formed merged group will have been required to obtain external finance in order to meet its short-term cash liquidity requirements and to be able to satisfy its financial obligations as they fall due.

If, for any reason, the proposed merger does not complete, then the npower Retail Group will remain a part of the innogy SE group where continued access to the innogy SE group's financing arrangements will be granted.

Therefore, as at the date of publication of the consolidated historical financial information, management continue to prepare the consolidated historical financial information on a going concern basis.

### **Use of estimates and judgements**

The preparation of consolidated historical financial information conforming with IFRS requires the use of certain accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. A summary of estimates and judgements applied in the preparation of these consolidated historical financial information is included in the next section.

### **New standards, amendments and IFRIC interpretations**

No new accounting standards, or amendments to accounting standards, or IFRIC interpretations that are effective for the year ended 31 December 2017, have had a material impact on the npower Retail Group.

The IASB has adopted further Standards and amendments to Standards, which were not yet mandatory in the European Union (EU) in the period ending 31 December 2017. The most important changes are presented below. EU endorsement is still pending in some cases.

**IFRS 9 Financial Instruments (2014)** replaces the previous regulations of IAS 39 on financial instruments. The Standard contains amended regulations on measurement categories for financial assets and includes some smaller changes in relation to the measurement of financial liabilities. Fair value measurement without an effect on income is stipulated for certain debt instruments reported under assets. It also contains regulations on the impairment of assets and hedge accounting. The rules on impairment will now apply to expected losses. The new regulations on hedge accounting are intended to enable better reporting of the risk management activities in the consolidated financial statements. To this end, IFRS 9 expands the range of underlying transactions qualifying for hedge accounting and simplifies effectiveness testing, among other things. The new Standard becomes effective for fiscal years starting on or after 1 January 2018.

For npower Retail Group's investments in equity capital instruments with a total book value of £5.1m (2016: £5m; 2015: £4.6m), the option to capture the fair value changes in other comprehensive income will be exercised.

No material changes are anticipated with regard to the classification of financial assets which have previously been stated at amortised cost.

The accounting treatment of expected losses pursuant to the new impairment model results in the earlier recognition of impairments, higher volatility in the Consolidated Income Statement and lower equity at the time

of transition. First time application of the new impairment model is not expected to have a significant impact on the financial assets held by the npower Retail Group at the time of transition.

No material changes are anticipated in relation to the recognition of financial liabilities.

Hedge accounting under IAS 39 was not applied in 2015 to 2017. No additional hedge accounting is designated on the basis of IFRS 9.

The exercise of fair value options for own-use contracts is not planned. In the transition to the classification and measurement methods pursuant to IFRS 9, the npower Retail Group will not restate any previous-year figures and will thus adjust retained earnings as of 1 January 2018, in order to recognise the impacts from first-time application of the Standard.

**IFRS 15 Revenue from Contracts with Customers (2014)** including Amendments to IFRS 15, Effective Date of IFRS 15 (2015) and Clarifications to IFRS 15 Revenue from Contracts with Customers (2016) will replace the contents of IAS 18 Revenue and IAS 11 Construction Contracts and the corresponding Interpretations.

The new Standard does not distinguish between different types of orders and performance. It establishes uniform criteria as to when revenue is realised for a performance obligation at a point in time or over time. Accordingly, revenue is to be recognised when the customer obtains control of the agreed goods and services and can benefit from such. Application of the new Standard is required for annual periods beginning on or after 1 January 2018. npower Retail Group will apply the modified retrospective method as a transitional method for first-time application as of 1 January 2018. npower Retail Group has completed the IFRS 15 contract analysis and identified the below noted points required specific consideration. However it is not anticipated that there will be a significant effect in relation to the following:

- **Energy supply contracts with households which receive free gifts or goods at a reduced price.** According to IFRS 15, free benefits may represent separate performance obligations, a portion of which should be allocated to the transaction price, and thus revenue is to be recognised upon transfer of control. For goods which are offered at a reduced price, allocation of the total transaction price can result in a change in revenue compared to the current accounting treatment according to IAS 18.

Customers may be offered free benefits in conjunction with signing up for an energy tariff—these benefits represent separate performance obligations as part of the revenue transaction and as such should have a portion of the transaction price allocated to their value. The free benefits are insignificant in value in comparison to the total revenue derived from a typical energy supply contract, and the treatment of these under IFRS 15 will not represent a significant change to the npower Retail Group's treatment under IAS 18. Currently, under IAS 18 the costs associated with these free benefits are treated as an administrative expense.

- **Contracts with households which include warranties for customers.** Warranties can either be an assurance that the product complies with agreed-upon specifications ('assurance-type warranty') or assurances that go above and beyond this ('service-type warranty'). According to IFRS 15, service-type warranties represent separate performance obligations, to which a portion of the transaction price is to be allocated. Warranties which only provide an assurance of the agreed-upon specifications are accounted for in accordance with the principles of IAS 37 for provisions.

The npower Retail Group does offer a limited amount of 'assurance-type warranties' to customers who are on specific energy supply tariffs, however, currently there are no instances of the 'service-type warranties'. Which therefore means under IFRS 15 there will be no change required to the accounting for these arrangements.

- **Contract costs are costs which are additionally incurred in obtaining a contract.** If the npower Retail Group expects that it will recover these costs, they should be capitalised and amortised on a systematic basis consistent with the transfer of the goods or services to the customer. If the expected amortisation period is no longer than one year, in the interests of simplification the contract costs may be recognised as an expense when incurred. Implementation of this new IFRS 15 regulation is limited to changes in presentation and disclosure in the notes.

The only contract costs in relation to contracts with customers that have terms longer than one year, are for certain business customers. Currently, contract costs such as these are capitalised, and subsequently amortised over the same period as the contract term runs—therefore there will be no change to the current treatment of costs of this nature under IFRS 15.

- **Payments to customers for sales purposes are always recognised as a reduction of revenue.** Payment upon signing of the contract results in the recognition of an asset, which is to be amortised over the life of the contract. If the payment for sales purposes is only payable in the future, a provision is formed which is released upon payment.

Payments are not typically made to customers for sales purposes and as such there is no impact in this area expected on transition to IFRS 15.

- **Contracts with households frequently give the customer the right to terminate the contract early.** If the customer can cancel the contract on a monthly basis, the contract term is considered to be one month only in line with IFRS 15.

Contract terms are assessed in line with the earliest end date of the contract. For energy supply contracts, revenue is only recognised on transfer to the customer, as such there will be little impact from the adoption of IFRS 15 in this area.

### **Additional effects and first-time application**

The presentation and disclosure requirements under IFRS 15 are more detailed than the current requirements under IAS 18. In particular, more information will need to be disclosed around:

- **Contracts with customers**—including a disaggregation of revenue that shows how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors; information about the entity's contract assets and liabilities; and information about the entity's remaining performance obligations.
- **Significant judgements**—information about the entity's judgements, and any changes in judgements, in relation to the timing of, and the transaction price allocated to, the satisfaction of performance obligations. The npower Retail Group will be required to disclose how they have made these judgements and why these are a faithful depiction of the transfer of goods or services.
- **Assets recognised in relation to the cost of obtaining or fulfilling a contract**—the closing balance of any assets recognised in relation to costs incurred to obtain or fulfil a contract, in addition to any judgements exercised in determining the amount to be capitalised.

npower Retail Group has reviewed the new disclosures and revised its systems and processes to comply with the new requirements.

**IFRS 16 Leases (2016)** will replace IAS 17 Leases and the related Interpretations IFRIC 4, SIC-15 and SIC-27. According to this new Standard on leases, aside from short-term leases (less than 12 months) and leases of low-value assets, all leases are to be reported on the balance sheet. Consequently, regardless of economic ownership of the leased asset, the lessee must recognise a right-of-use asset and a corresponding lease liability in the amount of the present value of the fixed lease payments.

For lessors, the new Standard does not result in any significant changes to the current accounting treatment pursuant to IAS 17 also in terms of classifying the lease, which is still necessary. The new Standard becomes effective for fiscal years starting on or after 1 January 2019. npower Retail Group will not apply IFRS 16 early in 2018 in conjunction with IFRS 15 and is planning to apply the modified retrospective method in transitioning to IFRS 16. The effects of IFRS 16 on the npower Retail Group's consolidated financial statements are being reviewed. According to the first, preliminary estimations, starting from the financial year beginning 1 January 2019, implementation of IFRS 16 will result in an annual increase in amortisation and interest expense and an annual reduction in operating lease expense. Consequently npower Retail Group anticipate the impact on net income to be immaterial. Furthermore, based on the current, preliminary assessment, npower Retail Group's net financial debt will also increase as a result of implementing IFRS 16.

The following Standards, amendments to Standards, and Interpretations are not expected to have any material effects on npower Retail Group's consolidated financial statements:

- IFRS 17 Insurance Contracts (2017)
- Amendments to IFRS 9: Prepayment Features with Negative Compensation (2017)
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures (2017)
- Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (2016)

- Annual Improvements to IFRS Standards 2014–2016 Cycle (2016), which contains amendments and clarifications to IFRS 1 and IAS 28.
- Amendments to IAS 40 Transfers of Investment Property (2016)
- Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions (2016)
- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and an Associate or Joint Venture (2014). First-time application of these amendments in the EU was delayed indefinitely.
- IFRIC 22 Foreign Currency Transactions and Advance Consideration (2016)
- IFRIC 23 Uncertainty over Income Tax Treatments (2017)
- Annual Improvements to IFRS Standards 2015–2017 Cycle (2017); this collective Standard contains amendments and clarifications to IFRS 3, IFRS 11, IAS 12 and IAS 23.
- Amendments to IAS 19 Plan Amendment, Curtailment or Settlement (2018)

## **Consolidation**

### **(a) Subsidiaries**

Subsidiaries are all entities (including structured entities) over which the npower Retail Group has control. The npower Retail Group controls an entity when the npower Retail Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the npower Retail Group. They are deconsolidated from the date on which that control ceases.

### **(b) Changes in ownership interests in subsidiaries without change of control**

Transactions with non-controlling interests that do not result in loss of control would be accounted for as equity transactions—that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary would be recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

### **(c) Disposal of subsidiaries**

When the npower Retail Group ceases to have control, any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the npower Retail Group had directly disposed of the related assets or liabilities. This might mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

### **(d) Associates**

Associates are all entities over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the change in net assets of the investee after the date of acquisition.

### **(e) Joint arrangements**

The group applies IFRS 11 to all joint arrangements. Under IFRS 11, investments in joint arrangements are classified as either joint operations or joint ventures, depending on the contractual rights and obligations of each investor.

## **Foreign currency translation**

### **(a) Functional and presentation currency**

Items included in the financial statements of each of the npower Retail Group's entities are measured using the currency of the primary economic environment in which each entity operates ('the functional currency'). The

historical consolidated financial information is presented in pound sterling (£), which is the npower Retail Group's presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation (where items are remeasured). Foreign exchange gains and losses resulting from the settlement of monetary assets and liabilities denominated in foreign currencies are recognised in the Consolidated Income Statement. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the Consolidated Income Statement within 'net finance income or expense'. All other foreign exchange gains and losses are presented in the Consolidated Income Statement within 'Administrative expenses'.

(c) npower Retail Group companies

The results and financial position of all of the npower Retail Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of each transaction); and
- (iii) all resulting exchange differences are recognised in other comprehensive income.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity, and they are translated at the closing rate. Exchange differences arising are recognised in other comprehensive income.

### **Revenue recognition**

Revenue comprises the value of sales of goods and services, excluding VAT and other indirect taxes, in the normal course of business.

Revenue is recognised at the point of supply of electricity, gas, and related services to customers.

### **Cost of sales**

Cost of sales comprises mainly energy commodity costs, renewable obligation costs and the costs of metering.

### **Administrative expenses**

Administrative expenses comprises all other operating charges not included within cost of sales, this includes all employee benefit costs, IT charges, depreciation & amortisation, cost of outsourced third party providers, bad debt expense, and other operating expenses.

### **Interest**

Interest receivable and payable is credited or charged to the Consolidated Income Statement on an accruals basis.

### **Taxation**

The tax expense for the year comprises current and deferred tax. Tax is recognised in profit or loss, except that a change attributable to an item of income or expense recognised as other comprehensive income is also recognised directly in other comprehensive income.

The current income tax charge is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the reporting date in the countries where the npower Retail Group operates and generates taxable income.

Deferred income tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements and on unused tax losses or tax credits in the npower Retail Group. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the reporting date.

The carrying amounts of deferred tax assets are reviewed at each reporting date and a valuation allowance is set up against deferred tax assets so that the net carrying amount equals the highest amount that is more likely than not to be recovered based on current or future taxable profit.

### **Intangible assets**

Intangible assets are carried at amortised cost. With the exception of goodwill, intangible assets have finite useful lives and are amortised using the straight-line method. The useful lives and methods of amortisation are reviewed on an annual basis.

Goodwill arising on the acquisition of an entity represents the excess of the cost of acquisition over the npower Retail Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the entity recognised at the date of acquisition. Goodwill is initially recognised as an asset at cost. The carrying value of goodwill is tested for impairment annually, or more frequently if indicators of impairment exist.

Expenditure on internally developed software assets and technical applications includes contractors' fees and directly attributable labour and overheads. Software for commercial and technical applications is amortised over a period of five years.

An impairment loss is recognised for an intangible asset if the recoverable amount of the asset is less than its carrying amount. If the reason for an impairment loss recognised in prior periods has ceased to exist, a reversal to intangible assets is performed. The increased carrying amount resulting from the reversal may not, however, exceed the amortised cost.

Impairment losses on goodwill are not reversed.

### **Amortisation**

Amortisation is provided on intangible assets so as to write off the cost, less any estimated residual value, over their expected useful economic life as follows:

<u>Asset class</u>	<u>Amortisation method and rate</u>
Goodwill . . . . .	Not amortised
Software and capital development costs . . . . .	5 years
Intangible assets under construction . . . . .	Not amortised

### **Property, plant and equipment**

Property, plant and equipment are stated in the Consolidated Balance Sheet at cost, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The cost of property, plant and equipment includes directly attributable incremental costs incurred in their acquisition and installation.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the Consolidated Income Statement during the financial year in which they are incurred.



## Depreciation

Depreciation is charged on a straight-line basis, so as to write off the cost of assets, other than land and assets under construction over their estimated useful lives, as follows:

Asset class	Depreciation method and rate
Land . . . . .	Not depreciated
Buildings . . . . .	40 years
Furniture, fittings and equipment . . . . .	5 years
Assets under construction . . . . .	Not depreciated
Other property, plant and equipment . . . . .	5 years

## Available for sale financial assets

Available for sale assets, classified as available for sale financial assets, are stated at fair value with movements recognised within other comprehensive income, until disposed of at which point the cumulative gain/loss is recycled through the Consolidated Income Statement.

## Impairment of non-financial assets

Intangible assets that have an indefinite useful life or intangible assets not ready to use are not subject to amortisation and are tested annually for impairment.

The npower Retail Group's management reviews the carrying amounts of its fixed assets, which includes property, plant and equipment and intangibles, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent, if any, of the impairment loss. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (CGUs).

If the recoverable amount of an asset or income generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or income generating unit is reduced to its recoverable amount. An impairment loss is recognised immediately in the Consolidated Income Statement.

The recoverable amount of an asset is the higher of fair value less costs of disposal and value in use. Value in use is the present value of the future cash flows expected to be derived from use of the asset. The cash flow projections are based on future economic and market assumptions and forecast trading conditions drawn up by the npower Retail Group's management as follows:

- Future market conditions and prices are based on detailed analysis and predictions prepared by npower Retail Group economists based on the specific circumstances of the UK retail energy market
- Cash flow projections are based on management's approved long term business plan which incorporate the predictions of future market conditions above
- The cash flows obtained are discounted at a rate estimated to be appropriate for the retail energy business in the UK

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, not exceeding the carrying amount that would have been determined had no impairment loss been recognised. A reversal of an impairment loss is recognised in the Consolidated Income Statement.

## Financial assets

### Classifications

The group classifies its financial assets in the following categories: at fair value through profit or loss; loans and receivables; and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

#### (a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivative financial instruments are also categorised as held for trading, unless they are designated as hedges. Assets in

this category are classified as current assets if expected to be settled within 12 months, otherwise they are classified as non-current.

**(b) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The npower Retail Group's loans and receivables comprise 'other receivables and other assets' and 'cash and cash equivalents' in the Consolidated Balance Sheet.

**(c) Available for sale financial assets**

Available for sale financial assets are non-derivative financial instruments that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.

**Recognition and measurement**

Regular purchases and sales of financial assets are recognised on the trade date—that is, the date on which the npower Retail Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the Consolidated Income Statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred, and the npower Retail Group has transferred substantially all risks and rewards of ownership. Available for sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are presented in the Consolidated Income Statement within 'cost of sales' in the period in which they arise.

Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in other comprehensive income.

If securities classified as available for sale were to be sold or impaired, the accumulated fair value adjustments recognised in equity would be included in the Consolidated Income Statement as 'gains and losses from investment securities'.

Dividends on available for sale equity instruments are recognised in the Consolidated Income Statement when the npower Retail Group's right to receive payments is established, these dividends are net off within 'administrative expenses'.

**Offsetting financial instruments**

Financial assets and liabilities are offset, and the net amount is reported in the Consolidated Balance Sheet, when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events, and it must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

**Impairment of financial assets**

*Assets carried at amortised cost*

The npower Retail Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event'), and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Evidence of impairment might include indications that the debtors or a group of debtors are experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they

will enter bankruptcy or other financial reorganisation, and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

For loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the Consolidated Income Statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the npower Retail Group can measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in the Consolidated Income Statement.

### **Derivative financial instruments**

Derivative financial instruments are recognised as assets or liabilities. All derivative financial instruments are measured at fair value regardless of their purpose. Changes in the fair value are recognised with an effect on the Consolidated Income Statement.

Prices on active markets are drawn upon for measurement of fair value derivative financial instruments. If no prices are available, for example because the market is not sufficiently liquid, the fair values are determined on the basis of generally accepted valuation methods. In doing so, prices on active markets are drawn on as much as possible.

Future power and gas positions are forward traded in line with expected future volume delivery/usage. These trades may be bought and sold as the forward market changes, hence there is a practice of net settlement. In line with IAS 39 all unrealised trading positions at the Consolidated Balance Sheet date are recognised at fair value and held on the Consolidated Balance Sheet as a liability or asset with year on year movement through the Consolidated Income Statement. However a portion of these transactions take the form of contracts that were entered into and continue to be held for the purpose of receipt or delivery of the physical commodity in accordance with the npower Retail Group's expected sale, purchase or usage requirements ('own use'), and are not within the scope of IAS 39.

### **Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand and call deposits, that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

During 2015 and 2016 npower Retail Group pooled their funds with innogy SE/RWE by granting or receiving short term loans or borrowings. Since 2017 the npower Retail Group participates in an innogy SE Group-wide centralised treasury and cash management system. Under these arrangements significant cash balances are remitted on a daily basis into a central overnight account and items such as recharges or payment for tax related group relief are charged or credited by way of intercompany transactions. innogy SE Group policy requires all legal entities' cash balances to be pooled in order to maximise the cash position for the innogy SE Group. This creates a receivable/payable balance and an interest income/expense balance between npower Retail Group and a UK subsidiary of innogy SE. These balances are recorded gross within npower Retail Group.

### **Trade receivables**

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at the transaction price. They are subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for the impairment of trade receivables is established when there is objective evidence that the npower Retail Group will not be able to collect all amounts due according to the original terms of the debt.

**Inventories**

Inventories are stated at the lower of cost and net realisable value, after due regard for obsolete and slow moving Inventories. Net realisable value is based on selling price less anticipated costs to completion and selling costs.

**Trade payables**

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at the transaction price and subsequently measured at amortised cost using the effective interest method.

**Borrowings**

All borrowings are initially recorded at the amount of proceeds received, net of transaction costs. Borrowings are subsequently carried at amortised cost, with the difference between the proceeds, net of transaction costs, and the amount due on redemption being recognised as a charge to the Consolidated Income Statement over the period of the relevant borrowing.

Interest expense is recognised on the basis of the effective interest method and is included in finance expense.

Borrowings are classified as current liabilities unless the npower Retail Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

**Provisions**

Provisions are recognised when the npower Retail Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the npower Retail Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the reporting date and are discounted to present value where the effect is material.

**Renewable Obligations Certificates**

Under the Renewable Obligations Certificates (ROCs) scheme, certificates purchased from innogy SE group companies and third parties are initially recognised at cost (purchase price) within other receivables. A liability for the renewables obligation is recognised based on the level of electricity supplied to customers, and is calculated in accordance with percentages set by the UK Government and the renewable obligation certificate buyout price for that period.

Renewable energy certificates are accounted for as intangible assets and reported under Trade and other receivables.

The ROCs asset, is surrendered and the liability is extinguished at the end of each one year compliance period to reflect the consumption of economic benefits. As a result, allowances which are purchased and allowances allocated free of charge are both stated at cost and are not amortised.

**Called up share capital**

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of the direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement is on a present value basis.

**Defined contribution pension obligation**

A defined contribution plan is a pension plan under which fixed contributions are paid into a separate entity and has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

For defined contribution plans, contributions are paid to publicly or privately administered pension insurance plans on a mandatory or contractual basis. The contributions are recognised as employee benefit expense when

they are due. If contribution payments exceed the contribution due for service, the excess is recognised as an asset.

### **Defined benefit pension obligation**

The corporate pension system in the UK is managed by Electricity Supply Pension Scheme (ESPS) in its own special-purpose section. The innogy UK section, with its principal employer Innogy Renewables UK Limited, contains the obligation for the retail and renewables businesses in the UK. For the purpose of the consolidated historical financial information a share of the innogy UK section was allocated to the npower Retail Group and is presented in the following consolidated historical financial information. This share was calculated based on the proportionate cash contributions to the innogy UK section.

Typically, defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors, such as age, years of service and compensation.

The liability recognised in the Consolidated Balance Sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period, less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

The current service cost of the defined benefit plan, recognised in 'Administrative expenses' in the Consolidated Income Statement, except where included in the cost of an asset, reflects the increase in the defined benefit obligation resulting from service in the current year, benefit changes, curtailments and settlements.

Past service costs are recognised immediately in income.

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is included in 'Administrative expenses' in the Consolidated Income Statement.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

### **Operating leases**

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

### **Share based payments**

Certain executive employees of the npower Retail Group are able to take part in a Long-term Incentive Plan, the Strategic Performance Plan (SPP). The SPP uses an internal performance target derived from the medium-term planning (adjusted net income) and takes account of the development of innogy SE's share price. The executives receive a number of notional shares. The final number of the notional shares of a tranche is determined after a year, based on the degree to which the target Adjusted Net Income (ANI) is achieved. This is followed by a three-year vesting period before any potential pay-out. For more detail on the SPP see note 21.

### **Contingent liability**

A contingent liability is a possible obligation that arises from past events whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events beyond the control of the npower Retail Group or a present obligation that is not recognised because it is not probable that an outflow of resources will be required to settle the obligation. The npower Retail Group does not recognise a contingent liability but discloses its existence in the consolidated historical financial information.

### **Critical accounting judgements and key sources of estimation uncertainty**

The npower Retail Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a

significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

#### **Unbilled revenue—estimation uncertainty**

In accounting for energy revenue and direct costs, the npower Retail Group employs a forecasting process using models to calculate the energy unbilled revenue required at the financial year end. The models are regularly updated with historical actual data downloaded from the financial ledgers which in turn improve the accuracy of the forecast data. The accuracy of the forecast data is reviewed each year end to identify any significant movements to actual results and adjustments made where necessary.

Unbilled revenue is determined by a bottom-up calculation, using a computer generated simulation. This simulation calculates the estimated unbilled volume and value for each customer within the billing system. A review is performed to ensure that revenue volume (billed and unbilled) in any year is no greater than the industry's view of billable settlement volumes, less an expected revenue leakage element (assessed at 1% for 2017 based on recent trends). When this gap is lower than 1% on a year-to-date basis, revenue is reduced down to this level via a settlement gap adjustment to billed and unbilled revenue. Where the underlying gap is higher than 1%, management apply a conservative approach and make no upward adjustment to revenue. Management continue to review and refine the estimation techniques employed. As at 31 December 2017 the unbilled revenue balance for the Domestic business was being carried at £178.2m (2016: £196.7m; 2015: £184.1m). A 0.5% increase or decrease in the percentage used would see revenue decrease or increase respectively by £11.2m for the year ended 31 December 2017 (2016: £12.9m, 2015: £13.7m).

#### **Valuation of trade receivables—estimation uncertainty**

The npower Retail Group's exposure to credit risk, and therefore the basis of determining the provisions for bad and doubtful debts, is explained within the notes to the consolidated historical financial information, see note 27. While the provisions are considered to be appropriate, changes in estimation basis or in economic conditions could lead to a change in the level of provisions recorded and consequently on the charge or credit to the Consolidated Income Statement.

The analysis of the ageing of trade receivables past due and not impaired, movement in the allowance for impairment on financial assets, and the net trade receivables expected to be recoverable is detailed within note 27.

#### **Determination of energy derivative fair values—estimation uncertainty**

npower Retail Group enters into forward commodity purchase (and sales) contracts to meet the future demand requirements to supply energy to customers. Certain of these contracts are determined to be derivative financial instruments under IAS 39 and as such are required to be recorded at their fair value.

Fair values of energy derivative financial instruments are estimated by reference in part to published price quotations in active markets and in part by using valuation techniques. More detail on the assumptions used in determining fair valuations of energy derivative financial instruments is provided in note 27, along with information on the sensitivities to these assumptions, also shown in note 27. The identification and allocation forward contracts to the fair-value or own-use books is a source of judgement which could lead to differences in the total of the fair-value book.

#### **Impairment testing of goodwill—estimation uncertainty**

The npower Retail Group reviews the carrying amount of goodwill to determine whether any impairment of the carrying amount is required to be recorded. In conducting its reviews, the npower Retail Group makes estimates and assumptions behind the calculation of the recoverable amount of goodwill per cash generating unit (CGU). Changes to the estimates and assumptions could impact the recoverable value of goodwill and consequently impact the npower Retail Group's Consolidated Income Statement and Consolidated Balance Sheet. Further detail of the calculation basis and key assumptions used in the impairment review and sensitivity of this assessment is included in note 8.

#### **Retirement benefit obligations—estimation uncertainty**

The assumptions in relation to the cost of providing post-retirement benefits during the period are based on npower Retail Group's best estimates and are set after consultation with qualified actuaries. While these assumptions are believed to be appropriate, a change in these assumptions would impact the level of the

retirement benefit obligation recorded and the cost to the npower Retail Group of administering the schemes. Further detail of the calculation bases and key assumptions used, the resulting movements in obligations and the sensitivity of key assumptions to the obligation is disclosed in note 18. The allocation of the retirement benefit obligation to the npower Retail Group is a source of judgement, the allocation has been made with regard to the respective cash contributions of the innogy UK pension scheme participant companies.

### Segmental information

For the reporting periods of the consolidated historical financial information, the segment reporting is based on the internal reporting to the chief operating decision maker of the npower Retail Group. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the npower Executive Committee that makes strategic decisions.

The npower Retail Group is divided into three reportable segments which can be defined as follows:

- **Domestic**—comprises the financial results from the supply of electricity and gas to residential customers. Within the reportable segment ‘Domestic’ are the combined results from three components of the npower Retail Group, being: ‘Domestic Core’; ‘Telecom Plus’; and ‘Domestic Powershop’. The nature of the underlying products and services, production processes, and the types of customer supplied are all comparable. Further, the distribution methods are similar, and the components are subject to the same regulatory environment as each other. As the operating segments therefore show similar economic characteristics, they are combined to the reportable segment “Domestic”.
- **npower Business**—This is the segment that supplies energy to small and medium enterprise customers. Due to the nature of the products supplied, the characteristics of the underlying customers, and the standard terms of business this operating segment has been deemed to be sufficiently distinct to the other operating segments within the npower Retail Group and has met the quantitative criteria per IFRS 8 to be presented as its own reportable operating segment.
- **npower Business Solutions**—The segment ‘npower Business Solutions’ covers the supply of energy and related services to industrial and commercial customers. Within the reportable segment ‘npower Business Solutions’ are the combined results from three components of the npower Retail Group, being: ‘npower Business Solutions’; ‘Technical Services’; and ‘Generation Services’. The nature of the underlying products and services, production processes, and the types of customer supplied covers the supply of energy and related services to industrial and commercial customers and thus are all comparable. Further, the distribution methods are similar, and the components are subject to the same regulatory environment as each other. As the operating segments therefore show similar economic characteristics, they are combined to the reportable segment “npower Business Solutions”.
- The ‘Unallocated’ segment presented below relates to the fair value adjustments made to the forward purchase contracts on commodities at the period end and fixed asset impairments. Commodity forwards are transacted at a group level and therefore are not easily apportioned to individual segments.

The information shown below summarises the performance of the reportable operating segments for the three financial reporting periods ending 31 December 2015, 2016, and 2017.

#### (i) Revenue by segment

##### *npower Retail Group*

	Total external revenue 2015	Total external revenue 2016	Total external revenue 2017
		£m	
Domestic . . . . .	3,151.0	2,965.6	2,846.5
npower Business . . . . .	421.0	345.7	283.3
npower Business Solutions . . . . .	3,118.0	2,841.0	2,884.8
	<u>6,690.0</u>	<u>6,152.3</u>	<u>6,014.6</u>

(ii) Operating (loss) / profit by segment

***npower Retail Group***  
**2015**

	Before exceptional operating items and certain re-measurements	Exceptional operating items and certain re-measurements	Total
		£m	
Domestic . . . . .	(116.4)	(10.0)	(126.4)
npower Business . . . . .	(21.4)	—	(21.4)
npower Business Solutions . . . . .	38.8	—	38.8
Unallocated . . . . .	—	(144.5)	(144.5)
	<u>(99.0)</u>	<u>(154.5)</u>	<u>(253.5)</u>

***npower Retail Group***  
**2016**

	Before exceptional operating items and certain re-measurements	Exceptional operating items and certain re-measurements	Total
		£m	
Domestic . . . . .	(89.0)	—	(89.0)
npower Business . . . . .	(22.7)	—	(22.7)
npower Business Solutions . . . . .	22.3	—	22.3
Unallocated . . . . .	—	275.2	275.2
	<u>(89.4)</u>	<u>275.2</u>	<u>185.8</u>

***npower Retail Group***  
**2017**

	Before exceptional operating items and certain re-measurements	Exceptional operating items and certain re-measurements	Total
		£m	
Domestic . . . . .	(55.8)	—	(55.8)
npower Business . . . . .	(40.9)	—	(40.9)
npower Business Solutions . . . . .	41.4	—	41.4
Unallocated . . . . .	—	8.4	8.4
	<u>(55.3)</u>	<u>8.4</u>	<u>(46.9)</u>

The information shown below summarises the cost and carrying value of goodwill by segment for the three financial reporting periods ending 31 December 2015, 2016 and 2017. Goodwill arose on previous acquisition of subsidiaries within the npower Retail Group. The goodwill has been allocated to segments for the purposes of the consolidated historical financial information using a reasonable basis of allocation based on segmental forecast information.

In 2015 the npower Retail Group acquired RUMM Ltd. The consideration transferred in respect of acquiring the net assets of RUMM Ltd. was £5.0m, which resulted in a corresponding goodwill balance of £4.7m being recognised.



## Goodwill

	Domestic	npower Business £m	npower Business Solutions	Total
<b>Cost</b>				
Balance at 1 January 2015	376.7	24.0	125.0	525.7
Additions	—	—	4.7	4.7
Balance at 31 December 2015	376.7	24.0	129.7	530.4
<b>Accumulated amortisation</b>				
Balance at 1 January 2015	(33.8)	—	—	(33.8)
Impairment losses	(10.0)	—	—	(10.0)
Balance at 31 December 2015	(43.8)	—	—	(43.8)
<b>Carrying values</b>				
Balance at 1 January 2015	342.9	24.0	125.0	491.9
Balance at 31 December 2015	332.9	24.0	129.7	486.6

## Goodwill

	Domestic	npower Business £m	npower Business Solutions	Total
<b>Cost</b>				
Balance at 1 January & 31 December 2016	376.7	24.0	129.7	530.4
<b>Accumulated amortisation</b>				
Balance at 1 January & 31 December 2016	(43.8)	—	—	(43.8)
<b>Carrying values</b>				
Balance at 1 January & 31 December 2016	332.9	24.0	129.7	486.6

## Goodwill

	Domestic	npower Business £m	npower Business Solutions	Total
<b>Cost</b>				
Balance at 1 January & 31 December 2017	376.7	24.0	129.7	530.4
<b>Accumulated amortisation</b>				
Balance at 1 January & 31 December 2017	(43.8)	—	—	(43.8)
<b>Carrying values</b>				
Balance at 1 January & 31 December 2017	332.9	24.0	129.7	486.6

## Notes to the Consolidated Income Statement

### 1. Revenue

Generally revenue is recorded when the goods have been delivered or the services have been rendered, and the risks related to the goods or services have been transferred to the customer.

A breakdown of revenue by division is contained in the segment reporting on page 134. The npower Retail Group did not generate more than 10% of revenues with any single customer in the years ended 31 December 2015, 2016 and 2017.

### 2. Exceptional operating items and certain re-measurements

Exceptional operating charges or credits, and the tax effects thereof, are considered unusual by nature or scale and of such significance that separate disclosure is required for the underlying operating performance of the

npower Retail Group to be properly understood. These are presented separately and within the line items to which they best relate.

### *Exceptional operating items and certain re-measurements*

	<u>2015</u>	<u>2016</u>	<u>2017</u>
		<u>£m</u>	
Mark-to-market impact on commodity forward contracts . . . . .	(23.6)	275.2	8.4
Impairment of intangible assets . . . . .	(120.9)	—	—
Impairment of goodwill . . . . .	(10.0)	—	—
	<u>(154.5)</u>	<u>275.2</u>	<u>8.4</u>

### **Exceptional operating items**

**Impairment of intangible assets** relates to impairment charges on intangible asset balances which are being carried at an amount greater than their recoverable amount. In the year ending 31 December 2015 there were certain IT system development costs, held as intangible assets, which were identified as being impaired. As such, the npower Retail Group reduced the carrying amount of these items to be in line with their recoverable amount.

**Impairment of goodwill** relates to charges recorded during the year ending 31 December 2015 to reduce the carrying amount of goodwill on a subsidiary of the npower Retail Group, after a decision was taken to close the business. This was in order to ensure that the carrying value was not greater than the recoverable amount.

### **Certain re-measurements**

**Mark-to-market impact on commodity forward contracts.** npower Retail Group enters into forward commodity purchase (and sales) contracts to meet the future demand requirements to supply energy to customers. Certain of these contracts are determined to be derivative financial instruments under IAS 39 and as such are required to be recorded at their fair value. Changes in the fair value of those commodity contracts designated as IAS 39 financial instruments are reflected in the combined income statement (as part of ‘certain re-measurements’). Npower Retail Group shows the change in the fair value of these forward contracts separately as this mark-to-market movement is not relevant to the underlying performance of its operating segments. npower Retail Group will recognise the underlying value of these contracts as the relevant commodity is delivered, which will predominately be within the subsequent 12 to 24 months. Conversely, commodity contracts that are not financial instruments under IAS 39 are accounted for as ‘own use’ contracts. The re-measurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of the npower Retail Group.

### **3. Employee benefit expense**

The aggregate employee benefit expenses for the npower Retail Group were as follows:

### *Employee benefit expense*

	<u>2015</u>	<u>2016</u>	<u>2017</u>
		<u>£m</u>	
Wages and salaries . . . . .	(219.4)	(215.4)	(210.9)
Social security costs . . . . .	(19.6)	(21.2)	(22.2)
Defined benefit pension costs . . . . .	(25.3)	(20.3)	(21.7)
Defined contribution pension costs . . . . .	(4.2)	(4.6)	(4.8)
	<u>(268.5)</u>	<u>(261.5)</u>	<u>(259.6)</u>

#### 4. Depreciation, amortisation and impairment losses

Operating (loss)/profit is arrived at after charging:

##### *Depreciation, amortisation and impairment losses*

	<u>2015</u>	<u>2016</u>	<u>2017</u>
		£m	
Intangible assets*	(176.0)	(76.7)	(80.4)
Property, plant and equipment	(4.1)	(4.2)	(3.9)
	<u>(180.1)</u>	<u>(80.9)</u>	<u>(84.3)</u>

\* During the year ended 31 December 2015, in relation to intangible assets, an impairment loss of £120.9m was recognised in relation to IT development costs and an impairment loss of £10m was recognised in relation to goodwill, see note 2 for further details.

#### 5. Net finance expense

##### *Net finance expense*

	<u>2015</u>	<u>2016</u>	<u>2017</u>
		£m	
Net interest receivable from related undertakings	—	—	0.7
Other financial income	0.9	0.1	0.7
<b>Finance income</b>	<b>0.9</b>	<b>0.1</b>	<b>1.4</b>
Net interest payable to related undertakings	(66.0)	(67.5)	(337.7)
Interest accretion on pensions	(5.5)	(5.4)	(2.9)
Interest accretion on provisions	—	(0.2)	—
Impairment of financial assets	(5.5)	(0.8)	—
Other financial costs	(2.5)	(3.1)	(5.0)
<b>Finance expense</b>	<b>(79.5)</b>	<b>(77.0)</b>	<b>(345.6)</b>
	<u>(78.6)</u>	<u>(76.9)</u>	<u>(344.2)</u>

Net finance expense is composed of net interest, interest accretion to provisions, other financial income and other finance costs. Interest accretion on pensions is reduced by interest income on plan assets for the coverage of pension obligations. Net interest includes interests on loans and a prepayment penalty of £272.8m for the restructuring of npower Retail Group's financing in 2017.

##### *Net interest to related undertakings*

	<u>2015</u>	<u>2016</u>	<u>2017</u>
		£m	
Interest and similar income	—	—	0.7
Interest and similar expenses	(65.8)	(67.5)	(337.7)
	<u>(65.8)</u>	<u>(67.5)</u>	<u>(337.0)</u>

## 6. Taxation

Tax included in the Consolidated Income Statement:

### Current tax

	2015	2016	2017
		£m	
UK corporation tax on (losses) / profits for the year	1.8	(3.9)	1.2
Adjustment in respect of prior periods	3.8	(18.8)	4.8
<b>Total current tax</b>	<b>5.6</b>	<b>(22.7)</b>	<b>6.0</b>
<b>Deferred tax</b>			
Origination and reversal of timing differences	(64.0)	41.8	(25.0)
Impact of change in tax rate	21.8	(4.4)	2.2
Adjustment in respect of prior periods	(13.3)	15.0	(2.5)
<b>Total deferred tax</b>	<b>(55.5)</b>	<b>52.4</b>	<b>(25.3)</b>
<b>Total taxation (credit) / charge for the year</b>	<b>(49.9)</b>	<b>29.7</b>	<b>(19.3)</b>

Tax included in the Statement of Comprehensive Income:

	2015	2016	2017
		£m	
<b>Current tax</b>	<b>(16.6)</b>	<b>(13.7)</b>	<b>(18.9)</b>
<b>Deferred tax</b>			
Origination and reversal of timing differences	(1.1)	(5.0)	27.9
Impact of change in tax rate	17.4	8.9	—
<b>Total deferred tax</b>	<b>16.3</b>	<b>3.9</b>	<b>27.9</b>
<b>Total taxation (credit) / charge for the year</b>	<b>(0.3)</b>	<b>(9.8)</b>	<b>9.0</b>

The tax (charge) / credit relating to components of other comprehensive income is as follows:

### 2015

	Before tax	Tax (credit) / charge £m	After tax
Actuarial (losses) / gains of defined benefit pension plans and similar obligations	(12.0)	0.6	(11.4)
Currency translation differences	(0.9)	—	(0.9)
Change in value of available for sale financial assets	(0.6)	(0.3)	(0.9)
<b>Other comprehensive income</b>	<b>(13.5)</b>	<b>0.3</b>	<b>(13.2)</b>
Current tax		16.6	
Deferred tax		(16.3)	
		0.3	

### 2016

	Before tax	Tax (credit) / charge £m	After tax
Actuarial (losses) / gains of defined benefit pension plans and similar obligations	(40.6)	10.7	(29.9)
Currency translation differences	(1.3)	—	(1.3)
Change in value of available for sale financial assets	0.5	(0.9)	(0.4)
<b>Other comprehensive income</b>	<b>(41.4)</b>	<b>9.8</b>	<b>(31.6)</b>
Current tax		13.7	
Deferred tax		(3.9)	
		9.8	

	<u>Before tax</u>	<u>Tax (credit) / charge</u> £m	<u>After tax</u>
Actuarial (losses) / gains of defined benefit pension plans and similar obligations . . . . .	70.0	(9.0)	61.0
Currency translation differences . . . . .	(1.1)	—	(1.1)
Change in value of available for sale financial assets . . . . .	<u>0.1</u>	<u>—</u>	<u>0.1</u>
<b>Other comprehensive income . . . . .</b>	<b><u>69.0</u></b>	<b><u>(9.0)</u></b>	<b><u>60.0</u></b>
Current tax . . . . .		18.9	
Deferred tax . . . . .		<u>(27.9)</u>	
		<u>(9.0)</u>	

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the loss / profit before tax is as follows:

	<u>2015</u>	<u>2016</u> £m	<u>2017</u>
(Loss) / profit before taxation . . . . .	(332.1)	108.9	(391.1)
Tax on (loss) / profit at standard UK corporation tax rate of 19.25% (2016: 20%, 2015: 20.25%) . . . . .	(67.3)	21.8	(75.3)
Expenses not deductible for tax purposes . . . . .	4.9	15.9	51.7
Non-taxable dividend income . . . . .	—	(0.1)	(0.1)
Impact of change in tax rate . . . . .	21.8	(4.4)	2.2
Difference between current and deferred tax rates . . . . .	0.2	0.3	(0.1)
Corporation tax adjustment in respect of prior periods . . . . .	3.8	(18.8)	4.8
Deferred tax adjustment in respect of prior periods . . . . .	<u>(13.3)</u>	<u>15.0</u>	<u>(2.5)</u>
<b>Total tax (credit) / charge for the year . . . . .</b>	<b><u>(49.9)</u></b>	<b><u>29.7</u></b>	<b><u>(19.3)</u></b>

Expenses not deductible for tax purposes in 2017 relate predominantly to the assumption that a deduction for the interest expense incurred in the year may not be available. This is not expected to be a recurring item.

The deferred tax prior year adjustment in 2015 relates to adjustments to the capital allowances claimed in the tax returns. The current and deferred tax prior year adjustments in 2016 both relate predominantly to tax losses which were no longer carried forward and additional capital allowances being claimed in the tax returns. Changes to capital allowance claims are likely to be a recurring element of prior year adjustments, although the quantum of such adjustments will vary from year to year.

Legislation to reduce the corporation tax rate from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020 was substantively enacted on 26 October 2015. As these changes were substantively enacted at 31 December 2015, deferred tax at that date was calculated accordingly. Legislation was substantively enacted on 15 September 2016 to further reduce the corporation tax rate to 17% from 1 April 2020. As this change has been substantively enacted by 31 December 2016, deferred tax has been calculated accordingly.

## 7. Notes to the Consolidated Balance Sheet

### Property, plant and equipment

#### Property, plant and equipment

	Land and buildings	Furniture, fittings and equipment	Other property, plant and equipment £m	Assets under construction	Total
<b>Cost</b>					
<b>Balance at 1 January 2015</b>	<b>34.4</b>	<b>49.2</b>	<b>4.5</b>	<b>13.4</b>	<b>101.5</b>
Additions	—	—	—	1.2	1.2
Transfers	0.3	6.6	2.5	(9.4)	—
Disposals	(26.8)	(14.7)	(0.1)	—	(41.6)
<b>Balance at 31 December 2015</b>	<b>7.9</b>	<b>41.1</b>	<b>6.9</b>	<b>5.2</b>	<b>61.1</b>
<b>Accumulated depreciation</b>					
<b>Balance at 1 January 2015</b>	<b>(6.5)</b>	<b>(40.7)</b>	<b>(4.3)</b>	<b>—</b>	<b>(51.5)</b>
Depreciation charge for the reporting year	(0.6)	(3.3)	(0.2)	—	(4.1)
Disposals	3.4	13.1	0.1	—	16.6
<b>Balance at 31 December 2015</b>	<b>(3.7)</b>	<b>(30.9)</b>	<b>(4.4)</b>	<b>—</b>	<b>(39.0)</b>
<b>Carrying amounts</b>					
<b>Balance at 1 January 2015</b>	<b>27.9</b>	<b>8.5</b>	<b>0.2</b>	<b>13.4</b>	<b>50.0</b>
<b>Balance at 31 December 2015</b>	<b>4.2</b>	<b>10.2</b>	<b>2.5</b>	<b>5.2</b>	<b>22.1</b>

#### Property, plant and equipment

	Land and buildings	Furniture, fittings and equipment	Other property, plant and equipment £m	Assets under construction	Total
<b>Cost</b>					
<b>Balance at 1 January 2016</b>	<b>7.9</b>	<b>41.1</b>	<b>6.9</b>	<b>5.2</b>	<b>61.1</b>
Additions	4.2	—	0.2	1.2	5.6
Transfers	—	0.5	2.7	(6.4)	(3.2)
Disposals	(1.9)	(3.1)	—	—	(5.0)
<b>Balance at 31 December 2016</b>	<b>10.2</b>	<b>38.5</b>	<b>9.8</b>	<b>—</b>	<b>58.5</b>
<b>Accumulated depreciation</b>					
<b>Balance at 1 January 2016</b>	<b>(3.7)</b>	<b>(30.9)</b>	<b>(4.4)</b>	<b>—</b>	<b>(39.0)</b>
Depreciation charge for the reporting year	(0.3)	(3.3)	(0.6)	—	(4.2)
Disposals	1.9	3.1	—	—	5.0
<b>Balance at 31 December 2016</b>	<b>(2.1)</b>	<b>(31.1)</b>	<b>(5.0)</b>	<b>—</b>	<b>(38.2)</b>
<b>Carrying amounts</b>					
<b>Balance at 1 January 2016</b>	<b>4.2</b>	<b>10.2</b>	<b>2.5</b>	<b>5.2</b>	<b>22.1</b>
<b>Balance at 31 December 2016</b>	<b>8.1</b>	<b>7.4</b>	<b>4.8</b>	<b>—</b>	<b>20.3</b>

*Property, plant and equipment*

	Land and buildings	Furniture, fittings and equipment	Other property, plant and equipment £m	Assets under construction	Total
<b>Cost</b>					
<b>Balance at 1 January 2017</b>	<b>10.2</b>	<b>38.5</b>	<b>9.8</b>	<b>—</b>	<b>58.5</b>
Additions	—	0.5	—	4.6	5.1
Transfers	0.6	0.7	0.1	0.1	1.5
Disposals	(0.6)	(14.5)	(4.4)	—	(19.5)
<b>Balance at 31 December 2017</b>	<b>10.2</b>	<b>25.2</b>	<b>5.5</b>	<b>4.7</b>	<b>45.6</b>
<b>Accumulated depreciation</b>					
<b>Balance at 1 January 2017</b>	<b>(2.1)</b>	<b>(31.1)</b>	<b>(5.0)</b>	<b>—</b>	<b>(38.2)</b>
Depreciation charge for the reporting year	(0.3)	(2.7)	(0.9)	—	(3.9)
Disposals	0.1	14.5	4.4	—	19.0
<b>Balance at 31 December 2017</b>	<b>(2.3)</b>	<b>(19.3)</b>	<b>(1.5)</b>	<b>—</b>	<b>(23.1)</b>
<b>Carrying amounts</b>					
<b>Balance at 1 January 2017</b>	<b>8.1</b>	<b>7.4</b>	<b>4.8</b>	<b>—</b>	<b>20.3</b>
<b>Balance at 31 December 2017</b>	<b>7.9</b>	<b>5.9</b>	<b>4.0</b>	<b>4.7</b>	<b>22.5</b>

*8. Intangible assets*

	*Intangible assets	Assets under construction £m	Goodwill	Total
<b>Cost</b>				
<b>Balance at 1 January 2015</b>	<b>435.3</b>	<b>238.2</b>	<b>525.7</b>	<b>1,199.2</b>
Additions	—	135.5	4.7	140.2
Transfers	295.8	(295.8)	—	—
Disposals	(100.6)	—	—	(100.6)
<b>Balance at 31 December 2015</b>	<b>630.5</b>	<b>77.9</b>	<b>530.4</b>	<b>1,238.8</b>
<b>Accumulated amortisation</b>				
<b>Balance at 1 January 2015</b>	<b>(320.4)</b>	<b>—</b>	<b>(33.8)</b>	<b>(354.2)</b>
Amortisation charge	(45.1)	—	—	(45.1)
Impairment charge	(120.9)	—	(10.0)	(130.9)
Disposals	99.5	—	—	99.5
<b>Balance at 31 December 2015</b>	<b>(386.9)</b>	<b>—</b>	<b>(43.8)</b>	<b>(430.7)</b>
<b>Carrying values</b>				
<b>Balance at 1 January 2015</b>	<b>114.9</b>	<b>238.2</b>	<b>491.9</b>	<b>845.0</b>
<b>Balance at 31 December 2015</b>	<b>243.7</b>	<b>77.9</b>	<b>486.6</b>	<b>808.1</b>

\* Intangible assets relate to internally generated software and capitalised development costs.

	<u>*Intangible assets</u>	<u>Assets under construction</u> £m	<u>Goodwill</u>	<u>Total</u>
<b>Cost</b>				
<b>Balance at 1 January 2016</b>	<b>630.5</b>	<b>77.9</b>	<b>530.4</b>	<b>1,238.8</b>
Additions	19.2	49.3	—	68.5
Transfers	28.1	(24.9)	—	3.2
Disposals	(16.7)	—	—	(16.7)
<b>Balance at 31 December 2016</b>	<b>661.1</b>	<b>102.3</b>	<b>530.4</b>	<b>1,293.8</b>
<b>Accumulated amortisation</b>				
<b>Balance at 1 January 2016</b>	<b>(386.9)</b>	<b>—</b>	<b>(43.8)</b>	<b>(430.7)</b>
Amortisation Charge	(76.7)	—	—	(76.7)
Disposals	16.6	—	—	16.6
<b>Balance at 31 December 2016</b>	<b>(447.0)</b>	<b>—</b>	<b>(43.8)</b>	<b>(490.8)</b>
<b>Carrying values</b>				
<b>Balance at 1 January 2016</b>	<b>243.6</b>	<b>77.9</b>	<b>486.6</b>	<b>808.1</b>
<b>Balance at 31 December 2016</b>	<b>214.1</b>	<b>102.3</b>	<b>486.6</b>	<b>803.0</b>

\* Intangible assets relate to internally generated software and capitalised development costs.

	<u>* Intangible assets</u>	<u>Assets under construction</u> £m	<u>Goodwill</u>	<u>Total</u>
<b>Cost</b>				
<b>Balance at 1 January 2017</b>	<b>661.1</b>	<b>102.3</b>	<b>530.4</b>	<b>1,293.8</b>
Additions	17.4	27.6	—	45.0
Transfers	32.8	(34.3)	—	(1.5)
Disposals	(200.9)	—	—	(200.9)
<b>Balance at 31 December 2017</b>	<b>510.4</b>	<b>95.6</b>	<b>530.4</b>	<b>1,136.4</b>
<b>Accumulated amortisation</b>				
<b>Balance at 1 January 2017</b>	<b>(447.0)</b>	<b>—</b>	<b>(43.8)</b>	<b>(490.8)</b>
Amortisation Charge	(80.4)	—	—	(80.4)
Disposals	197.8	—	—	197.8
<b>Balance at 31 December 2017</b>	<b>(329.6)</b>	<b>—</b>	<b>(43.8)</b>	<b>(373.4)</b>
<b>Carrying values</b>				
<b>Balance at 1 January 2017</b>	<b>214.1</b>	<b>102.3</b>	<b>486.6</b>	<b>803.0</b>
<b>Balance at 31 December 2017</b>	<b>180.8</b>	<b>95.6</b>	<b>486.6</b>	<b>763.0</b>

\* Intangible assets relate to internally generated software and capitalised development costs.

Goodwill is allocated to CGUs that represent the lowest level at which the goodwill is monitored for internal management purposes.

In the third quarter of every fiscal year, an impairment test is performed to determine if there is any need to write down goodwill. In this test, goodwill is allocated to the CGUs at the operating segment level. The recoverable amount of the CGUs is determined, which is defined as the higher of fair value less costs to sell or value in use. Fair value is the best estimate of the price that an independent third party would pay to purchase the CGU as of the balance-sheet date. Value in use reflects the present value of the future cash flows which are expected to be generated with the CGU.

Fair value is assessed from an external perspective and value in use from a company-internal perspective. Values are determined using a business valuation model, based on planned future cash flows. These cash flows are based on the business plan, as approved by the Executive Board and valid at the time of the impairment test. They pertain to a detailed planning period of up to three years. The cash flow plans are based on experience as well as on expected market trends in the future. If available, market transactions in the same sector or third-party valuations are taken as a basis for determining fair value. Based on the use of internal planning assumptions, the determined fair values are assigned to level 3 of the fair value hierarchy.



Mid-term business plans are based on UK specific assumptions regarding the development of key economic indicators such as gross domestic product, consumer prices, interest rate levels and nominal wages. These estimates are, amongst others, derived from macroeconomic and financial studies.

The key planning assumptions for the business segments active in the UK's electricity and gas markets relate to the development of wholesale prices for electricity and natural gas, retail prices of electricity and gas, market shares and regulatory framework conditions.

The after tax discount rates used for business valuations are determined on the basis of market data. With regard to CGUs, in 2017 this was 5.5% (2016: 4.75%, 2015: 5.75%).

For the extrapolation of future cash flows going beyond the detailed planning horizon, in 2017 constant growth rates of 1.0% were used (2016: 1.0%, 2015: 1.0%). These figures are derived from experience and future expectations for the individual divisions and do not exceed the long-term average growth rates in the markets in which the npower Retail Group companies are active. In calculating cash flow growth rates, the capital expenditures and working capital required to achieve the assumed cash flow growth are subtracted.

In 2017, 2016 and 2015, the recoverable amounts were higher than the carrying amounts of the CGUs. These surpluses react especially sensitively to changes in the discount rate, the growth rate and the operating result after taxes in the terminal value.

During the year ended 31 December 2017, the Segment npower Business exhibited the smallest surpluses of recoverable amount over the carrying amount. The recoverable amount was £181.8m higher than the carrying amount. An after-tax discount rate increased by more than 12.6 percentage points to above 18.1%, a growth rate decreased by more than 15.4 percentage points to below -14.4%, or an operating result reduced by more than £11.2m million in terminal value would, all changes taken in isolation, result in the recoverable amount being equal to the carrying amount.

During the year ended 31 December 2016, the Segment npower Business exhibited the smallest surpluses of recoverable amount over the carrying amount. The recoverable amount was £63.9m higher than the carrying amount. An after-tax discount rate increased by more than 3.9 percentage points to above 8.6%, a growth rate decreased by more than 4.2 percentage points to below -3.2%, or an operating result reduced by more than £3.8m million in terminal value would, all changes taken in isolation, result in the recoverable amount being equal to the carrying amount.

During the year ended 31 December 2016, npower Retail Group made the decision to invest in improving IT infrastructure within the npower Business segment. The project costs were included within the business forecasts from the year ended 31 December 2016 and hence significant outlay was included in these forecasts, however the benefits of the project were not realised within the forecast which therefore reduced the value of the operating result in the terminal year. As such, there is significantly less headroom within the npower Business segment for the year ended 31 December 2016. However, from the year ended 31 December 2017, cost savings which were realised from the investments made, improved the outlook, which is why the forecast results improve significantly following the year ended 31 December 2016.

## 9. Available for sale financial assets

### Available for sale financial assets

	<u>2015</u>	<u>2016</u>	<u>2017</u>
		£m	
<b>Telecom Plus plc shares</b> . . . . .	<b>4.6</b>	<b>5.0</b>	<b>5.1</b>

Available for sale financial assets are stated at fair value. The npower Retail Group holds 426,989 shares in Telecom Plus plc (2016 & 2015: 426,989 shares). The investment is recorded at fair value, based on a closing mid-market price of £12.01 per ordinary share (2016: £11.76; 2015: £10.71 per ordinary share).

## 10. Derivative financial instruments

### Derivative financial instruments asset balances

	<u>31 December 2015</u>		<u>31 December 2016</u>		<u>31 December 2017</u>	
	<u>Non-current</u>	<u>Current</u>	<u>Non-current</u>	<u>Current</u>	<u>Non-current</u>	<u>Current</u>
			£m			
<b>Derivative financial instruments</b> . . . .	<b>60.4</b>	<b>95.9</b>	<b>66.2</b>	<b>107.8</b>	<b>41.5</b>	<b>89.2</b>

### *Derivative financial instruments liability balances*

	31 December 2015		31 December 2016		31 December 2017	
	Non-current	Current	Non-current	Current	Non-current	Current
	£m					
<b>Derivative financial instruments</b>	<b>(148.7)</b>	<b>(243.8)</b>	<b>(37.4)</b>	<b>(89.9)</b>	<b>(11.1)</b>	<b>(65.5)</b>

By nature all derivative financial instruments are classified as financial assets or liabilities.

### *11. Deferred Taxes*

Deferred tax assets and liabilities are attributable to the following:

#### *Deferred tax*

	Assets			Liabilities			Net		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
	£m								
Tangible fixed assets	64.6	68.7	82.0	—	—	—	64.6	68.7	82.0
Provisions	5.5	6.8	16.1	—	—	—	5.5	6.8	16.1
Pension	33.2	30.2	3.0	—	—	—	33.2	30.2	3.0
Financial assets	41.0	—	—	—	(8.1)	(9.5)	41.0	(8.1)	(9.5)
Losses	13.4	3.8	7.2	—	—	—	13.4	3.8	7.2
<b>Net tax assets</b>	<b>157.7</b>	<b>109.5</b>	<b>108.3</b>	<b>—</b>	<b>(8.1)</b>	<b>(9.5)</b>	<b>157.7</b>	<b>101.4</b>	<b>98.8</b>

#### *Movement in deferred tax*

	Tangible fixed assets	Provisions	Financial assets	Pension	Losses	Total
	£m					
<b>At 1 January 2015</b>	<b>26.6</b>	<b>2.0</b>	<b>40.8</b>	<b>49.1</b>	<b>—</b>	<b>118.5</b>
Recognised in income	38.0	3.9	0.2	—	13.4	55.5
Recognised in Other Comprehensive Income	—	(0.4)	—	(15.9)	—	(16.3)
<b>At 31 December 2015</b>	<b>64.6</b>	<b>5.5</b>	<b>41.0</b>	<b>33.2</b>	<b>13.4</b>	<b>157.7</b>
Recognised in income	4.1	2.2	(49.1)	—	(9.6)	(52.4)
Recognised in Other Comprehensive Income	—	(0.9)	—	(3.0)	—	(3.9)
<b>At 31 December 2016</b>	<b>68.7</b>	<b>6.8</b>	<b>(8.1)</b>	<b>30.2</b>	<b>3.8</b>	<b>101.4</b>
Recognised in income	13.3	9.3	(1.4)	0.7	3.4	25.3
Recognised in Other Comprehensive Income	—	—	—	(27.9)	—	(27.9)
<b>At 31 December 2017</b>	<b>82.0</b>	<b>16.1</b>	<b>(9.5)</b>	<b>3.0</b>	<b>7.2</b>	<b>98.8</b>

There are no unrecognised deferred tax assets included in the consolidated historical financial information.

### *12. Inventories*

#### *Raw materials and consumables*

	31 December 2015	31 December 2016	31 December 2017
	£m		
Raw materials and consumables	0.9	1.6	3.1

Inventories are assets which are held for sale in the ordinary course of business. Inventories are carried at the lower of cost or net realisable value.

If the net realisable value of inventories written down in earlier periods has increased, the reversal of the write-down is recognised as a reduction in the cost of sales.

The amounts charged to the income statement in each period are as shown below.

**Raw materials and consumables expense**

	<u>31 December 2015</u>	<u>31 December 2016</u>	<u>31 December 2017</u>
		£m	
Raw materials and consumables expense . . . . .	3.5	3.9	6.2

**13. Other financial receivables**

**Other financial receivables**

	<u>31 December 2015</u>	<u>31 December 2016</u>	<u>31 December 2017</u>
		£m	
Amounts falling due within one year:			
Amounts owed by related undertakings . . . . .	—	70.0	—

Other financial receivables at 31 December 2016 represent a short term loan balance with innogy SE which was part of the cash-pooling with innogy SE.

**14. Trade and other receivables**

**Trade receivables**

	<u>31 December 2015</u>	<u>31 December 2016</u>	<u>31 December 2017</u>
		£m	
Amounts falling due within one year			
ROCs and other Green Certificates . . . . .	269.2	312.7	288.0
Prepayments . . . . .	67.7	70.7	108.2
Miscellaneous other assets . . . . .	30.2	4.2	8.7
Trade receivables . . . . .	482.3	460.0	639.5
Unbilled revenue accrual . . . . .	581.1	578.5	647.7
Amounts owed by related undertakings . . . . .	100.4	25.6	11.2
	<b>1,530.9</b>	<b>1,451.7</b>	<b>1,703.3</b>
of which: financial assets . . . . .	1,191.2	1,065.6	1,298.6
of which: non-financial assets . . . . .	339.7	386.1	404.7

**15. Cash and cash equivalents**

	<u>31 December 2015</u>	<u>31 December 2016</u>	<u>31 December 2017</u>
		£m	
Cash . . . . .	45.0	—	3.6

As detailed in the Accounting policies note, during 2015 and 2016 npower Retail Group pooled their funds with innogy SE/RWE AG by granting or receiving short term loans or borrowings. Since 2017 the npower Retail Group participates in an innogy SE Group-wide centralised treasury and cash management system.

**16. Equity**

The breakdown of fully paid-in shareholders' equity is presented on page 119.

All equity is attributable to Npower Group Limited (formerly Npower Group plc) shareholders. During 2017 the Npower Group Limited (formerly Npower Group plc) issued 1,883,788,492 shares at nominal value of £1 per share.

The **Accumulated deficit** contains the npower Retail Group's income generated in the past, insofar as such has not been distributed. Additionally, this item contains the re-measurement components of pensions and similar obligations.

**Available for sale financial assets reserve** income reflects changes in the fair values of financial instruments available for sale.

# 17. Provisions for liabilities and charges

## Roll-forward of provisions for liabilities and charges

2015						
	Opening balance	Additions	Unused amounts reversed	Amounts used	Transfers	Closing balance
	£m					
Liabilities and claims	6.5	32.4	(3.3)	(2.1)	—	33.5
Restructuring	8.5	7.5	(1.1)	(10.9)	—	4.0
Other provisions	—	1.4	—	—	—	1.4
	<u>15.0</u>	<u>41.3</u>	<u>(4.4)</u>	<u>(13.0)</u>	<u>—</u>	<u>38.9</u>

## Roll-forward of provisions for liabilities and charges

2016						
	Opening balance	Additions	Unused amounts reversed	Amounts used	Transfers	Closing balance
	£m					
Liabilities and claims	33.5	23.6	—	(26.0)	(6.8)	24.3
Restructuring	4.0	12.6	(5.3)	(5.8)	—	5.5
Other provisions	1.4	1.2	—	—	—	2.6
	<u>38.9</u>	<u>37.4</u>	<u>(5.3)</u>	<u>(31.8)</u>	<u>(6.8)</u>	<u>32.4</u>

## Roll-forward of provisions for liabilities and charges

2017						
	Opening balance	Additions	Unused amounts reversed	Amounts used	Transfers	Closing balance
	£m					
Liabilities and claims	24.3	29.3	(19.0)	(16.6)	—	18.0
Restructuring	5.5	1.8	(0.8)	(3.7)	—	2.8
Other provisions	2.6	2.2	—	—	—	4.8
	<u>32.4</u>	<u>33.3</u>	<u>(19.8)</u>	<u>(20.3)</u>	<u>—</u>	<u>25.6</u>

## Provisions for liabilities and charges

31 December 2015			
	Non-current provisions	Current provisions	Total
	£m		
Liabilities and claims	—	33.5	33.5
Restructuring	0.4	3.6	4.0
Other provisions	—	1.4	1.4
	<u>0.4</u>	<u>38.5</u>	<u>38.9</u>

## Provisions for liabilities and charges

31 December 2016			
	Non-current provisions	Current provisions	Total
	£m		
Liabilities and claims	0.4	23.9	24.3
Restructuring	0.4	5.1	5.5
Other provisions	0.2	2.4	2.6
	<u>1.0</u>	<u>31.4</u>	<u>32.4</u>

### *Provisions for liabilities and charges*

	31 December 2017		
	Non-current provisions	Current provisions	Total
		£m	
Liabilities and claims . . . . .	0.4	17.6	18.0
Restructuring . . . . .	0.8	2.0	2.8
Other provisions . . . . .	1.1	3.7	4.8
	<u>2.3</u>	<u>23.3</u>	<u>25.6</u>

The liabilities and claims provision relate to ongoing investigations by and potential claims from organisations into certain aspects of the npower Retail Group's activities. The amount provided represents management's best estimate of the amounts required to settle any potential costs arising from these claims and investigations and are expected to be utilized within 12 months.

The restructuring provision represents the provision for people-related costs in respect of business re-organisation, which is expected to be utilised within 12 months.

Other provisions include liabilities held by npower Retail Group with regard to long term incentive schemes.

Provisions have not been discounted by the directors as the impact is not material.

### **18. Provisions for pensions and similar obligations**

The npower Retail Group pension plans consist of defined contribution and defined benefit plans. Defined benefit plans mainly relate to pension commitments based on final salary.

Corporate defined benefit plans are legally mandated to provide adequate and suitable assets to cover pension provisions. The corporate pension system in the UK is managed by Electricity Supply Pension Scheme (ESPS) in its own special-purpose section.

Within the scope of the preparation for the demerger from RWE AG and initial public offering of innogy SE on 7 October 2016, the RWE UK pension plan was split into two new independent sections as of 31 July 2016. Each of the new sections comprises associated pension obligations and associated plan assets for UK subsidiaries of the innogy SE Group and of the RWE Group. The innogy UK section, with its principal employer Innogy Renewables UK Limited, contains the obligation for the retail and renewables businesses. For the purpose of the consolidated historical financial information a share of the innogy UK section has been allocated to the npower Retail Group and is presented below. This share was calculated based on the proportionate cash contributions to the innogy UK section.

The share of this pension scheme has been allocated to npower Retail Group only for the purpose of the consolidated historical financial information. Upon completion of the intended merger, as detailed on page 121, it is intended that the assets and liabilities of the members of the Retail section innogy UK Group of ESPS (created in March 2018 with active Retail members at that time), who will form part of the merged group, will transfer to a new and separate pension scheme. Current pensioners and deferred members will remain within the innogy UK pension scheme and therefore the assets and liabilities of new scheme are likely to be materially different to the assets and liabilities apportioned within this consolidated historical financial information.

The last valuation of innogy UK section of the ESPS was carried out on 31 March 2016 and showed a deficit of £377.7m. A deficit repair plan was prepared to rectify the deficit, under which npower Retail Group will pay £284.9m. Annual payments commenced in 2017 of £71.4m and reduce in 2018 to £26.7m and thereafter remain constant through to 2025. The scheduled 2018 payment of £26.7m in 2018 was paid early in 2017. The next valuation of the scheme is due to occur on 31 March 2019, from this point in time the innogy group and the trustees have 15 months to approve the valuation. The innogy UK section of the ESPS is managed by nine trustees who are responsible for the management of the plan, including investments, pension payments and financing plans.

Provisions for defined benefit plans are determined using actuarial methods. The npower Retail Group applies the following assumptions:

**Calculation assumptions %**

	31 December 2015	31 December 2016	31 December 2017
Discount rate . . . . .	3.60	2.60	2.40
Compensation increase . . . . .	3.00	3.30	3.20
Pension increase . . . . .	1.90; 2.80	2.20; 3.10	2.10; 3.00

**Calculation assumptions years**

	31 December 2015	31 December 2016	31 December 2017
Minimum life expectancy of 65 year old male/female	20 / 24	21 / 25	22 / 24
Minimum life expectancy of old male/female at the age of 65 currently 40 year . . . . .	22 / 26	23 / 27	23 / 26
Average duration of liabilities . . . . .	15	18	18

**Composition of plan assets (fair value)**

	31 December 2015		31 December 2016		31 December 2017	
	Assets	Of which: active market	Assets	Of which: active market	Assets	Of which: active market
	£m					
Equities . . . . .	244.3	244.0	308.0	308.0	307.8	146.9
Government bonds . . . . .	926.8	584.8	1,255.6	530.9	1,326.6	560.9
Corporate bonds . . . . .	351.8	123.2	521.7	145.0	591.4	—
Property . . . . .	2.3	—	0.1	—	—	—
Hedge fund . . . . .	257.7	—	441.0	—	434.7	—
Asset backed securities . . . . .	34.6	34.5	—	—	—	—
Other . . . . .	(4.3)	1.6	52.9	3.2	96.5	2.7
	<b>1,813.2</b>	<b>988.1</b>	<b>2,579.3</b>	<b>987.1</b>	<b>2,757.0</b>	<b>710.5</b>

The investment goal of the trustees in the United Kingdom is to acquire suitable assets with appropriate liquidity and security, which generate income and capital gains, and together with the contributions of employees and employers are adequate to cover the costs for accrued and future provisions. In the course of this, the trustees seek to limit the risk that the plan assets will not be sufficient to meet the pension obligations. This also serves to lower the risk of future increases in contributions by employers in the event of deterioration in market conditions in the future. This long-term target portfolio management approach divides the portfolio into income and capital generating investments, with a transition from income to capital generating investments to occur as the remaining term of the obligations grows shorter.

The trustees have agreed to determine the investment risk in relation to the obligations. The goal of this investment risk is to achieve a higher return than would be the case with congruent assets.

At the same time, a cautious approach is taken with regard to fulfilling the scheme's obligations. In addition to the goal of achieving suitable overall investment risk, the trustees attempt to diversify risk across several different sources. The trustees seek to take risks for which they will be rewarded over time in the form of surplus returns. For some asset classes, the scheme's trustees have decided to use active management and have selected investment managers, which they believe have the ability and judgement to generate a profit after the deduction of expenses. Furthermore, an appropriate portion of the obligations' interest and inflation risk is to be hedged using the plan assets. This occurs via investment in corporate bonds, nominal and inflation-linked government bonds and derivative positions, which exhibit interest and inflation sensitivity similar to the obligations.

All fair values are provided by the fund managers. Where available, fair values are based quoted prices (listed equity, government and corporate bonds). Other fair value are provided by the fund manager in accordance with relevant guidance.

## Changes in pension provisions

	31 December 2015	31 December 2016	31 December 2017
		£m	
<b>Pension liabilities</b>			
<b>Opening balance</b>	<b>(2,197.3)</b>	<b>(2,002.4)</b>	<b>(2,755.4)</b>
Current service cost	(18.0)	(15.9)	(17.9)
Interest cost on DBO	(68.4)	(74.2)	(69.8)
Contributions by scheme participants	(3.1)	(2.8)	(3.0)
Benefits paid	102.7	91.5	106.2
Severance	(5.6)	(1.6)	(2.2)
Change in financial assumptions	36.6	(388.3)	(42.5)
Change in demographic assumptions	—	(51.3)	57.7
Experience gains /(losses) on scheme liabilities	9.4	107.8	(21.5)
Actuarial gains /(losses)	141.3	(418.2)	(24.7)
<b>Closing balance</b>	<b>(2,002.4)</b>	<b>(2,755.4)</b>	<b>(2,773.1)</b>
<b>Plan assets</b>			
<b>Opening balance</b>	<b>1,953.1</b>	<b>1,813.2</b>	<b>2,579.3</b>
Interest Income on scheme assets	62.9	68.8	66.9
Return on scheme assets, excluding interest income	(64.6)	286.7	88.2
Administration expenses	(1.7)	(2.8)	(1.6)
Contributions by employer	97.8	79.4	114.6
Contributions by scheme participants	3.1	2.8	3.0
Benefits paid	(102.7)	(91.5)	(106.2)
Actuarial gains /(losses)	(134.7)	422.7	12.8
<b>Closing balance</b>	<b>1,813.2</b>	<b>2,579.3</b>	<b>2,757.0</b>
<b>Net liability end of period</b>	<b>(189.2)</b>	<b>(176.1)</b>	<b>(16.1)</b>

All pension schemes are funded pension plans. The funding level in each respective year was:

	31 December 2015	31 December 2016	31 December 2017
Funding Level	91%	94%	99%

Through its defined benefit pension plans, the group is exposed to a number of risks, the most significant of which are detailed below:

**Asset volatility:** The plan liabilities are calculated using a discount rate set with reference to UK corporate bond yields. If plan assets underperform this yield, this will create a deficit. The assets contain a significant amount of equities, which provide volatility in the short term.

**Changes in bond yields:** A decrease in corporate bond yields will increase plan liabilities. The dependence of pension provisions on market interest rates is limited by a counteracting effect. This is because the obligations arising from corporate pension plans are largely funded and the plan assets are largely negatively correlated to the market yields on fixed-interest securities. Therefore, declines in market interest rates are typically reflected in rises in plan assets and vice-versa.

**Life expectancy:** The majority of the plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities.

Changes in actuarial assumptions would lead to the following changes in the projected benefit obligation.

**Changes of present values of defined benefit obligations**

	31 December 2015		31 December 2016		31 December 2017	
			£m			
Change in the imputed discount rate by +50/–50 basis points . . . . .	(226.9)	256.4	(228.1)	261.6	(223.9)	256.5
Change in the salary trend by –50/+50 basis points . . .	(26.2)	30.2	(20.0)	23.2	(19.5)	22.8
Change in the pension trend by –50/+50 basis points . .	(161.1)	179.9	(170.1)	187.5	(166.0)	187.5
Increase in life expectancy by 1 year . . . . .		111.4		84.4		84.6

The sensitivity analyses are based on a change of one assumption each, with all other assumptions remaining unchanged. Actual developments will probably be different than this. The methods for calculating the aforementioned sensitivities and for calculating the pension provisions are identical.

**19. Other financial liabilities**

**Other financial liabilities**

	31 December 2015		31 December 2016		31 December 2017	
	Non-current	Current	Non-current	Current	Non-current	Current
			£m			
Borrowings from related undertakings . .	1,515.0	315.8	915.0	1,153.2	—	600.1
Miscellaneous other financial liabilities .	—	—	—	7.7	—	187.6
	<b>1,515.0</b>	<b>315.8</b>	<b>915.0</b>	<b>1,160.9</b>	<b>—</b>	<b>787.7</b>

As at the year ending 31 December 2017 all borrowings have a fixed interest rate, are denominated in pound sterling and mature within one year (31 December 2016: latest maturity 2030; 31 December 2015: latest maturity 2030). Please refer to note 22 for further information on the interest rates. The 2017 balance of £187.6m shown within the ‘Miscellaneous other financial liabilities’ line above represents the liability with innogy Business Services UK Limited in relation to the intra-innogy SE Group cash pooling arrangement. The 2016 balance of £7.7m shown within the ‘Miscellaneous other financial liabilities’ line above represents a bank overdraft.

In 2017 a debt for equity swap took place, whereby £1,883.8m of share capital was injected into the npower Retail Group which was used to repay outstanding debt of £1,565.0m, a prepayment penalty of £272.8m and interest of £46.0m.

**20. Current trade and other payables**

**Trade and other payables:** amounts falling due within one year

	31 December 2015	31 December 2016	31 December 2017
	£m		
Trade payables . . . . .	443.7	441.4	471.3
Amounts owed to related parties . . . . .	621.3	552.6	566.7
Other creditors . . . . .	396.8	305.4	222.6
Accruals and deferred income . . . . .	437.0	489.1	560.4
	<b>1,898.8</b>	<b>1,788.5</b>	<b>1,821.0</b>

**Other information**

**21. Share-based payment**

For executives of the npower Retail Group, there existed until 2016 a group-wide share-based payment system known as BEAT 2010, that was oriented towards RWE AG’s share price. As part of the IPO of innogy SE in 2016 a new Long-term Incentive Plan, the Strategic Performance Plan (SPP) was devised. Any executive wishing to take part in the SPP had to forego their rights to the BEAT plan. All executives employed by npower Retail Group agreed to the terms of the SPP and only past executives classed as ‘good-leavers’ retain



benefits under the BEAT plan, as the value of these benefits is immaterial no disclosure is made for the BEAT plan within this consolidated historical financial information.

The new SPP uses an internal performance target derived from the medium-term planning (adjusted net income of innogy SE) and takes account of the development of innogy SE's share price. The executives receive a number of notional shares. The final number of the notional shares of a tranche is determined after each year, based on the degree to which the target adjusted net income is achieved. This is followed by a three-year vesting period before any potential pay-out.

### ***Strategic Performance Plan***

	<u>2016 tranche</u>	<u>2017 tranche</u>
Start of term . . . . .	1 January 2016	1 January 2017
Number of conditionally granted performance shares . . . . .	17,870	75,824
	Adjusted net	Adjusted net
Performance target . . . . .	income	income
Term . . . . .	4 years	4 years
Cap /number of performance Shares . . . . .	150%	150%
Cap /payment amount . . . . .	200%	200%

Determination of payment      The payment amount is calculated on the basis of the determined number of finally granted performance shares multiplied by the sum of

- a) the mathematical average of the closing share prices (including all available decimal places) of the innogy SE share (ISIN DE 000A2AAD02) in Deutsche Börse AG's Xetra trading (or a successor system which subsequently takes the place of the Xetra system) for the last 30 trading days prior to the end of the vesting period rounded to two decimal places according to standard commercial practice and
- b) the dividends paid per share for the fiscal years between the determination of the performance shares and the end of the vesting period. Dividends do not bear interest and are not reinvested. If a dividend payment occurs during the 30-day period for calculating the share price, the share prices of the trading days leading up to the payment (CUM share prices) are adjusted by the dividend, as the dividend would otherwise be considered twice.

Payment amount = (number of finally granted performance shares) x (mathematical average of the share price + dividends paid)

The payment amount calculated in this manner is limited to no more than 200% of the grant amount.

Change in corporate control / merger

A change in corporate control ("change of control") shall occur if

- a) a shareholder gains control in accordance with Section 29 of the German Securities Acquisition and Takeover Act (WpÜG) by holding at least 30% of the voting rights including third-party voting rights attributable to it in accordance with Section 30 WpÜG or
- b) a control agreement in accordance with Section 291 of the German Stock Corporation Act (AktG) is concluded by a company that does not belong to the RWE Group with innogy SE as a dependent company, or
- c) innogy SE is merged with another legal entity that does not belong to the Group in accordance with Section 2 of the German Company Transformation Act (UmwG) unless the value of the other legal entity is less than 50% of the value of innogy SE based on the agreed conversion rate; in such a case, item a) shall not apply.

In the event of a change of control, the performance shares that fully vested and have not yet been paid out shall be paid out early. The payment amount shall be calculated by applying exercise conditions analogously, wherein in deviation here from, the basis of calculation shall be the last 30 stock exchange trading days before the

announcement of the change of control in addition to the dividends paid per share in the fiscal years between the vesting of the performance shares and the effective date of the change of control relative to the fully vested performance shares.

The payment amount calculated in this manner shall be paid to the plan participant together with his or her next salary payment.

All conditionally granted performance shares as of the effective date of the change of control shall lapse without consideration.

Personal investment	Not necessary for executives
Form of settlement	Cash settlement

The fair values of the performance shares conditionally granted in the SPP programme as of the grant date are shown in the following table:

***Performance shares from SPP***

	<u>2016 tranche</u>	<u>2017 tranche</u>
	£	
Fair value per share	<u>32.94</u>	<u>28.45</u>

The fair values of the tranches are derived from the current share prices of innogy SE plus the dividends per share which are paid out to shareholders during the terms of the respective tranches. The limited pay-out per SPP was calculated using the fair value of a call option. The option value determined using the Black-Scholes model was deducted. In determining the price of the option, due consideration was taken of the maximum payment stipulated in the programme's conditions for each conditionally granted SPP (= strike price of the option), the discount rates for the remaining term, the volatilities and the expected dividends of innogy SE.

As of 31 December 2016 and 2017, the number of performance shares developed as follows:

***Performance shares from SPP 2016***

	<u>2016 tranche</u>	<u>2017 tranche</u>
Outstanding at 1 January 2016	—	—
Granted	17,870	—
Change (granted /expired)	(120)	—
Paid out	—	—
<b>Outstanding 31 December 2016 / 1 January 2017</b>	<b><u>17,750</u></b>	<b><u>—</u></b>
Payable at 31 December 2016	—	—
Granted	—	75,824
Change (granted /expired)	(240)	(2,743)
Paid out	—	—
<b>Outstanding 31 December 2017</b>	<b><u>17,510</u></b>	<b><u>73,081</u></b>
Payable at 31 December 2017	—	—

The remaining contractual term amounts to three years for the 2017 tranche and two years for the 2016 tranche.

During the periods under review, expenses for share-based payments totalled as follows:

***Performance shares from SPP***

	<u>2016</u>	<u>2017</u>
	£m	
Expenses	0.1	1.0

As of the balance-sheet date, provisions for cash-settled share-based payments amounted to:

**Performance shares from SPP**

	2016	2017
	£m	
Provisions . . . . .	0.1	1.1

**22. Related party transactions**

Within the framework of ordinary business activities, npower Retail Group and its subsidiaries have business relationships and transactions with numerous related party companies. These include the parent companies innogy SE and RWE AG and their subsidiaries, associates and joint ventures as well as associates and joint ventures of the npower Retail Group.

The following business and financial transactions are included in the npower Retail Group's consolidated historical financial information (note that transactions with entities in the innogy SE Group are not included within the RWE AG balances):

**Key items from transactions with related parties**

	Subsidiaries, joint ventures and associates of the RWE Group			Subsidiaries, joint ventures and associates of the innogy SE Group		
	2015	2016	2017	2015	2016	2017
	£m					
Income . . . . .	66.1	0.5	16.1	6.2	7.9	12.3
Expenses . . . . .	(3,604.2)	(3,286.2)	(3,202.8)	(374.2)	(364.5)	(615.2)

**Key items from transactions with related parties**

	Subsidiaries, joint ventures and associates of the RWE Group			Subsidiaries, joint ventures and associates of the innogy SE Group		
	31 December 2015	31 December 2016	31 December 2017	31 December 2015	31 December 2016	31 December 2017
	£m					
Receivables . . . . .	95.0	23.7	8.5	5.4	71.9	2.7
Liabilities . . . . .	(2,199.1)	(319.0)	(309.5)	(253.0)	(2,301.8)	(1,044.9)

The items resulting from transactions with related parties mainly stemmed from supply and service as well as financial transactions with RWE AG and innogy SE Group companies with the npower Retail Group. The receivables and liabilities included loans and other financial positions owed to or from the parent companies:

**Financial assets and liabilities**

	Subsidiaries, joint ventures and associates of the RWE Group			Subsidiaries, joint ventures and associates of the innogy SE Group		
	31 December 2015	31 December 2016	31 December 2017	31 December 2015	31 December 2016	31 December 2017
	£m					
Receivables . . . . .	—	—	—	—	70.0	—
Liabilities . . . . .	(1,830.8)	—	—	—	(2,068.2)	(787.7)

The underlying interest rates of the loans and financial liabilities owed to the RWE Group and innogy SE Group and their underlying terms ranged from:

**Interest rates %**

	Subsidiaries, joint ventures and associates of the RWE Group and innogy SE Group		
	2015	2016	2017
Range . . . . .	0.8–6.3	0.6–6.3	0.9
Average . . . . .	3.9	3.5	0.9

npower Retail Group companies entered into contracts with RWE Group companies, in particular with RWE Supply & Trading GmbH, to purchase or supply commodities, mainly electricity and gas. In addition, services were provided by innogy SE Group companies to the npower Retail Group based on service level agreements.

**Key items from transactions with related parties**

	RWE Group			innogy SE Group		
	2015	2016	2017	2015	2016	2017
			£m			
<b>Income</b> . . . . .	66.1	0.5	16.1	6.2	7.9	12.3
of which: income from supply and service transactions . . . . .	66.1	0.5	16.1	6.2	7.9	11.6
of which: income from financial transactions . . .	—	—	—	—	—	0.7
<b>Expenses</b> . . . . .	(3,604.2)	(3,286.2)	(3,202.8)	(374.2)	(364.5)	(615.2)
of which: expenses from supply and service transactions . . . . .	(3,538.9)	(3,285.0)	(3,202.8)	(374.2)	(297.0)	(277.5)
of which: expenses from financial transactions . .	(65.3)	(1.2)	—	—	(67.5)	(337.7)

Sales and purchases from related parties are made at normal market prices. The following receivables and liabilities were due within one year:

**Receivables and liabilities due within one year**

	Subsidiaries, joint ventures and associates of the RWE Group			Subsidiaries, joint ventures and associates of the innogy SE Group		
	31 December 2015	31 December 2016	31 December 2017	31 December 2015	31 December 2016	31 December 2017
			£m			
Receivables . . . . .	95.0	23.7	8.5	5.4	71.9	2.7
Liabilities . . . . .	(684.1)	(319.0)	(309.5)	(253.0)	(1,386.8)	(1,044.9)

Other obligations from executory contracts amounted:

**Obligations from executory contracts**

	Subsidiaries, joint ventures and associates of the RWE Group			Subsidiaries, joint ventures and associates of the innogy SE Group		
	31 December 2015	31 December 2016	31 December 2017	31 December 2015	31 December 2016	31 December 2017
			£m			
Purchase commitments . .	3,062.2	3,046.8	2,626.7	2,817.8	2,529.1	2,295.4
of which: relates to capital expenditure . . .	127.1	137.1	160.0	—	—	—
Delivery commitments . .	1,013.1	590.1	558.4	—	—	—

The commitments consist of purchases and sales of power and gas as well as a certain amount of ROCs in order to meet Ofgem requirements. These are purchased from within the innogy SE group. Other commitments also include ongoing IT projects/services, provided by innogy Business Services UK Ltd. 2017.

Above and beyond this, the npower Retail Group did not execute any material transactions with related companies or persons. Transactions with the immediate parent company are included within transactions with the RWE group in 2015 / 2016 and the innogy SE group in 2016 / 2017.

### 23. Compensation of key management personnel

The remuneration of directors and other members of key management personnel during the year was as follows:

#### Key management compensation

	31 December 2015	31 December 2016	31 December 2017
		£m	
Short-term benefits . . . . .	3.0	3.0	2.9
Post-employment benefits . . . . .	0.4	0.3	0.4
Other long-term benefits . . . . .	—	—	—
Share-based payments . . . . .	—	—	—
Termination benefits . . . . .	3.7	—	0.3
	<u>7.1</u>	<u>3.3</u>	<u>3.6</u>

The total cost of contributions paid into the defined contribution pension scheme for the year ended 31 December 2017 was £0.1m (2016: £0.1m; 2015: £0.1m).

### 24. Financial commitments

#### Guarantees and indemnities

npower Retail Group has provided guarantees on behalf of other group undertakings and related parties as follows:

#### Guarantees

	2015	2016	2017
		£m	
Letters of credit . . . . .	0.2	0.2	0.1
Guarantees on behalf of related parties . . . . .	15.0	15.0	15.0
	<u>15.2</u>	<u>15.2</u>	<u>15.1</u>

Where the npower Retail Group enters into financial guarantee contracts to guarantee indebtedness of the other companies within its group, or within the innogy SE group, the npower Retail Group considers these to be insurance arrangements, and accounts for them as such. In this respect, the npower Retail Group treats the guarantee contract as a contingent liability until such time as it becomes probable that the npower Retail Group will be required to make payment under the guarantee.

### 25. Other financial commitments

At each period ending 31 December shown below, npower Retail Group was committed to capital expenditure as detailed below. This capital expenditure primarily relates to software development. In addition to this, there are other commitments with related parties for ongoing IT services, the amount committed to related parties is disclosed in note 22—Related Party transactions.

#### Other financial commitments

	2015	2016	2017
		£m	
Capital commitments . . . . .	46.8	23.0	12.7

#### Operating lease commitments

	2015	2016	2017
		£m	
Within one year . . . . .	9.0	8.2	7.5
In two to five years . . . . .	20.2	17.5	14.6
In over five years . . . . .	13.3	10.7	8.2
	<u>42.5</u>	<u>36.4</u>	<u>30.3</u>

The amount of non-cancellable operating lease payments recognised as an expense for the year end 31 December 2017 was £9.7m (2016: £11.2m, 2015: £10.6m).

## 26. Earnings per share

### Earnings per share:

		2015	2016	2017
Net (loss)/ income attributable to npower Retail Group share holders	£m	(282.2)	79.2	(371.8)
Number of shares outstanding (weighted average)	('000)	33,213	33,213	229,333
Basic and diluted earnings per share	£	(8.5)	2.4	(1.6)
Dividend per share	£	—	—	—

Basic and diluted earnings per share are calculated by dividing the portion of net income attributable to npower Retail Group shareholders by the weighted average number of shares outstanding. There were no dilutive shares in any period noted above.

## 27. Reporting on financial instruments

Financial instruments are divided into non-derivative and derivative. Non-derivative financial assets essentially include other non-current financial assets, accounts receivable and cash and cash equivalents. Financial instruments in the “available for sale” category are recognised at fair value, and other non-derivative financial assets at amortised cost. The fair value of financial instruments “available for sale” which are reported under other financial assets is the published exchange price, insofar as the financial instruments are traded on an active market. On the liabilities side, non-derivative financial instruments principally include liabilities recorded at amortised cost. The fair value of non-quoted debt is determined on the basis of discounted expected payment flows, taking into consideration macro-economic developments and corporate business plan data. Current market interest rates corresponding to the remaining maturity are used for discounting.

Derivative financial instruments are recognised at their fair value as of the balance-sheet date, insofar as they fall under the scope of IAS 39. Forward contracts are measured on the basis of publicly available broker quotations or, if such quotations are not available, of generally accepted valuation methods. In doing so, the npower Retail Group draw on prices on active markets as much as possible. If such are not available, company-specific planning estimates are used in the measurement process. These estimates encompass those market factors which other market participants would take into account in the course of price determination. Assumptions pertaining to the energy sector and economy are made within the scope of a comprehensive process with the involvement of both in-house and external experts. Measurement of the fair value of a group of financial assets and financial liabilities is conducted on the basis of the net risk exposure per business partner, in accordance with IFRS 13.48.

The following overview presents the classifications of financial instruments measured at fair value in the fair value hierarchy prescribed by IFRS 13. In accordance with IFRS 13, the individual levels of the fair value hierarchy are defined as follows:

- Level 1: Measurement using (unadjusted) prices of identical financial instruments formed in active markets
- Level 2: Measurement on the basis of input parameters which are not the prices from Level 1, but which can be observed for the financial instrument either directly (i.e. as price) or indirectly (i.e. derived from prices)
- Level 3: Measurement using factors which cannot be observed on the basis of market data

### *Fair Value hierarchy*

	31 December 2015			
	Level 1	Level 2	Level 3	Total
	£m			
<b>Financial Assets</b>				
Energy derivative financial instruments . . . . .	—	156.3	—	<b>156.3</b>
Available for sale financial assets . . . . .	4.6	—	—	<b>4.6</b>
	<u>4.6</u>	<u>156.3</u>	<u>—</u>	<u><b>160.9</b></u>
<b>Financial Liabilities</b>				
Energy derivative financial instruments . . . . .	—	(383.9)	(8.6)	<b>(392.5)</b>
Loans . . . . .	—	(1,830.8)	—	<b>(1,830.8)</b>
	<u>—</u>	<u>(2,214.7)</u>	<u>(8.6)</u>	<u><b>(2,223.3)</b></u>

### *Fair Value hierarchy*

	31 December 2016			
	Level 1	Level 2	Level 3	Total
	£m			
<b>Financial Assets</b>				
Energy derivative financial instruments . . . . .	—	167.1	6.9	174.0
Loans . . . . .	—	70.0	—	70.0
Available for sale financial assets . . . . .	5.0	—	—	5.0
	<u>5.0</u>	<u>237.1</u>	<u>6.9</u>	<u><b>249.0</b></u>
<b>Financial Liabilities</b>				
Energy derivative financial instruments . . . . .	—	(119.5)	(7.8)	<b>(127.3)</b>
Loans . . . . .	—	(2,075.9)	—	<b>(2,075.9)</b>
	<u>—</u>	<u>(2,195.4)</u>	<u>(7.8)</u>	<u><b>(2,203.2)</b></u>

### *Fair value hierarchy*

	31 December 2017			
	Level 1	Level 2	Level 3	Total
	£m			
<b>Financial Assets</b>				
Energy derivative financial instruments . . . . .	—	126.2	4.5	<b>130.7</b>
Available for sale financial assets . . . . .	5.1	—	—	<b>5.1</b>
	<u>5.1</u>	<u>126.2</u>	<u>4.5</u>	<u><b>135.8</b></u>
<b>Financial Liabilities</b>				
Energy derivative financial instruments . . . . .	—	(70.1)	(6.5)	<b>(76.6)</b>
Loans . . . . .	—	(787.7)	—	<b>(787.7)</b>
	<u>—</u>	<u>(857.8)</u>	<u>(6.5)</u>	<u><b>(864.3)</b></u>

The development of the fair values of Level 3 financial instruments is presented in the following table:

### *Level 3 financial instruments: Development in 2015*

	Changes		
	Balance at 1 January 2015	Recognised in profit or loss	Balance at 31 December 2015
	£m		
Derivative financial instruments (assets) . . . . .	8.1	—	(8.1)
Derivative financial instruments (liabilities) . . . . .	(0.3)	(8.6)	0.3

**Level 3 financial instruments: Development in 2016**

	Changes		
	Balance at 1 January 2016	Recognised in profit or loss	Balance at 31 December 2016
		With a cash effect	
		£m	
Derivative financial instruments (assets) . . . . .	—	6.9	6.9
Derivative financial instruments (liabilities) . . . . .	(8.6)	(7.8)	(7.8)

**Level 3 financial instruments: Development in 2017**

	Changes		
	Balance at 1 January 2017	Recognised in profit or loss	Balance at 31 December 2017
		With a cash effect	
		£m	
Derivative financial instruments (assets) . . . . .	6.9	4.5	4.5
Derivative financial instruments (liabilities) . . . . .	(7.8)	(6.5)	(6.5)

Amounts recognised in profit or loss generated through Level 3 financial instruments were recognised in the following line items on the Consolidated Income Statement:

**Level 3: financial instruments: Amounts recognised in profit or loss 2017**

	Total 2015	Of which: attributable to financial instruments held at the balance-sheet date	Total 2016	Of which: attributable to financial instruments held at the balance-sheet date	Total 2017	Of which: attributable to financial instruments held at the balance-sheet date
				£m		
Cost of sales . . . . .	(8.6)	(8.6)	(0.9)	(0.9)	(2.0)	(2.0)

Level 3 derivative financial instruments essentially consist of weather derivative financial instruments to hedge temperature-dependent fluctuations in demand. The valuation of such depends on the development of temperatures in particular. As a rule, all other things being equal, rising temperatures cause the fair values to increase and vice-versa. Assumptions that the future development of average temperatures will differ from the past long-term average over the derivative financial instruments' remaining term to maturity may only be made for extremely short periods of time. Therefore, the fair values are predominantly determined based on the long-term average temperatures. A change in temperature by +/-0.1 °C would cause the market value to rise or decline by the following amounts.

**Level 3: Sensitivity of change in temperature**

	+/- 0.1 °C
	£m
31 December 2015 . . . . .	7.5
31 December 2016 . . . . .	8.0
31 December 2017 . . . . .	7.2

The following impairments were recognised on financial assets which fall under the scope of IFRS 7 and are reported under the balance-sheet items stated below:

**Impairments on financial assets**

	2015	2016	2017
		£m	
Balance at 1 January . . . . .	(180.9)	(197.2)	(186.6)
Increase in allowance for impairment . . . . .	(100.6)	(79.4)	(76.2)
Impairment losses recognised . . . . .	84.3	90.0	108.5
<b>Balance at 31 December . . . . .</b>	<b>(197.2)</b>	<b>(186.6)</b>	<b>(154.3)</b>



At the end of each reporting period a review of the provision for bad and doubtful debts is performed. It is an assessment of the potential amount of trade receivables which will not be paid by customers after the Balance Sheet date. This amount is calculated by reference to the age, status and risk of each class of receivable, historical trend analysis is used to estimate the level of provision required.

As of the cut-off date, there were unimpaired, past due receivables falling under the scope of IFRS 7 in the following amounts:

***Receivables, past due and not impaired***

	31 December 2015	31 December 2016	31 December 2017
		£m	
Not past due . . . . .	1,122.1	1,012.7	1,256.7
Past due and impaired . . . . .	197.2	186.6	154.3
Past due but not individually impaired:			
0–30 days . . . . .	24.2	30.8	30.9
31–90 days . . . . .	9.1	13.3	7.0
Over 90 days . . . . .	35.8	8.8	4.0
Less: allowance for impairment . . . . .	(197.2)	(186.6)	(154.3)
<b>Net Trade and other receivables . . . . .</b>	<b><u>1,191.2</u></b>	<b><u>1,065.6</u></b>	<b><u>1,298.6</u></b>

Financial assets and liabilities can be broken down into categories with the following carrying amounts:

***Carrying amounts by category***

	31 December 2015				
	Amortised Cost or Other (i)	Classified as trading (ii)	Available for Sale (iii)	Total Carrying Value	Fair Value
			£m		
<b>Financial Assets</b>					
<b>Current</b>					
Trade and other receivables . . . . .	1,191.2	—	—	1,191.2	1,191.2
Cash and cash equivalents . . . . .	45.0	—	—	45.0	45.0
Derivative financial assets . . . . .	—	95.9	—	95.9	95.9
	<b><u>1,236.2</u></b>	<b><u>95.9</u></b>	<b><u>—</u></b>	<b><u>1,332.1</u></b>	<b><u>1,332.1</u></b>
<b>Non-current</b>					
Available for sale financial assets . . . . .	—	—	4.6	4.6	4.6
Derivative financial assets . . . . .	—	60.4	—	60.4	60.4
	<b><u>—</u></b>	<b><u>60.4</u></b>	<b><u>4.6</u></b>	<b><u>65.0</u></b>	<b><u>65.0</u></b>
	<b><u>1,236.2</u></b>	<b><u>156.3</u></b>	<b><u>4.6</u></b>	<b><u>1,397.1</u></b>	<b><u>1,397.1</u></b>
<b>Financial Liabilities</b>					
<b>Current</b>					
Trade and other payables . . . . .	(1,885.5)	—	—	(1,885.5)	(1,885.5)
Loans . . . . .	(315.8)	—	—	(315.8)	(315.8)
Derivative financial liabilities . . . . .	—	(243.8)	—	(243.8)	(243.8)
	<b><u>(2,201.3)</u></b>	<b><u>(243.8)</u></b>	<b><u>—</u></b>	<b><u>(2,445.1)</u></b>	<b><u>(2,445.1)</u></b>
<b>Non-current</b>					
Loans . . . . .	(1,515.0)	—	—	(1,515.0)	(1,623.3)
Derivative financial liabilities . . . . .	—	(148.7)	—	(148.7)	(148.7)
	<b><u>(1,515.0)</u></b>	<b><u>(148.7)</u></b>	<b><u>—</u></b>	<b><u>(1,663.7)</u></b>	<b><u>(1,772.0)</u></b>
	<b><u>(3,716.3)</u></b>	<b><u>(392.5)</u></b>	<b><u>—</u></b>	<b><u>(4,108.8)</u></b>	<b><u>(4,217.1)</u></b>
<b>Net financial position . . . . .</b>	<b><u>(2,480.1)</u></b>	<b><u>(236.2)</u></b>	<b><u>4.6</u></b>	<b><u>(2,711.7)</u></b>	<b><u>(2,820.0)</u></b>

*Carrying amounts by category*

	31 December 2016				
	Amortised Cost or Other (i)	Classified as trading (ii)	Available for Sale (iii) £m	Total Carrying Value	Fair Value
<b>Financial Assets</b>					
<b>Current</b>					
Financial receivables . . . . .	70.0	—	—	70.0	70.0
Trade and other receivables . . . . .	1,065.6	—	—	1,065.6	1,065.6
Derivative financial assets . . . . .	—	107.8	—	107.8	107.8
	<u>1,135.6</u>	<u>107.8</u>	<u>—</u>	<u>1,243.4</u>	<u>1,243.4</u>
<b>Non-current</b>					
Available for sale financial assets . . . . .	—	—	5.0	5.0	5.0
Derivative financial assets . . . . .	—	66.2	—	66.2	66.2
	<u>—</u>	<u>66.2</u>	<u>5.0</u>	<u>71.2</u>	<u>71.2</u>
	<u>1,135.6</u>	<u>174.0</u>	<u>5.0</u>	<u>1,314.6</u>	<u>1,314.6</u>
<b>Financial Liabilities</b>					
<b>Current</b>					
Trade and other payables . . . . .	(1,778.5)	—	—	(1,778.5)	(1,778.5)
Loans . . . . .	(1,160.9)	—	—	(1,160.9)	(1,160.9)
Derivative financial liabilities . . . . .	—	(89.9)	—	(89.9)	(89.9)
	<u>(2,939.4)</u>	<u>(89.9)</u>	<u>—</u>	<u>(3,029.3)</u>	<u>(3,029.3)</u>
<b>Non-current</b>					
Loans . . . . .	(915.0)	—	—	(915.0)	(1,157.2)
Derivative financial liabilities . . . . .	—	(37.4)	—	(37.4)	(37.4)
	<u>(915.0)</u>	<u>(37.4)</u>	<u>—</u>	<u>(952.4)</u>	<u>(1,194.6)</u>
	<u>(3,854.4)</u>	<u>(127.3)</u>	<u>—</u>	<u>(3,981.7)</u>	<u>(4,223.9)</u>
<b>Net financial position . . . . .</b>	<u>(2,718.8)</u>	<u>(46.7)</u>	<u>5.0</u>	<u>(2,667.1)</u>	<u>(2,909.3)</u>

## Carrying amounts by category

	31 December 2017				
	Amortised Cost or Other (i)	Classified as trading (ii)	Available for Sale (iii) £m	Total Carrying Value	Fair Value
<b>Financial Assets</b>					
<b>Current</b>					
Trade and other receivables . . . . .	1,298.6	—	—	1,298.6	1,298.6
Cash and cash equivalents . . . . .	3.6	—	—	3.6	3.6
Derivative financial assets . . . . .	—	89.2	—	89.2	89.2
	<u>1,302.2</u>	<u>89.2</u>	<u>—</u>	<u>1,391.4</u>	<u>1,391.4</u>
<b>Non-current</b>					
Available for sale financial assets . . . . .	—	—	5.1	5.1	5.1
Derivative financial assets . . . . .	—	41.5	—	41.5	41.5
	<u>—</u>	<u>41.5</u>	<u>5.1</u>	<u>46.6</u>	<u>46.6</u>
	<u>1,302.2</u>	<u>130.7</u>	<u>5.1</u>	<u>1,438.0</u>	<u>1,438.0</u>
<b>Financial Liabilities</b>					
<b>Current</b>					
Trade and other payables . . . . .	(1,800.9)	—	—	(1,800.9)	(1,800.9)
Loans and cash pooling liabilities . . . . .	(787.7)	—	—	(787.7)	(787.7)
Derivative financial liabilities . . . . .	—	(65.5)	—	(65.5)	(65.5)
	<u>(2,588.6)</u>	<u>(65.5)</u>	<u>—</u>	<u>(2,654.1)</u>	<u>(2,654.1)</u>
<b>Non-current</b>					
Derivative financial liabilities . . . . .	—	(11.1)	—	(11.1)	(11.1)
	<u>—</u>	<u>(11.1)</u>	<u>—</u>	<u>(11.1)</u>	<u>(11.1)</u>
	<u>(2,586.6)</u>	<u>(76.6)</u>	<u>—</u>	<u>(2,665.2)</u>	<u>(2,665.2)</u>
<b>Net financial position . . . . .</b>	<u>(1,286.4)</u>	<u>54.1</u>	<u>5.1</u>	<u>(1,227.2)</u>	<u>(1,227.2)</u>

As a rule, the carrying amounts of financial assets and liabilities within the scope of IFRS 7 are identical to their fair values, except for long-term loans. Their respective fair values are disclosed in the table above.

The following net results from financial instruments as per IFRS 7 were recognised on the Consolidated Income Statement, depending on the category:

## Net gain /loss by category

	2015	2016	2017
		£m	
Financial assets and liabilities recognised at fair value through profit or loss . . .	(55.8)	31.7	57.9
of which: held for trading . . . . .	(55.8)	31.7	57.9
Financial assets available for sale . . . . .	0.1	0.4	0.2
Loans and receivables . . . . .	(128.4)	(105.9)	(77.9)
Financial liabilities carried at (amortised) cost . . . . .	(54.1)	(59.2)	(346.8)

The net result as per IFRS 7 essentially includes interest, dividends, impairment losses and compensation payments for restructuring of npower Retail Group's financing in 2017.

The npower Retail Group is exposed to market, credit and liquidity risks in its ordinary business activity. These risks are limited via systematic, group-wide risk management. The range of action, responsibilities and controls are defined in binding internal directives.

Market risks stem from changes in interest rates and commodity prices, which can have an influence on business results. Currency risks can be considered small as there are only few transactions in Euros.

Interest rate risks stem primarily from financial debt. Market interest rates also affect the level of provisions, as the discount rates for determining the net present value of obligations are oriented towards them. This means the reductions in market interest rates tend to cause provisions to increase and vice-versa.

For commodity operations, directives have been established. These regulations stipulate that derivative financial instruments may be used to hedge price risks. This includes the application of appropriate hedge policies, the measurement of commodity risks, the setting of approved transaction limits, the reporting of unhedged positions and the conduct of scenario analyses and stress tests. Financial contracts are typically also purchased to manage the impact of weather variations on customer demand. One of the most important instruments to limit market risk is the utilisation of hedging transactions. The instruments most commonly used are power and gas forwards. Maturities of derivative financial instruments for the purpose of hedging are based on the maturities of the underlying transactions and are thus primarily short term and medium term in nature. All derivative financial instruments are recognised as assets or liabilities and are measured at fair value. When interpreting their positive and negative fair values, it should be taken into account that these financial instruments are generally matched with underlying transactions that carry offsetting risks but are not accounted for as a derivative. The npower Retail Group does not use derivative financial instruments for trading purposes.

npower Retail Group's exposure to commodity price risk according to IFRS 7 is measured by reference to the npower Retail Group's IAS 39 commodity contracts. IFRS 7 requires disclosure of a sensitivity analysis for market risks that is intended to illustrate the sensitivity of the npower Retail Group's financial position and performance to changes in market variables impacting upon the fair value or cash flows associated with the Group's financial instruments.

Therefore, the sensitivity analysis provided discloses the effect on profit or loss and equity at the Consolidated Balance Sheet date assuming that a reasonably possible change in the relevant commodity price had occurred, and been applied to the risk exposures in existence at that date. The reasonably possible changes in commodity prices used in the sensitivity analysis were determined based on calculated or implied volatilities where available, or historical data.

The sensitivity analysis has been calculated on the basis that the proportion of commodity contracts that are IAS 39 financial instruments remains consistent with those at that point. Excluded from this analysis are all commodity contracts that are not financial instruments under IAS 39.

### **Commodity prices**

	<b>31 December 2015</b>		<b>31 December 2016</b>		<b>31 December 2017</b>	
	<b>Base Price<sup>(i)</sup></b>	<b>Reasonably possible increase/decrease in variable</b>	<b>Base Price<sup>(i)</sup></b>	<b>Reasonably possible increase/decrease in variable</b>	<b>Base Price<sup>(i)</sup></b>	<b>Reasonably possible increase/decrease in variable</b>
UK gas (p/therm) . . . . .	33.37	11	48.71	11	47.07	11
UK power (£/MWh) . . . . .	35.68	10	46.08	10	45.08	10

(i) The base price represents the average forward market price over the duration of 3 years.

The impacts of reasonably possible changes in commodity prices on profit after taxation based on the rationale described are as follows:

### **Incremental profit / (loss)**

	<b>31 December 2015</b>	<b>31 December 2016</b>	<b>31 December 2017</b>
	<b>Impact on profit and equity</b>	<b>Impact on profit and equity</b>	<b>Impact on profit and equity</b>
		<b>£m</b>	
Commodity prices combined—increase . . . . .	127.7	155.9	131.4
Commodity prices combined—decrease . . . . .	(127.7)	(155.9)	(131.4)

Credit risks. In the fields of finance and commodities npower Retail Group primarily have credit relationships with banks, customers and other business partners with good creditworthiness. The resulting counterparty risks are reviewed upon concluding contracts and constantly monitored. The npower Retail Group mitigate them by establishing credit limits that are adjusted if necessary, for instance in the event of changes in creditworthiness. To hedge credit risks, npower Retail Group use guarantees and other forms of security. The credit risk is constantly monitored and proactively managed in all business fields. The maximum balance-sheet default risk is derived from the carrying values of the receivables stated on the Consolidated Balance Sheet. If default risks materialise, they are recognized through impairments. The default risks for derivative financial instruments correspond to their positive fair values.

Liquidity risks. npower Retail Group is centrally financed by innogy SE and is part of innogy's cashpooling. The short-term liquidity risk can be considered low. npower Retail Group currently has several short term loans from other innogy SE group companies to ensure sufficient funds. The maturity of the liabilities of financial derivative financial instruments match the maturity of underlying sales contracts. Accordingly, the medium-term liquidity risk can be classified as low. Financial liabilities falling under the scope of IFRS 7 are expected to result in the following (undiscounted) payments in the coming years:

***Repayments and interest payments on financial liabilities 2015***

	Carrying amounts 31 December 2015	Repayments			Interest		
		2016	2017 to 2020	From 2021	2016	2017 to 2020	From 2021
		£m					
Derivative financial liabilities . . . . .	392.5	243.8	148.7	—	—	—	—
Loans . . . . .	1,830.8	315.8	600.0	915.0	65.7	230.7	291.6

***Repayments and interest payments on financial liabilities 2016***

	Carrying amounts 31 December 2016	Repayments			Interest		
		2017	2018 to 2021	From 2022	2017	2018 to 2021	From 2022
		£m					
Derivative financial liabilities . . . . .	127.3	89.9	37.4	—	—	—	—
Loans . . . . .	2,075.9	1,160.9	—	915.0	66.6	221.6	236.0

***Repayments and interest payments on financial liabilities 2017***

	Carrying amounts 31 December 2017	Repayments			Interest		
		2018	2019 to 2022	From 2023	2018	2019 to 2022	From 2023
		£m					
Derivative financial liabilities . . . . .	76.6	65.5	11.1	—	—	—	—
Loans and Cashpooling . . . . .	787.7	787.7	—	—	1.1	—	—

**Capital management**

The npower Retail Group's main objective, when managing capital, is to safeguard the npower Retail Group's ability to continue as a going concern as part of the innogy SE group. The focus of innogy SE's financing policy is on ensuring access to the capital market at all times, to enable the efficient refinancing of maturing debts at any time. This goal is pursued by maintaining a solid investment grade rating and by targeting positive cash flow and partially pre-financing the non-current provisions with invested financial assets.

The npower Retail Group manages capital by reviewing the level of net debt, net debt is calculated as total borrowings less cash balances. Net debt at 31 December 2017 amounted to £784.1m (2016: £2,075.9m, 2015: £1,785.8m). In 2017 net debt fell as a result of a debt for equity swap with £1,883.8m of equity injected and £1,565.0m borrowings repaid.

**28. Notes to the Cash Flow Statement**

The Cash Flow Statement classifies cash flows according to operating, investing and financing activities.

Cash and cash equivalents in the cash flow statement correspond to the amount stated in the balance sheet. Cash and cash equivalents comprise cash on hand and call deposits, that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Amongst other things, cash flows from operating activities during the year ended 31 December 2017 include a cash outflow in relation to loan termination prepayment fee of £272.8m (2016: £nil, 2015: £nil) which is included within interest paid of £358.7m.

Cash flows from financing activities during the year ended 31 December 2017 include cash inflows in relation to an equity injection of £1,883.8m (2016: £nil, 2015: £nil) and cash outflows in relation to repayment of borrowings of £1,565.0m (2016: £nil, 2015: £nil).

The movements in the npower Retail Group's current and non-current borrowings are as follows:

**Financial liabilities**

	<u>1 January 2015</u>	<u>Financing cash flows</u>	<u>Accretion of interest</u>	<u>Interest payments</u>	<u>31 December 2015</u>
			£m		
Borrowings from related undertakings . . . . .	<u>(1,684.6)</u>	<u>(139.2)</u>	<u>(65.8)</u>	<u>58.8</u>	<u>(1,830.8)</u>
<b>Total</b> . . . . .	<u><b>(1,684.6)</b></u>	<u><b>(139.2)</b></u>	<u><b>(65.8)</b></u>	<u><b>58.8</b></u>	<u><b>(1,830.8)</b></u>

**Financial liabilities**

	<u>1 January 2016</u>	<u>Financing cash flows</u>	<u>Accretion of interest</u>	<u>Interest payments</u>	<u>31 December 2016</u>
			£m		
Borrowings from related undertakings* . . . . .	<u>(1,830.8)</u>	<u>(167.2)</u>	<u>(67.5)</u>	<u>67.3</u>	<u>(1,998.2)</u>
<b>Total</b> . . . . .	<u><b>(1,830.8)</b></u>	<u><b>(167.2)</b></u>	<u><b>(67.5)</b></u>	<u><b>67.3</b></u>	<u><b>(1,998.2)</b></u>

**Financial liabilities**

	<u>1 January 2017</u>	<u>Financing cash flows</u>	<u>Accretion of interest</u>	<u>Interest payments</u>	<u>31 December 2017</u>
			£m		
Borrowings from related undertakings . . . . .	<u>(1,998.2)</u>	<u>1,189.5</u>	<u>(337.7)</u>	<u>358.7</u>	<u>(787.7)</u>
<b>Total</b> . . . . .	<u><b>(1,998.2)</b></u>	<u><b>1,189.5</b></u>	<u><b>(337.7)</b></u>	<u><b>358.7</b></u>	<u><b>(787.7)</b></u>

Borrowings from related undertakings include fixed interest rate current and non-current loans, and current receivable balances in relation to the innogy SE cash pooling arrangement, at December 2016 this receivable was £70.0m (2017: £nil, 2015: £nil). For detail on the maturity profile of these balances, please see note 19.

**29. Companies included in the consolidation**

The subsidiaries of the npower Retail Group are listed in the following tables. The shown shareholding in percentage refers to the npower Retail Group:

**Fully consolidated companies**

	<u>Shareholding in %</u>		
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Innogy Solutions Ireland Limited, Dublin /Ireland . . . . .	100	100	100
Npower Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Business and Social Housing Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Commercial Gas Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Direct Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Financial Services Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Gas Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Group Limited (formerly Npower Group plc), Swindon /United Kingdom . . . . .	100	100	100
Npower Northern Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Yorkshire Limited, Swindon /United Kingdom . . . . .	100	100	100
Npower Yorkshire Supply Limited (Dormant), Swindon /United Kingdom . . . . .	100	100	100
Octopus Electrical Limited, Swindon /United Kingdom . . . . .	100	100	100
Plus Shipping Services Limited, Swindon /United Kingdom . . . . .	100	100	100
PS Energy UK Limited, Swindon /United Kingdom . . . . .	100	100	100
RUMM Limited, Ystrad Mynach /United Kingdom . . . . .	100	100	100

## Immaterial subsidiaries

	Shareholding in %		
	2015	2016	2017
Meterplus Limited (Dissolved in 2016), Swindon /United Kingdom . . . . .	100	—	—
npower Northern Supply Limited (Dormant), Swindon /United Kingdom . . . . .	100	100	100
Scarcroft Investments Ltd (Dormant), Swindon /United Kingdom . . . . .	100	100	100
YE Gas Limited (Dissolved in 2017), Swindon /United Kingdom . . . . .	100	100	—

## Immaterial associates and joint ventures

	Shareholding in %		
	2015	2016	2017
Alt Han Company Limited, London /United Kingdom . . . . .	—	21	21
DCUSA Ltd, London /United Kingdom . . . . .	10	10	10
Gemserv Limited, London /United Kingdom . . . . .	14	14	14
Homepower Retail Limited (50% Joint Venture, liquidated and deleted in 2017), Bristol /United Kingdom . . . . .	50	50	—
MRA Service Company Limited, London /United Kingdom . . . . .	4	4	3
NFPA Holdings Limited, Newcastle Upon Tyne /United Kingdom . . . . .	25	25	25
Smart Energy Code Company Limited, London /United Kingdom . . . . .	7	7	7
SPAA Ltd, London /United Kingdom . . . . .	10	10	10
St. Clements Services Limited, Northamptonshire /United Kingdom . . . . .	38	38	38
Telecom Plus plc, London /United Kingdom . . . . .	1	1	1

### 30. Controlling parties

The npower Retail Group's immediate parent is innogy International Participations N.V., a company incorporated in the Netherlands. The immediate parent company from 1 January 2015 to 29 April 2016 was RWE Generation UK Holdings plc, a company incorporated in the United Kingdom.

The name of the parent undertaking of the smallest group in whose consolidated financial statements the npower Retail Group's financial statements are consolidated is innogy SE, a company incorporated in Germany. These financial statements are available upon request from innogy SE, Opernplatz 1, 45128 Essen, Germany.

The ultimate parent company and controlling party is RWE AG, a company incorporated in Germany, which is the parent undertaking of the largest group to consolidate these financial statements. Copies of RWE AG consolidated financial statements can be obtained from RWE AG, Altenessener Straße 35, 45141 Essen, Germany.

### 31. Subsequent events

As detailed in note 18, Provisions for pensions and similar obligations, on the completion of the proposed Transaction, the pension assets and liabilities of the npower Retail Group members of the innogy Group of ESPS will transfer to a new and separate pension scheme. In advance of the merger the innogy Group of ESPS was sectionalised into two sections on 31 March 2018:

- The innogy section—which contains all deferred and pensioner members on 31 March 2018, plus the active members employed by innogy Renewables UK Limited.
- The Retail section—which contains all active members on 31 March 2018 employed by npower Limited, npower Yorkshire Limited and Innogy Business Services Limited.

On completion of the proposed Transaction, the Retail section will transfer into the newly formed merged group.

The split of the assets and liabilities to each section has not yet been finalised. As such, an estimate of the financial effect of the change in pension arrangements cannot currently be made, however as all deferred and pensioner members of the innogy Group of ESPS will remain within the innogy section, the liabilities of the Retail section will be limited only to active employee members.

## PART XII FURTHER DETAILS OF THE TRANSACTION

The Transaction is conditional, among other things, upon the passing of the Resolutions to be proposed as ordinary resolutions at the General Meeting.

### 1. Summary of the Transaction

SSE proposes to separate SSE Energy Services from the SSE Group by way of a demerger into a new company, MergeCo, in return for which SSE Shareholders will receive shares in MergeCo. On the following day, the innogy Group will transfer the entire issued share capital of npower to MergeCo in consideration of which the innogy Group will also receive shares in MergeCo.

The Demerger will be effected by SSE declaring a special dividend (in kind in the form of MergeCo Shares) in respect of the SSE Shares of an amount equal to the book value of SSE's shareholding in Retail HoldCo, which will be satisfied by the transfer to MergeCo of the entire issued share capital of Retail HoldCo, the holding company of SSE Energy Services. In consideration for that transfer, MergeCo will allot and issue MergeCo Shares, credited as fully paid up, to the SSE Shareholders who are registered on the SSE share register at the Demerger Record Time on the basis of:

**one MergeCo Share  
for each SSE Share**

save that the number of MergeCo Shares to be allotted and issued to each of the two initial subscribers in MergeCo (each of whom is, and will at the Demerger Record Time continue to be, an SSE Shareholder) will be reduced by the number of MergeCo Shares already held by them so that, upon the Demerger becoming effective, all SSE Shareholders (including the two initial subscribers in MergeCo) will hold one MergeCo Share for each SSE Share held at the Demerger Record Time. As an example, if you hold 10 SSE Shares at the Demerger Record Time, you will hold 10 SSE Shares and 10 MergeCo Shares following the Demerger.

SSE Shareholders are being asked to approve the Demerger Dividend and the Whitewash Resolution in accordance with the SSE articles of association. The Resolutions are set out in the Notice of General Meeting.

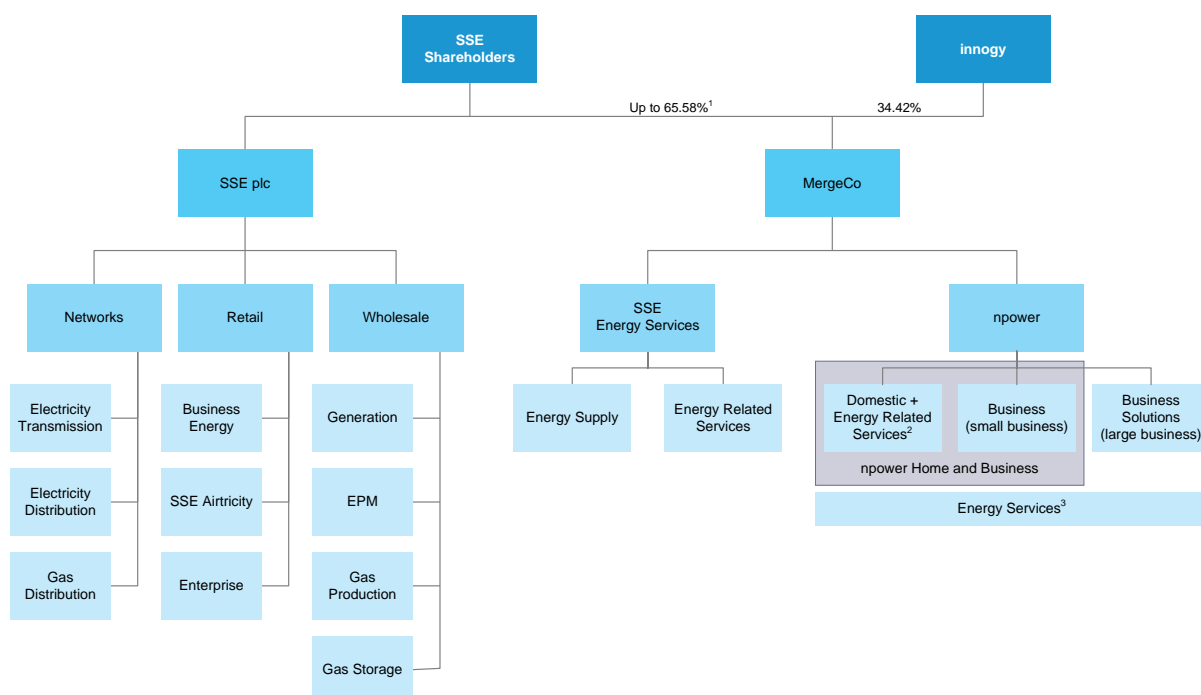
Upon completion of the Combination, MergeCo's ordinary shares are expected to be admitted to the premium listing segment of the Official List and to trading on the main market for listed securities of the London Stock Exchange.

Subject to the restrictions described in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular, following Admission SSE Shareholders will own shares in two independent, separately listed companies: SSE and MergeCo (to be subsequently renamed).

In aggregate, SSE Shareholders will own 100 per cent. of the SSE Shares in issue and up to 65.58 per cent. of the MergeCo Shares in issue as at the date of Completion. The exact percentage of MergeCo Shares that will be owned by SSE Shareholders at this time is dependent on the number of SSE Shareholders who are located outside the United States or who make the Investor Declarations as discussed in more detail in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular. The innogy Group will hold 34.42 per cent. of the MergeCo Shares in issue as at the date of Completion and has contractually agreed to retain them for a period of at least six months from Admission, subject to certain limited exceptions.



The following chart shows the structure of the SSE and MergeCo Businesses immediately following the Transaction.



(1) The exact percentage of MergeCo Shares that will be owned by SSE Shareholders at this time is dependent on the number of SSE Shareholders who are located outside the United States or who make the Investor Declarations as discussed in more detail in paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

(2) npower's Energy Related Services comprise Powershop, electric vehicles and boiler/central heating care and are reported within the domestic business.

(3) Energy Services provides metering services for the three npower divisions and is reported within each division.

## 2. Conditions

Completion of the Transaction is conditional upon various conditions being satisfied or waived on or prior to 30 June 2019 (or such other date as the parties may agree). Conditions that have not yet been satisfied or waived include:

- (i) a decision by the CMA to clear the Transaction on terms reasonably satisfactory to the parties to the Contribution Agreement;
- (ii) the approval by SSE Shareholders of the Demerger Resolution by 31 July 2018 (which is the subject matter of this Circular);
- (iii) no material adverse change having occurred in relation to SSE Energy Services or the npower Group before the date on which the condition relating to CMA approval is satisfied;
- (iv) the Takeover Panel agreeing that innogy is not obliged to make a mandatory offer for MergeCo as a result of the Transaction (subject to SSE Shareholders passing the Whitewash Resolution);
- (v) certain key licences for each of SSE Energy Services and npower not having been revoked or terminated and no notice of revocation having been received by Ofgem, and Ofgem not proposing any material modifications or replacement of such key licences other than of terms reasonably satisfactory to SSE and innogy;
- (vi) the FCA having provided certain change of control consents in respect of regulated businesses within SSE Energy Services and npower (namely, SSE Home Services Ltd and Npower Northern Limited);
- (vii) the FCA having acknowledged to MergeCo or its agent (and such acknowledgement not having been withdrawn) that the application for the admission of the MergeCo Shares to the Official List with a premium listing has been approved and (after satisfaction of any conditions to which such approval is expressed to be subject) will become effective as soon as a dealing notice has been issued by the FCA and any such listing conditions having been satisfied; and

(viii) the London Stock Exchange having acknowledged to MergeCo or its agent (and such acknowledgment not having been withdrawn) that the MergeCo Shares will be admitted to trading.

The condition that has already been satisfied is:

- (i) innogy obtaining supervisory board approval by 31 December 2017.

### **3. Uncertificated SSE Shareholders**

If you hold your SSE Shares in uncertificated form at the Demerger Record Time, the MergeCo Shares allotted and issued to you on completion of the Demerger will be held in uncertificated form and dispatched to your CREST account with effect from Admission.

### **4. Certificated SSE Shareholders**

Temporary documents of title will not be issued for MergeCo Shares held in certificated form, and transfers of such shares will be certified against the register pending receipt of definitive certificates. It is intended to post certificates to all holders of MergeCo Shares issued in certificated form by no later than 14 days from their allotment.

The MergeCo share certificates will be sent by pre-paid first class post, at the risk of such holders, to the registered address of the relevant holders (or, in the case of joint holders, to the address of that one of the joint holders whose name stands first in the register in respect of such joint holding).

### **5. Important Information for SSE Shareholders**

**Each SSE Shareholder must represent, warrant and confirm to and for the benefit of SSE, that such SSE Shareholder, and any person on whose behalf such SSE Shares are held, is a person who is located outside the United States.**

If such SSE Shareholder (or any person on whose behalf such SSE Shares are held) is located inside the United States (each a ***US SSE Shareholder***), in order to establish such person's eligibility for the MergeCo Shares, such SSE Shareholder must represent, warrant and confirm (the ***Investor Declarations***) to and for the benefit of SSE that:

- the US SSE Shareholder understands and acknowledges that the MergeCo Shares are being offered in a transaction not involving any public offering in the United States within the meaning of the Securities Act, and that the MergeCo Shares have not been and will not be registered under the Securities Act or any state securities laws;
- the US SSE Shareholder is (a) a "qualified institutional buyer" within the meaning of Rule 144A or an "accredited investor" within the meaning of Rule 501 of Regulation D under the Securities Act and a person who may be lawfully offered and sold the MergeCo Shares; and (b) aware that any offer or sale of the MergeCo Shares to it pursuant to the Transaction will be made in a transaction exempt from, or otherwise not subject to, the registration requirements of the Securities Act;
- the US SSE Shareholder acknowledges and agrees that the MergeCo Shares may not be reoffered, sold, pledged or otherwise transferred, and that they will not directly or indirectly reoffer, sell, pledge or otherwise transfer the MergeCo Shares, except (a) in an "offshore transaction" in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act; (b) to a person reasonably believed to be a QIB pursuant to Rule 144A under the Securities Act purchasing for its own account or for the account of another QIB; or (c) pursuant to any other available exemption from the registration requirements of the Securities Act, subject in each of the foregoing cases to any requirement of law that the disposition of its property or the property of such investor account or accounts be at all times within its or their control and in compliance with any applicable state securities laws, and any applicable local laws and regulations;
- the US SSE Shareholder understands that the MergeCo Shares are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act;
- the US SSE Shareholder understands and acknowledges that upon the initial issuance thereof, and until such time as the same is no longer required under the Securities Act or applicable state securities laws, the certificates representing the MergeCo Shares (to the extent such securities are in certificated form), and all

certificates issued in exchange therefor or in substitution thereof, shall bear a legend substantially in the form below:

“THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR ANY OTHER APPLICABLE STATE SECURITIES LAW. BY ITS ACCEPTANCE OF THESE SECURITIES THE PURCHASER REPRESENTS THAT IT IS A QUALIFIED INSTITUTIONAL BUYER (“QIB”) AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT AND THAT IT IS EITHER PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF OTHER PURCHASERS WHO ARE QIBs AND AGREES THAT THE SECURITIES ARE NOT BEING ACQUIRED WITH A VIEW TO DISTRIBUTION AND ANY RESALE OF SUCH SECURITIES WILL BE MADE ONLY (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QIB PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ANOTHER QIB, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (3) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, SUBJECT IN EACH OF THE FOREGOING CASES TO ANY REQUIREMENT OF LAW THAT THE DISPOSITION OF ITS PROPERTY OR THE PROPERTY OF SUCH INVESTOR ACCOUNT OR ACCOUNTS BE AT ALL TIMES WITHIN ITS OR THEIR CONTROL AND TO COMPLIANCE WITH ANY APPLICABLE STATE SECURITIES LAWS, AND ANY APPLICABLE LOCAL LAWS AND REGULATIONS”;

- the US SSE Shareholder understands and acknowledges that no representation has been, or will be, made by SSE as to the availability of Rule 144 under the Securities Act or any state securities laws for the reoffer, pledge or transfer of the MergeCo Shares; and
- the US SSE Shareholder understands and acknowledges that SSE may request the making of notations on MergeCo’s records of the MergeCo Shares or give instructions to MergeCo’s registrar and any transfer agent in order to implement the restrictions on transfer set forth and described herein.

**(a) If you hold your SSE Shares in certificated form:**

If you hold your SSE Shares in certificated form, you must certify the eligibility of your entire holding in order to retain new MergeCo Shares. Certificated Shareholders wishing to certify their holding and provide the abovementioned representations, warranties and confirmations should visit [www.sse-shares.com](http://www.sse-shares.com) or call the Shareholder Helpline as outlined on page 4 of this Circular from 27 June 2018 and follow the instructions provided by no later than 3:00 p.m. (UK time) on the Demerger Record Date. If you fail to input this instruction by 3:00 p.m. (UK time) on the Demerger Record Date, you may be, at the absolute discretion of SSE, deemed to be an Ineligible Shareholder and SSE may transfer (pursuant to provisions to be included in MergeCo’s articles of association) the legal title of your MergeCo Shares to the Trustee, to procure purchasers for such MergeCo Shares with the net proceeds remitted to you in accordance with the following expected procedures:

The Placing Agent will use reasonable endeavours to procure, by not later than 4:30 p.m. on the fifth day following the Demerger Record Date, purchasers for all MergeCo Shares which relate to Ineligible Shares. Such MergeCo Shares will be sold and the proceeds (net of the expenses of procuring such purchasers, including any applicable brokerage commissions and amounts in respect of any value added tax, and any stamp duty or SDRT) will be paid by a cheque drawn on a branch of a UK bank, without interest, to Ineligible Shareholders pro rata to the number of MergeCo Shares held by each such Ineligible Shareholder.

Net proceeds due to any Ineligible Shareholder whose registered address is in the United States of America will be converted from pounds sterling and paid in US dollars. All other Ineligible Shareholders will be paid in pounds sterling. If the net proceeds due to any Ineligible Shareholders is £2.99 or less, such sum will be donated to charity.

Cheques for the amounts due will be sent by post, at the risk of the person(s) entitled, to the registered addresses (or the registered address of the first named holder in the case of joint holders).

None of SSE, MergeCo, the Placing Agent or any other person shall be responsible or have any liability whatsoever for any loss, expense or damage (whether actual or alleged) arising from the price achieved, terms or timing of any such transaction with respect to the Ineligible Shares.

**(b) If you hold your SSE Shares in uncertificated form:**

If you hold your SSE Shares in uncertificated form, in order to confirm the number of Eligible Shares held by you, you must make the Investor Declarations through the electronic CREST proxy appointment service by 3:00 p.m. (UK time) on the Demerger Record Date. Such uncertificated SSE Shareholders will be able to input this instruction following the CMA's approval of the Transaction, and CREST will notify all such uncertificated SSE Shareholders of this date by means of a CREST bulletin issued by Euroclear. Failure to input this instruction by 3:00 p.m. (UK time) on the Demerger Record Date may result in legal title to your MergeCo Shares being transferred (pursuant to provisions to be included in MergeCo's articles of association) to the Trustee, and being re-materialised and held in certificated form.

The input of this instruction will constitute a confirmation that the number of SSE Shares specified in such instruction are Eligible Shares in respect of which the relevant CREST Shareholder is making the representations, warranties and confirmations contained in this paragraph 5, including the Investor Declarations, if applicable.

CREST members who wish to provide their Investor Declarations through CREST may do so by using the electronic CREST proxy appointment service functionality, the procedures of which are described in the CREST Manual. CREST Personal Members or other CREST sponsored members should refer to their CREST sponsor, who will be able to take the appropriate action on their behalf.

In order for an Investor Declaration instructed using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with Euroclear's specifications, and must contain the information required for such instruction, as described in the CREST Manual (available via [www.euroclear.com](http://www.euroclear.com)).

The message, regardless of whether it constitutes a new declaration or is an amendment to an instruction given previously must, in order to be valid, be transmitted so as to be received by Link Asset Services (ID RA10) by 3:00 p.m. (UK time) on the Demerger Record Date. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Application Host) from which Link Asset Services is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

CREST members and, where applicable, their CREST sponsors should note that Euroclear does not make available special procedures in CREST for any particular message. Therefore, normal system timings and limitations will apply in relation to the input of the CREST Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member, to procure that their CREST sponsor take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

*Submitting a CREST instruction*

In order to submit a valid CREST instruction, CREST members must ensure their instruction contains the following fields and is received by Link Asset Services by the closing time and date specified above:

- Participant ID. This identifies the participant in CREST who is making the investor declaration i.e. the registered holder.
- Account ID. This identifies the member account where the appropriate holding resides.
- ISIN. This is GB0007908733.
- Announcement Reference Number. This identifies the event to which the CREST instruction relates to.
- Issuers' Agent ID. This is RA10.
- Instruction Reference. This reference is given to the instruction by the inputter.
- Contact Details. This free format field allows the inputter to include contact details to be used in the event of a query.
- Proxy Appointment. This is "Other" (OTH).
- Responses to the Investor Declarations.
- The number of shares to which the investor declaration is being made must be inserted against each resolution as applicable.

SSE may treat as invalid any CREST residency declaration Instruction that does not contain the information described above or is received after 3:00 p.m. (UK time) on the Demerger Record Date.

**If you are an uncertificated SSE Shareholder and you do not make the Investor Declarations in respect of all or a portion of your SSE Shares in accordance with the above procedures, the legal title to all or a portion of the MergeCo Shares which you are issued with respect to such number of SSE Shares may, at the absolute discretion of SSE, as at Admission, be transferred to the Trustee and such shares will be re-materialised and held in certificated form.**

To the extent that you do not subsequently establish to the satisfaction of SSE that you, or the person on whose behalf you hold SSE Shares, are a person who either (a) is located outside the United States or (b) has made the Investor Declarations, MergeCo Shares issued to you may be, at the absolute discretion of SSE placed in the market with the net proceeds remitted to you in accordance with the following expected procedures:

The Placing Agent will use reasonable endeavours to procure, by not later than 4:30 p.m. on the fifth day following the Demerger Record Date, purchasers for all MergeCo Shares which relate to Ineligible Shares. Such MergeCo Shares will be sold and the proceeds (net of the expenses of procuring such purchasers, including any applicable brokerage commissions and amounts in respect of any value added tax, and any stamp duty or SDRT) will be paid in pounds sterling, without interest, to Ineligible Shareholders pro rata to the number of MergeCo Shares held by each such Ineligible Shareholder. The amount due will, unless SSE in its absolute discretion otherwise determines, be satisfied by SSE procuring the creation of an assured payment obligation in favour of the relevant CREST member's or CREST sponsored member's RTGS bank in respect of the cash amount concerned in accordance with the RTGS payment mechanism.

None of SSE, MergeCo, the Placing Agent or any other person shall be responsible or have any liability whatsoever for any loss, expense or damage (whether actual or alleged) arising from the price achieved, terms or timing of any such transaction with respect to the Ineligible Shares.

**(c) Deposits of SSE Shares into, and withdrawals of SSE Shares from, CREST**

Normal CREST procedures (including timings) apply in relation to any SSE Shares that are, or are to be, converted from uncertificated to certificated form, or from certificated to uncertificated form, during the course of the Transaction (whether any such conversion arises as a result of a transfer of SSE Shares or otherwise). SSE Shareholders who are proposing to convert any such shares are recommended to ensure that the conversion procedures are implemented in sufficient time to enable the person holding or acquiring the SSE Shares as a result of the conversion to take all necessary steps in connection with the Transaction as soon as possible and in any event prior to 3:00 p.m. (UK time) on the Demerger Record Date.

**(d) General**

None of SSE or MergeCo or any other person shall be responsible or have any liability whatsoever for any loss, expense or damage (whether actual or alleged) arising from the price achieved, terms or timing of any sale of MergeCo Shares by SSE under paragraphs 5(a) and 5(b) above.

**6. Important Information for ADR Holders**

Certain SSE Shares are traded in the United States in the form of American Depositary Shares evidenced by American Depositary Receipts. Each SSE ADS represents one SSE Share.

SSE ADR holders will be unable to retain MergeCo Shares pursuant to the Demerger. SSE will procure purchasers of the MergeCo Shares issued to the ADR Depositary. The ADR Depositary will receive the proceeds of such sales (net of the expenses of procuring such purchasers, including any applicable brokerage commissions and amounts in respect of any value added tax, and any stamp duty or SDRT) and remit such net proceeds (after deducting its own fees and expenses) to the SSE ADR holders, in US dollars, in accordance with the terms of the Deposit Agreement. The amount of money received by each SSE ADR holder will be calculated on an averaged basis so that all SSE ADR holders will receive the same price for each MergeCo Share, subject to rounding down to the nearest whole US cent.

SSE ADR holders will not be entitled to attend the General Meeting. In order to vote their underlying SSE Shares, SSE ADR holders will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement and ensure that they are registered as SSE Shareholders at, and have voted by proxy (if applicable) by, 2:00 p.m. on 17 July 2018 or, in the event that the General Meeting is adjourned, registered in the Register of Members of the Company 48 hours before the time of the adjourned meeting(s). Instructions for voting by proxy are found in Part XV (*Notice of General Meeting*) of this Circular.

SSE ADR holders wishing to do this should withdraw their ADRs in time to permit processing to be completed by the ADR Depositary and should note that certain fees, expenses and taxes may apply. SSE ADR holders who wish to take such action and who hold their SSE ADRs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which the SSE ADRs are held. SSE ADR holders are encouraged to consult their own legal and tax advisers.

Following the Demerger, SSE ADR holders will continue to hold the same number of SSE ADRs as they held prior to the Demerger, and each SSE ADS will continue to represent one SSE Share.

SSE ADR holders who wish to retain MergeCo Shares pursuant to the Demerger will need to withdraw their ADRs from the ADR programme in accordance with the terms of the Deposit Agreement and ensure that they are registered as SSE Shareholders by the Demerger Record Time. SSE ADR holders wishing to do this should withdraw their ADRs in time to permit processing to be completed by the ADR Depositary and should note that certain fees, expenses and taxes may apply. Such SSE ADR holders are encouraged to read paragraph 5 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*).

SSE ADR holders who hold their SSE ADRs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which the SSE ADRs are held. SSE ADR holders are encouraged to consult their own legal and tax advisers.

## **7. City Code Waiver**

### *The City Code*

Under Rule 9 of the City Code, when: (a) any person acquires, whether by a series of transactions over a period of time or not, an interest in shares which (taken together with shares in which persons acting in concert with him are interested) carry 30 per cent. or more of the voting rights of a company; or (b) any person, together with persons acting in concert with him, is interested in shares which in aggregate carry not less than 30 per cent. of the voting rights of a company but does not hold shares carrying more than 50 per cent. of such voting rights and such person, or any person acting in concert with him, acquires an interest in any other shares which increases the percentage of shares carrying voting rights in which he is interested, such person is normally required to make a general offer in cash for all the remaining equity share capital of the company at the highest price paid by him, or any persons acting in concert with him, for shares in the company within the 12 months prior to announcement of the offer.

Following Completion, innogy will hold 34.42 per cent of the MergeCo Shares in issue.

In this respect, SSE and innogy have applied to the Takeover Panel for a waiver of the obligation which would otherwise arise upon innogy pursuant to Rule 9 of the City Code to make an offer for the remaining MergeCo Shares (the ***Waiver***).

### *Waiver*

The Takeover Panel has agreed, subject to the approval of the SSE Shareholders on a poll, to waive the requirement for innogy and any person acting in concert with innogy to make a general offer to all shareholders where such an obligation would arise as a result of the Transaction.

The Waiver granted by the Takeover Panel relates only to the acquisition of 30 per cent. or more of the MergeCo Shares by innogy or any person acting in concert with innogy as a result of the Transaction and is conditional on the passing of the Whitewash Resolution by the SSE Shareholders on a poll.

### *innogy does not intend to make an offer*

If the Whitewash Resolution is passed, innogy does not intend to make an offer for MergeCo.

### *innogy's intentions*

innogy confirms that it has no intention, following Admission, to seek to change MergeCo's plans with respect to:

- the future of MergeCo's business, including any research and development functions;
- the location of MergeCo's (and MergeCo's subsidiaries') places of business, including the location and functions of headquarters;

- the continued employment of MergeCo's (and MergeCo's subsidiaries') employees and management, including any material change in conditions of employment or in the balance of the skills and functions of the employees and management;
- employer contributions into MergeCo's pension schemes (including with regard to current arrangements for the funding of any scheme deficit), the accrual of benefits for existing members and the admission of new members;
- the maintenance of any existing trading facilities for the relevant securities of MergeCo; or
- any redeployment of the fixed assets of MergeCo (or any of its subsidiaries), as a result of such proposals.

#### *Background information on innogy*

The innogy Group is a European distributor and supplier of electricity and gas and a producer of electricity from renewable energy sources with a diversified asset base. innogy was formed from the RWE AG group, pursuant to a carve-out and initial public offering in 2016.

innogy International Participations NV is a wholly-owned subsidiary of innogy and is the sole shareholder of npower.

The members of the innogy Management Board are:

<u>Name</u>	<u>Position</u>
Uwe Tigges . . . . .	Chief Executive Office
Dr. Bernhard Günther . . . . .	Chief Financial Officer
Martin Herrmann . . . . .	Chief Operating Officer Retail
Dr. Hans Bünting . . . . .	Chief Operating Officer Renewables
Arno Hahn . . . . .	Chief Human Resources Officer and Labour Director
Hildegard Müller . . . . .	Chief Operating Officer Grid & Infrastructure

innogy's credit ratings, as of 31 May 2018, are as follows:

	<u>Fitch</u>	<u>Moody's</u>	<u>S&amp;P</u>
Long-Term Issuer Default Rating . . . . .	BBB+	Baa2	BBB
Outlook . . . . .	Watch Negative	Stable	Stable
Senior Unsecured Rating . . . . .	A-	Baa2	BBB
Short-Term Issuer Default Rating . . . . .	F2	P-2	A-2

The following documents relating to innogy are incorporated by reference into this document and are available on innogy's website:

- 2017 Financial Statements of innogy SE  
(<https://www.innogy.com/web/cms/mediablob/en/3875786/data/0/5/financial-statements-2017.pdf>);
- 2016 Financial Statements of innogy SE  
(<https://www.innogy.com/web/cms/extshort/en/3705842/financial-statements-2016>);
- The interim financial information for the period from January to March 2018  
(<https://www.innogy.com/web/cms/mediablob/en/3905134/data/0/8/Q1-2018-statement.pdf>);
- The information contained on the 'innogy at a glance' page of innogy's website, at <https://iam.innogy.com/en/about-innogy/innogy-at-a-glance>; and
- innogy's articles of incorporation  
(<https://iam.innogy.com/-/media/innogy/documents/ueber-innogy/Investor-Relations/satzung-und-geschaeftsordnung/satzung-15-Mai-201-englisch.pdf>).

#### *E.ON/RWE Transaction*

On 12 March 2018, RWE announced that it had concluded an agreement with E.ON on the sale of RWE's 76.8 per cent. stake in innogy. If the E.ON/RWE Transaction completes, E.ON would therefore become the majority owner and ultimate controller of innogy and, indirectly, innogy's 34.42 per cent. stake in MergeCo should the Transaction complete. One of the conditions of the Contribution Agreement was innogy's supervisory board approval which was obtained in December 2017 and the Contribution Agreement does not include provision relating to change of control. SSE therefore does not believe that its agreement with innogy

should be affected by the potential E.ON/RWE Transaction. See “*Merger clearance consents may take longer than expected to obtain and/or may not be granted or may be granted subject to conditions or remedies*” in Part III (*Risk Factors*) of this Circular.

The following information about E.ON is sourced from publicly available documentation and E.ON’s website at [www.eon.com](http://www.eon.com). The Directors take responsibility for the accurate reproduction of the information from such sources but have not independently verified the accuracy of the statements.

E.ON is an international, privately owned energy supplier based in Essen, Germany, with around 42,700 employees. It primarily supplies electricity and gas, but its activities may encompass energy generation and/or production, transport, acquisition, distribution and trading. In 2017 E.ON reported revenue of €38.0 billion and adjusted EBIT of €3.1 billion.

#### *No mandatory offer by E.ON*

The Panel Executive has confirmed that if the E.ON/RWE Transaction completes, it will not require E.ON to make an offer for MergeCo pursuant to note 8 of Rule 9.1 of the City Code. This is on the basis that: (a) innogy’s shareholding in MergeCo is not significant in relation to innogy; and (b) securing control of MergeCo is not considered to be a significant purpose of E.ON acquiring control of innogy. SSE and E.ON agree with the Panel’s confirmation.

#### *Arrangements in connection with the Transaction*

Neither innogy nor any person acting in concert with innogy has entered into any agreement, arrangement or understanding with any of the directors of MergeCo which has any connection with or dependence upon the proposals set out in this Circular. In addition, the Directors are not aware of any agreement, arrangement or understanding having any connection with or dependence upon the proposals set out in this document between innogy or any person acting in concert with innogy and any person interested or recently interested in MergeCo’s shares, or any other recent director of MergeCo.

#### *Ultimate owner of securities acquired*

innogy will not, in connection with the Transaction, transfer its MergeCo Shares to any other persons and pursuant to the Relationship Agreement, innogy will be subject to certain transfer restrictions in respect of its shares in MergeCo for a lock-up period of six months following Completion.

#### *Persons acting in concert with innogy*

In addition to the directors of innogy (together with their close relatives and related trusts) and members of the innogy Group, the persons who, for purposes of the City Code, are acting in concert with innogy in respect of the Transaction and who are required to be disclosed are:

<u>Name</u>	<u>Registered Office</u>	<u>Relationship with innogy</u>
E.ON SE . . . . .	Brüsseler Platz 1 45131 Essen Federal Republic of Germany	See “E.ON/RWE Transaction” above
Goldman Sachs International .	Peterborough Court 133 Fleet Street London EC4A 2BB	Financial adviser
RWE AG . . . . .	Altenessener Straße 35 45141 Essen Federal Republic of Germany	Holder of 76.8 per cent. stake in innogy



## PART XIII ADDITIONAL INFORMATION

### 1. Responsibility

- 1.1 The Directors, whose names are set out in paragraph 4 of this Part XIII (*Additional Information*), accept responsibility for the information contained in this Circular (including any expression of opinion), except for any information for which the members of the innogy Management Board take responsibility in accordance with paragraph 1.2 below. To the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document for which they are responsible is in accordance with the facts and does not omit anything likely to affect the import of such information.
- 1.2 The members of the innogy Management Board, whose names are set out in paragraph 7 of Part XII (*Further details of the Transaction*), accept responsibility for the purposes of Rule 19.2 of the City Code for the information contained in this document (including any expressions of opinion) relating to the innogy Group (excluding the npower Group) and the directors of innogy, their close relatives, related trusts and other connected persons. To the best of the knowledge and belief of the members of the innogy Management Board (who have taken all reasonable care to ensure that such is the case), the information contained in this document for which they are responsible is in accordance with the facts and does not omit anything likely to affect the import of such information.

### 2. SSE information

SSE was incorporated on 1 April 1989 under the Companies Act 1985 as a public limited company with the name of North of Scotland Electricity plc. On 1 August 1989, North of Scotland Electricity plc changed its name to Scottish Hydro-Electric plc. On 14 December 1998, Scottish Hydro-Electric plc changed its name to Scottish and Southern Energy plc. On 30 September 2011, Scottish and Southern Energy plc changed its name to SSE plc.

SSE's principal and registered office is at Inveralmond House, 200 Dunkeld Road, Perth, Perthshire, PH1 3AQ and the telephone number of its registered office is +44 (0) 1738 456000. SSE plc is admitted to the premium listing segment of the Official List and trades on the main market for listed securities of the London Stock Exchange.

The principal laws and legislation under which SSE operates are the Companies Act 2006 and the regulations made thereunder.

### 3. MergeCo information

MergeCo was incorporated on 3 November 2017 under the Companies Act 2006 as a private limited company with the name of ShiftMCo123 Ltd.

MergeCo's principal and registered office is at No. 1 Forbury Place, 43 Forbury Road, Reading, RG1 3JH.

The principal laws and legislation under which MergeCo operates are the Companies Act 2006 and the regulations made thereunder.

### 4. SSE Directors

The information set forth under the heading "Board of Directors" on pages 90–92 of the SSE 2018 Annual Report is incorporated by reference into this Circular.

### 5. Interests and dealings in relevant securities

#### 5.1 Definitions used in this section

For the purposes of this paragraph 5:

"**acting in concert**" with SSE or innogy, as the case may be, means any person acting or deemed to be acting in concert with SSE or innogy, as the case may be, for the purposes of the City Code;

"**dealing**" has the meaning given to it in the City Code and "**dealt**" has the corresponding meaning;

"**derivative**" includes any financial product the value of which, in whole or in part, is determined directly or indirectly by reference to the price of an underlying security;

“**Disclosure Date**” means the close of business on 21 June 2018, being the latest practicable date prior to the publication of this Circular;

“**Disclosure Period**” means the period commencing on 27 June 2017 (being the date 12 months prior to the date of publication of this Circular) and ending on the Disclosure Date;

“**financial collateral arrangements**” are arrangements of the kind referred to in Note 4 on Rule 4.6 of the City Code;

“**interest**” in shares, securities and relevant securities has the meaning given to it in the City Code;

“**Note 11 arrangement**” includes any indemnity or option arrangement, and any agreement or understanding, formal or informal, of whatever nature, relating to relevant securities which may be an inducement to deal or refrain from dealing;

“**relevant innogy securities**” means:

- (a) ordinary shares of innogy and any other securities of innogy which carry voting rights;
- (b) equity share capital of innogy; and
- (c) securities of innogy carrying conversion or subscription rights into any of the foregoing;

“**relevant securities**” means relevant innogy securities and relevant SSE securities;

“**relevant SSE securities**” means:

- (a) SSE Shares and any other securities of SSE which carry voting rights;
- (b) equity share capital of SSE; and
- (c) securities of SSE carrying conversion or subscription rights into any of the foregoing; and

“**short position**” means any short position (whether conditional or absolute and whether in the money or otherwise), including any short position under a derivative, any agreement to sell or any delivery obligation or right to require another person to purchase or take delivery.

## 5.2 SSE and SSE concert parties' interests

### (a) Interests in relevant innogy securities

As at the Disclosure Date, none of: (i) SSE; (ii) any Director or (iii) Katie Bickerstaffe, had any interest in, right to subscribe for or short position in any relevant innogy securities.

### (b) Interests in relevant SSE securities

Save as disclosed below, as at the Disclosure Date, none of: (i) SSE; (ii) any Director; or (iii) any other person deemed to be acting in concert with SSE, had any interest in, right to subscribe for or short position in any relevant SSE securities.

#### (i) SSE Directors

As at the Disclosure Date, the Directors (excluding their close relatives and related trusts) held the following SSE Shares:

<u>Director</u>	<u>Number of SSE Shares</u>	<u>Percentage of SSE issued share capital</u>
Richard Gillingwater CBE . . . . .	2,043	— <sup>(1)</sup>
Alistair Phillips-Davies . . . . .	65,236	0.006
Gregor Alexander . . . . .	48,076	0.005
Martin Pibworth . . . . .	20,148	0.002
Crawford Gillies . . . . .	5,000	— <sup>(1)</sup>
Jeremy Beeton CB . . . . .	4,534	— <sup>(1)</sup>
Dame Sue Bruce DBE . . . . .	2,484	— <sup>(1)</sup>
Peter Lynas . . . . .	2,000	— <sup>(1)</sup>
Helen Mahy CBE . . . . .	2,027	— <sup>(1)</sup>
Tony Cocker . . . . .	—	—
<b>Total:</b> . . . . .	<b>151,548</b>	<b>0.015</b>

(1) Less than 0.001 per cent.

As at the Disclosure Date, the Directors held the following outstanding options and/or awards over SSE Shares:

	Share plan	Date of award	Normal exercise period (or vesting date)	Option exercise price	No. of shares under award at 21 June 2018
<b>Alistair Phillips-Davies</b>	DBP 2006	25/06/2015	25/06/2018	—	7,931
	DBP 2016	27/07/2016	27/07/2019	—	6,860
	DBP 2016	26/06/2017	26/06/2020	—	20,068
	PSP	25/06/2015	25/06/2018	—	76,138
	PSP	27/07/2016	27/07/2019	—	104,081
	PSP	26/06/2017	26/06/2020	—	115,479
	Sharesave	02/07/2014	01/10/2019–31/03/20	1,247p	1,202
<b>Gregor Alexander . . .</b>	DBP 2006	25/06/2015	25/06/2018	—	6,130
	DBP 2016	27/07/2016	27/07/2019	—	5,302
	DBP 2016	26/06/2017	26/06/2020	—	13,442
	PSP	25/06/2015	25/06/2018	—	58,848
	PSP	27/07/2016	27/07/2019	—	70,390
	PSP	26/06/2017	26/06/2020	—	78,099
	Sharesave	02/07/2014	01/10/2019–31/03/20	1,247p	2,213
	Sharesave	03/07/2015	01/10/20–31/03/21	1,288p	186
<b>Martin Pibworth . . . .</b>	DBP 2006	25/06/2015	25/06/2018	—	4,328
	DBP 2006	27/07/2016	27/07/2019	—	4,383
	DBP 2016	26/06/2017	26/06/2020	—	5,715
	PSP	25/06/2015	25/06/2018	—	26,940
	LSP	21/06/2016	21/06/2019	—	18,534
	LSP	26/06/2017	26/06/2020	—	23,411
	Retention Award	12/01/2017	12/01/2020	—	25,000
	Sharesave	02/07/2014	01/10/2019–31/03/20	1,247p	1,202
	Sharesave	06/07/2017	01/10/2022–31/03/23	1,194p	1,256

(ii) *Other persons deemed to be acting in concert with SSE*

As at the Disclosure Date, the interests in SSE Shares of other persons deemed to be acting in concert with SSE were as follows:

Name and reason for deemed SSE concert party status	Number of SSE Shares	Percentage of SSE issued share capital
The Scottish & Southern Energy Employee Trust (SSE employee benefit trust) . .	1,183,759	0.116
Scottish and Southern Employee Share Ownership Plan trust . . . . .	3,151	— <sup>(4)</sup>
Mr D M and Mrs J M Phillips-Davies (parents of Alistair Phillips-Davies) . . . .	6,000 <sup>(1)</sup>	0.001
Mr D and Mrs M Mahy (parents of Helen Mahy CBE) . . . . .	1,250 <sup>(2)</sup>	— <sup>(4)</sup>
Shirley Alexander (mother of Gregor Alexander) . . . . .	100	— <sup>(4)</sup>
Deborah Phillips-Davies (wife of Alistair Phillips-Davies) . . . . .	112,569	0.001
Jillian Alexander (wife of Gregor Alexander) . . . . .	115,895	0.001
Campbell Alexander (son of Gregor Alexander) . . . . .	337	— <sup>(4)</sup>
John Alexander Stewart Bruce (husband of Dame Sue Bruce DBE) . . . . .	220	— <sup>(4)</sup>
Mrs E J Gillies (mother of Crawford Gillies) . . . . .	2,151	— <sup>(4)</sup>
Gillies Family Trust (family trust of Crawford Gillies, in respect of which Crawford Gillies is trustee) . . . . .	1,950	— <sup>(4)</sup>
Katie Bickerstaffe (former director of SSE) . . . . .	6,433	0.001
Morgan Stanley B.V. (a Morgan Stanley group company) . . . . .	— <sup>(3)</sup>	—
<b>Total:</b> . . . . .	<b>1,431,624</b>	<b>0.140</b>

(1) Figure represents aggregate shareholding of Mr D M and Mrs J M Phillips-Davies.

(2) SSE Shares held jointly. Helen Mahy CBE may be able to exercise voting rights in respect of such SSE Shares.

(3) Morgan Stanley B.V. holds a note that has been issued in respect of a basket of securities that includes SSE Shares. The note is a cash settled derivative and represents a short position over 15,525 SSE Shares.

(4) Less than 0.001 per cent.

(c) *General*

As at the Disclosure Date, neither SSE nor any person acting in concert with SSE had borrowed or lent any relevant SSE securities (including any financial collateral arrangements), save for borrowed shares which have been either on-lent or sold.

As at the Disclosure Date, neither SSE nor any person acting in concert with SSE had any Note 11 arrangement with any other person and as such, no such person had any interest in, right to subscribe for or short position in any relevant SSE securities.

**5.3 *innogy and innogy concert parties' interests and dealings***

(a) *Interests and dealings in relevant SSE securities*

During the Disclosure Period and as at the Disclosure Date, neither: (i) innogy; (ii) any director of innogy; or (iii) any person deemed to be acting in concert with innogy had any interest in, right to subscribe for or short position in any relevant SSE securities, and no such person had dealt in any relevant SSE securities during the Disclosure Period.

(b) *General*

During the Disclosure Period and as at the Disclosure Date, neither innogy nor any person acting in concert with innogy has borrowed or lent any relevant SSE securities (including any financial collateral arrangements), save for borrowed shares which have been either on-lent or sold.

During the Disclosure Period and as at the Disclosure Date, neither innogy nor any person acting in concert with innogy had any Note 11 arrangement with any other person and as such, no such person had any interest in, right to subscribe for or short position in any relevant SSE securities.

**6. Directors' Service Agreements and Arrangements**

***SSE Directors***

The information set forth under the headings "Single total figure of remuneration (audited)" on page 124 and "Other remuneration disclosures" on page 128 of the SSE 2018 Annual Report is incorporated by reference into this Circular.

Current SSE Executive Directors have service contracts terminable by SSE immediately without notice upon breach by the individual or by SSE giving to the individual 12 months' notice or, at its discretion, payment in lieu of salary only during that notice. The payment in lieu of notice may be made in staged payments, and may either reduce or cease completely where the departing SSE Executive Director gains new employment. The SSE Executive Director may terminate his contract by giving SSE 12 months' notice.

The SSE Non-Executive Directors have letters of appointment, and are appointed for fixed terms of three years, subject to retirement and re-appointment at AGMs. SSE Non-Executive Directors on termination are not entitled to any payment in lieu of notice or any compensation for loss of office.

***Proposed MergeCo Directors***

***Katie Bickerstaffe (Chief Executive Designate)***

Katie Bickerstaffe was appointed on 6 April 2018. She will commence employment with the SSE Energy Services group on 24 September 2018 and from the date of Admission she will be employed as the Chief Executive of MergeCo. Her employment will be terminable by either party on not less than 12 months' notice.

Under the terms of her appointment, Ms Bickerstaffe will receive a basic annual salary of £650,000. She will receive health insurance (for herself, spouse and any dependent children), a car allowance of £15,000 per annum and will receive an annual cash allowance in lieu of a pension contribution equal to 20 per cent. of her basic salary.

Ms Bickerstaffe will be eligible to participate in short and long-term incentive arrangements in connection with her employment.

*Gordon Boyd (Chief Financial Officer Designate)*

Gordon Boyd will commence employment with the SSE Energy Services group on 4 July 2018 and from the date of Admission he will be employed as the Chief Financial Officer of MergeCo. His employment will be terminable by either party on not less than 12 months' notice.

Under the terms of his appointment, Mr Boyd will receive a basic annual salary of £450,000. He will receive an annual allowance in lieu of health insurance, a car allowance of £15,000 per annum and will receive an annual cash allowance in lieu of a pension contribution equal to 20 per cent. of his basic salary.

Mr Boyd will be eligible to participate in short and long-term incentive arrangements in connection with his employment.

Following Completion, the remuneration of the MergeCo executive directors will be subject to shareholder approval under the Companies Act 2006 and will be reported to shareholders in MergeCo's annual report.

## **7. Share Schemes**

Options or awards held pursuant to the SSE Share Schemes will be affected by the Transaction as described below. SSE will write to participants in the SSE Share Schemes as appropriate in due course to explain in more detail the impact of the Transaction on their outstanding options and awards.

### *Awards under the Share Incentive Plans*

Participants in the Scottish and Southern Employee Share Ownership Plan and the Scottish and Southern Energy Irish Share Incentive Plan (together, the **Share Incentive Plans**) are the beneficial owners of SSE Shares, which are held on their behalf by a trustee established in connection with the Share Incentive Plans.

Participants will receive MergeCo Shares pursuant to the Transaction on the same basis as other SSE Shareholders in respect of the SSE Shares held on their behalf pursuant to the Share Incentive Plans.

MergeCo Shares that are transferred to those participants in the Share Incentive Plans who remain employees of the SSE Group will be held on their behalf by the relevant trustee on the same terms as the SSE Shares to which they relate.

Participants who become employees of the MergeCo Group as a result of the Transaction will be entitled to request that the Free Shares, Partnership Shares, Matching Shares and/or Dividend Shares held on their behalf under the Scottish and Southern Employee Share Ownership Plan be transferred to them on or shortly following the Transaction, along with any MergeCo Shares received pursuant to the Transaction. Any holding period for such shares will cease to apply.

### *Options and awards held by participants who will remain employed by the SSE Group*

The Transaction will not trigger any right of early exercise or release of SSE Shares in respect of options or awards granted under any of the SSE Share Schemes held by any employees or former employees of the SSE Group whose employment does not transfer to the MergeCo Group.

Following the Transaction, SSE does not currently intend to materially alter its share incentive plans for employees of the SSE Retained Group.

### *Options and awards held by participants who will become employees of the MergeCo Group*

The SSE Remuneration Committee has determined that outstanding awards granted under the SSE plc Performance Share Plan or the SSE plc Leadership Share Plan, and which are held by participants who become employees of the MergeCo Group as a result of the Transaction, will become exercisable or will vest when the participant ceases to be an employee of the SSE Group as a result of the Transaction. The number of shares in respect of which these awards will vest will be determined by the SSE Remuneration Committee by reference to the extent to which the applicable performance conditions have been achieved as at Completion. The awards will also be reduced for time pro-rating. Participants will have six months from the vesting date to exercise any of the awards that have been granted in the form of nil-cost options.

The SSE Remuneration Committee has determined that outstanding awards granted under the SSE plc Deferred Bonus Scheme, and which are held by participants who become employees of the MergeCo Group, will vest in full when the participant ceases to be an employee of the SSE Group as a result of the Transaction.

Participants in the Scottish and Southern Energy plc Sharesave Scheme who become employees of the MergeCo Group as a result of the Transaction will be able to exercise their options and acquire SSE Shares for a six month period from or shortly following the date of the Transaction.

#### *Potential adjustments to outstanding options and awards*

The SSE Remuneration Committee may, if it determines that it is appropriate and subject to any necessary approvals, adjust any performance conditions and/or take steps to address any reduction in value to outstanding options and awards under the SSE Share Schemes, as a result of the Transaction.

## **8. Significant Shareholders**

As at the close of business on the Disclosure Date, the Company has been notified under Rule 5 of the Disclosure Guidance and Transparency Rules of the interests in its shares as shown in the table below:

<u>Shareholder</u>	<u>Number of SSE Shares<sup>(1)</sup></u>	<u>Percentage of total voting rights</u>	<u>Nature of holding</u>
The Capital Group Companies, Inc. . . . .	98,966,198	9.91%	Indirect
BlackRock, Inc. . . . .	72,378,011	7.13%	Indirect (6.12%), Securities Lending (0.04%) & CFDs <sup>(2)</sup> (0.18%)
UBS Investment Bank . . . . .	52,003,155	5.17%	Indirect (4.93%), Equity Options (0.19%) & Equity Swaps (0.04%)
Invesco Limited . . . . .	45,775,918	4.69%	Indirect

(1) As at the date of disclosure by the relevant entity.

(2) Contracts for difference

## **9. Material Contracts**

### ***MergeCo***

The following contract (not being a contract entered into in the ordinary course of business) is a contract which has been entered into by the MergeCo Group (a) within the two years immediately preceding the date of this document which is, or may be, material to MergeCo or (b) at any time and which contains provisions under which any member of the MergeCo Group has any obligations or entitlements which are, or may be, material to MergeCo as at the date of this document:

#### *Contribution Agreement*

For a description of the Contribution Agreement, see paragraph 1 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

Prior to Admission, the Directors expect that MergeCo will enter into the following contracts (not being contracts entered into in the ordinary course of business) which will, or may be, material to MergeCo or which will contain provisions under which any member of the MergeCo Group has any obligations or entitlements which are, or may be, material to MergeCo:

#### *Relationship Agreement*

For a description of the Relationship Agreement, see Part VII (*MergeCo Directors and Corporate Governance*) of this Circular.

#### *Transitional Services Agreements and long term supply arrangements*

For a description of the Transitional Services Agreements and long term supply arrangements, see paragraph 3 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

### ***SSE Energy Services***

#### *Separation Agreement*

For a description of the Separation Agreement, see paragraph 2 of Part IV (*Summary of the Principal Terms and Conditions of the Transaction*) of this Circular.

Other than as set out above and in the disclosure of material contracts for MergeCo, there are no further contracts (not being contracts entered into in the ordinary course of business) which are, or may be, material to SSE Energy Services or which contain provisions under which SSE Energy Services has any obligations or entitlements which are, or may be, material to SSE Energy Services as at the date of this document.

#### ***npower Group***

Other than as set out above, there are no further contracts (not being contracts entered into in the ordinary course of business) which are, or may be, material to the npower Group or which contain provisions under which the npower Group has any obligations or entitlements which are, or may be, material to the npower Group as at the date of this document.

#### ***innogy***

With respect to innogy, the Contribution Agreement and the Relationship Agreement are the only material contracts which are relevant to the Whitewash Resolution.

### **10. Litigation**

#### ***SSE Energy Services***

Save as set out below, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which SSE is aware) during the period covering the 12 months preceding the date of this document which may have, or have had in the recent past, significant effects on SSE Energy Services' financial position or profitability.

In July 2016 Ofgem opened an investigation in relation to SSE Energy Services' compliance with certain licence conditions relating to concerns that SSE Energy Services may not have been treating its customers fairly when switching them to PPMs. This investigation was closed in November 2017 and no action was taken by Ofgem.

In November 2017 Ofgem opened an investigation in relation to SSE Energy Services' compliance with certain licence conditions regarding annual statements issued to prepayment customers between June 2014 and September 2015. This matter was self-reported to Ofgem and SSE Energy Services voluntarily paid £1 million into Ofgem's consumer redress fund administered by the Energy Savings Trust. The investigation subsequently closed in June 2018 without formal enforcement action being taken.

#### ***npower Group***

Save as set out below, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the npower Group is aware) during the period covering the 12 months preceding the date of this document which may have, or have had in the recent past, significant effects on the npower Group's financial position or profitability.

In October 2014, Ofgem opened an investigation in relation to npower's compliance with certain licence conditions relating to the installation of advanced meters in the small business sector. A hearing was held before the Enforcement Decision Panel in May 2018. This investigation is ongoing and npower is co-operating fully with Ofgem. This investigation does not mean that npower has breached its licence obligations, however, any regulatory action increases the risk of penalties and a material adverse impact upon the reputation and financial standing of npower. npower is currently unable to predict how long the investigation will last and any potential penalties, if any, that may be levied.

### **11. No Significant Change**

#### ***SSE Energy Services***

There has been no significant change in the trading or financial position of SSE Energy Services since 31 March 2018 (the date to which the latest published audited financial information of SSE Energy Services was prepared).

#### ***npower Group***

There has been no significant change in the trading or financial position of the npower Group since 31 December 2017 (the date to which the latest published audited financial information of the npower Group was prepared).

## 12. Consents

KPMG is a member firm of the Institute of Chartered Accountants in England and Wales and has given and not withdrawn its written consent to the inclusion of its report in Part B of Appendix 1 (*SSE Quantified Financial Benefits Statement*) of this Circular in the form and context in which it appears.

PwC is a member firm of the Institute of Chartered Accountants in England and Wales and has given and not withdrawn its written consent to the inclusion of its report in Part B of Part XI (*Historical Financial Information*) of this Circular in the form and context in which it appears.

Credit Suisse has given and not withdrawn its written consent to the inclusion of its report in Part C of Appendix 1 (*SSE Quantified Financial Benefits Statement*) of this Circular and to the issue of this Circular with references to its name being included, each in the form and context in which they appear.

Morgan Stanley has given and not withdrawn its written consent to the inclusion of its report in Part C of Appendix 1 (*SSE Quantified Financial Benefits Statement*) of this Circular and to the issue of this Circular with references to its name being included, each in the form and context in which they appear.

## 13. Information Incorporated by Reference

Information from the following documents has been incorporated into this document by reference:

<b>Documents containing information incorporated by reference</b>	<b>Page reference</b>	<b>Available at:</b>
SSE's 2018 Annual Report and Accounts	<p>"Board of Directors" on pages 90–92</p> <p>"Single total figure of remuneration (audited)" on page 124</p> <p>"Other remuneration disclosures" on page 128</p>	<a href="http://fr.zone-secure.net/5521/826668/pdfs/Annual_Report_2018.pdf">http://fr.zone-secure.net/5521/826668/pdfs/Annual_Report_2018.pdf</a>
2017 Financial Statements of innogy		<a href="https://www.innogy.com/web/cms/mediablob/en/3875786/data/0/5/financial-statements-2017.pdf">https://www.innogy.com/web/cms/mediablob/en/3875786/data/0/5/financial-statements-2017.pdf</a>
2016 Financial Statements of innogy		<a href="https://www.innogy.com/web/cms/extshort/en/3705842/financial-statements-2016">https://www.innogy.com/web/cms/extshort/en/3705842/financial-statements-2016</a>
innogy interim financial information for the period from January to March 2018		<a href="https://www.innogy.com/web/cms/mediablob/en/3905134/data/0/8/Q1-2018-statement.pdf">https://www.innogy.com/web/cms/mediablob/en/3905134/data/0/8/Q1-2018-statement.pdf</a>
The information contained on the 'innogy at a glance' page of innogy's website		<a href="https://iam.innogy.com/en/about-innogy/innogy-at-a-glance">https://iam.innogy.com/en/about-innogy/innogy-at-a-glance</a>
innogy's articles of incorporation		<a href="https://iam.innogy.com/-/media/innogy/documents/ueber-innogy/Investor-Relations/satzung-und-geschaeftsordnung/satzung-15-Mai-201-englisch.pdf">https://iam.innogy.com/-/media/innogy/documents/ueber-innogy/Investor-Relations/satzung-und-geschaeftsordnung/satzung-15-Mai-201-englisch.pdf</a>

Where only parts of a document are being incorporated by reference in this document, the parts of the document which are not being incorporated by reference are either not relevant for the investor or are covered elsewhere in this document.

To the extent that any document or information incorporated by reference or attached to this Circular itself incorporates any information by reference, either expressly or impliedly, such information will not form part of this Circular, except where such information or documents are stated within this Circular as specifically being incorporated by reference or where this Circular is specifically defined as including such information.

Any statement contained in a document which is deemed to be incorporated by reference herein shall be deemed to be modified or superseded for the purpose of this Circular to the extent that a statement contained



herein (or in a later document which is incorporated by reference herein) modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Circular.

A person who has received this document may request a copy of such documents incorporated by reference. A copy of any such documents or information incorporated by reference will not be sent to such persons unless requested from SSE's registrars, Link Asset Services, by writing to 34 Beckenham Road, Beckenham BR3 4TU or calling +44 (0)345 143 4005. If requested, copies will be provided free of charge.

#### **14. Documents Available for Inspection**

Copies of the following documents will be available at [www.sse.com](http://www.sse.com) from the date of this Circular until Completion or termination of the Contribution Agreement. Such documents will also be available for inspection at the General Meeting for the duration of the General Meeting, and during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the offices of SSE at Inveralmond House, 200 Dunkeld Road, Perth, PH1 3AQ, United Kingdom and at the offices of Freshfields Bruckhaus Deringer LLP at 65 Fleet Street, London, EC4Y 1HT from the date of this Circular up to and including the date of the General Meeting and for the duration of the General Meeting:

- (i) the SSE RNS announcement in respect of the Transaction;
- (ii) the SSE RNS announcement in respect of publication of this Circular;
- (iii) this Circular;
- (iv) SSE articles of association;
- (v) MergeCo articles of association<sup>3</sup>;
- (vi) innogy articles of association;
- (vii) the consent letters referred to in paragraph 12 of this Part XIII (*Additional Information*);
- (viii) the Contribution Agreement (which appends the Transitional Services Agreements and the Relationship Agreement); and
- (ix) the Separation Agreement.

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<sup>3</sup> MergeCo's current articles of association are private limited company articles of association. It is proposed that prior to Completion they will be replaced by articles of association suitable for a UK listed, public limited company. The provisions of such new articles of association will be summarised in the prospectus relating to the MergeCo Shares (in accordance with the disclosure requirements of the Prospectus Rules of the FCA), which will be published shortly prior to Admission.

## PART XIV DEFINITIONS

The following definitions apply throughout this document unless the context requires otherwise:

Admission . . . . .	the admission of MergeCo Shares to the premium listing segment of the Official List and to trading on the London Stock Exchange's main market for listed securities
ADR . . . . .	American Depositary Receipt
ADR Depositary . . . . .	Deutsche Bank Trust Company Americas
ADS . . . . .	American Depositary Share
Authority . . . . .	the Gas and Electricity Markets Authority
B2B . . . . .	business-to-business
B2C . . . . .	business-to-consumer
Board . . . . .	the board of directors of SSE
Brexit . . . . .	the referendum in the United Kingdom in June 2016, in which a majority of voters voted in favour of the United Kingdom withdrawing from the European Union
capex . . . . .	capital expenditure
Circular . . . . .	this document
City Code . . . . .	the City Code on Takeovers and Mergers
CMA . . . . .	the UK Competition and Markets Authority
Combination . . . . .	the combination of SSE Energy Services with the npower Group resulting from the transfer of npower by the innogy Group to MergeCo following the Demerger
Completion . . . . .	completion of the Transaction pursuant to the terms of the Contribution Agreement
Contribution Agreement . . . . .	the contribution agreement entered into on 8 November 2017 between SSE, innogy International Participation NV, innogy and MergeCo
Credit Suisse . . . . .	Credit Suisse International
CREST . . . . .	the relevant system (as defined in the Regulations) in respect of which Euroclear is the operator (as defined in the Regulations)
CREST Manual . . . . .	the rules governing the operation of CREST, consisting of the CREST Reference Manual, CREST International Manual, CREST Central Counterparty Service Manual, CREST Rules, Registrars Service Standards, Settlement Discipline Rules, CCSS Operations Manual, Daily Timetable, CREST Application Procedure and CREST Glossary of Terms (all as defined in the CREST Glossary of Terms promulgated by Euroclear on 15 July 1996 and as amended since)
CREST Proxy Instruction . . . . .	a properly authenticated CREST message appointing and instructing a proxy to attend and vote in place of a SSE Shareholder at the General Meeting and containing the information required to be contained in the CREST Manual
CS Systems . . . . .	certain IT systems relating to customer service including registration, deregistration, metering, billing, payments and collections that SSE will be transferring to the MergeCo Group in connection with the Transaction
Default Tariff Cap . . . . .	the proposed temporary price cap for SVT and fixed-term default tariff customers in Great Britain
Demerger . . . . .	the demerger of SSE Energy Services from SSE

Demerger Dividend . . . . .	the special dividend (in kind in the form of MergeCo Shares) to be declared by SSE in respect of the SSE Shares of an amount equal to the book value of SSE's shareholding in Retail HoldCo, which will be satisfied by the transfer to MergeCo of the entire issued share capital of Retail HoldCo, and in consideration for that transfer, MergeCo will allot and issue MergeCo Shares to SSE Shareholders
Demerger Effective Time . . . . .	the time at which MergeCo Shares are issued to SSE Shareholders pursuant to the Demerger
Demerger Record Date . . . . .	the date on which the Demerger Record Time will occur
Demerger Record Time . . . . .	the time at which you must own SSE Shares in order to receive MergeCo Shares pursuant to the Demerger
Demerger Resolution . . . . .	the ordinary resolution to approve the Demerger Dividend to give effect to the Demerger
Deposit Agreement . . . . .	the amended and restated deposit agreement dated December 2005 between SSE, Deutsche Bank Trust Company Americas and holders of SSE ADRs
Directors . . . . .	the directors of SSE whose names appear in the section titled <i>Directors, Company Secretary, Registered Office and Advisers</i>
Disclosure Date . . . . .	close of business on 21 June 2018 (being the latest practicable date prior to the publication of this Circular)
Disclosure Guidance and Transparency Rules . . . . .	the Disclosure Guidance and Transparency Rules issued by the FCA
Eligible Shares . . . . .	SSE Shares held by any SSE Shareholder who (i) represents, warrants and confirms to and for the benefit of SSE that such SSE Shareholder, and any person on whose behalf such SSE Shares are held, is a person who is located outside the United States, or (ii) makes the Investor Declarations contained in paragraph 5 of Part XII ( <i>Further details of the Transaction</i> ) of this Circular
E.ON . . . . .	E.ON SE
E.ON/RWE Transaction . . . . .	the announcement by RWE on 12 March 2018 that it had concluded an agreement with E.ON on the sale of RWE's 76.8 per cent. stake in innogy
EPM . . . . .	SSE EPM Limited
Euroclear . . . . .	Euroclear UK & Ireland Limited
FCA . . . . .	the Financial Conduct Authority
Final Report . . . . .	the CMA's final report on its market investigation into competition in the British energy market published on 24 June 2016
Form of Direction . . . . .	the form of direction for use by participants in the Share Incentive Plans
Form of Proxy . . . . .	the form of proxy for the General Meeting to be sent to SSE Shareholders
FSMA . . . . .	the Financial Services and Markets Act 2000, as amended
GDP . . . . .	gross domestic product
GDPR . . . . .	the General Data Protection Regulation (Regulation (EU) 2016/679)
General Meeting . . . . .	the general meeting of SSE to be held at Perth Concert Hall, Mill Street, Perth, PH1 5HZ at 2.00 p.m. on 19 July 2018
Great Britain . . . . .	England, Scotland and Wales
Home and essential services . . . .	telephone, broadband and boiler care services provided by SSE Energy Services

I&C . . . . .	the industrial and commercial segment of the energy supply market
Ineligible Shareholder . . . . .	any SSE Shareholder who does not (i) represent, warrant and confirm to and for the benefit of SSE that such SSE Shareholder, and any person on whose behalf such SSE Shares are held, is a person who is located outside the United States, or (ii) make the Investor Declarations contained in paragraph 5 of Part XII ( <i>Further details of the Transaction</i> ) of this Circular
Ineligible Shares . . . . .	SSE Shares held by any SSE Shareholder who does not (i) represent, warrant and confirm to and for the benefit of SSE that such SSE Shareholder, and any person on whose behalf such SSE Shares are held, is a person who is located outside the United States, or (ii) make the Investor Declarations contained in paragraph 5 of Part XII ( <i>Further details of the Transaction</i> ) of this Circular
innogy . . . . .	innogy SE
innogy Group . . . . .	innogy SE and its subsidiaries and subsidiary undertakings from time to time
innogy Management Board . . . . .	the directors of innogy who sit on the innogy SE management board as set out in paragraph 7 of Part XII ( <i>Further details of the Transaction</i> ) of this Circular
Investor Declarations . . . . .	the representations, warranties and confirmations discussed in paragraph 5 of Part XII ( <i>Further details of the Transaction</i> ) of this Circular
KPMG . . . . .	KPMG LLP
Listing Rules . . . . .	the listing rules of the FCA
MergeCo . . . . .	ShiftMCo123 Ltd
MergeCo Board . . . . .	the board of directors of MergeCo
MergeCo DB Schemes . . . . .	new defined benefit arrangements which will be operated by MergeCo following Completion
MergeCo Directors . . . . .	the proposed directors of MergeCo whose names appear in Part VII ( <i>MergeCo Directors and Corporate Governance</i> ) of this Circular
MergeCo Group . . . . .	ShiftMCo123 Ltd and its subsidiaries and subsidiary undertakings from time to time
MergeCo Shareholders . . . . .	the holders of ordinary shares in the capital of MergeCo from Completion
MergeCo Shares . . . . .	the ordinary shares in the capital of MergeCo
Morgan Stanley . . . . .	Morgan Stanley & Co. International plc
Notice of General Meeting . . . . .	the notice of the General Meeting included at the end of this Circular
npower . . . . .	Npower Group Limited
npower DB Scheme . . . . .	the defined benefit pension scheme operated by npower
npower Group . . . . .	Npower Group Limited and its subsidiaries and subsidiary undertakings from time to time
Official List . . . . .	the Official List of the FCA
Ofgem . . . . .	the Office of Gas and Electricity Markets
opex . . . . .	operating expense
PCG . . . . .	parent company guarantee
Placing Agent . . . . .	expected to be Credit Suisse International or an affiliate thereof

PPM . . . . .	prepayment meters
PwC . . . . .	PricewaterhouseCoopers LLP
QIB . . . . .	a “qualified institutional buyer” within the meaning of Rule 144A of the Securities Act
Recovery Programme . . . . .	the recovery programme implemented by npower in 2015
Regulations . . . . .	the Uncertificated Securities Regulations 2001 of the United Kingdom
Relationship Agreement . . . . .	the relationship agreement to be entered into upon Completion between innogy and MergeCo governing the terms of innogy’s relationship with MergeCo in respect of its holding of MergeCo Shares
Resolutions . . . . .	the Demerger Resolution and the Whitewash Resolution
Retail HoldCo . . . . .	SSE Energy Services Group Limited (formerly ShiftRCo123 Ltd), the holding company of SSE Energy Services
Retail HoldCo Group . . . . .	Retail HoldCo and its subsidiaries and subsidiary undertakings from time to time
Revenue Code . . . . .	the US Internal Revenue Code of 1986, as amended
RNS . . . . .	Regulatory News Service
RTGS . . . . .	real-time gross settlement
RWE . . . . .	RWE AG
RWEST . . . . .	RWE Supply & Trading GmbH
SDRT . . . . .	Stamp Duty Reserve Tax
Securities Act . . . . .	United States Securities Act of 1933, as amended
Separation . . . . .	the reorganisation and separation of SSE Energy Services from the SSE Retained Group
Separation Agreement . . . . .	the separation agreement entered into on 8 November 2017 between SSE, Retail HoldCo, SSE Energy Supply Limited, Southern Electric Gas Limited, South Wales Electricity Limited (since re-named SSE Electricity Limited), SSE Retail Telecoms Limited, SSE Metering Limited, SSE Services plc and SSE Home Services Limited and which sets out the terms on which SSE Energy Services would be reorganised and separated from the SSE Retained Group
Share Incentive Plans . . . . .	the Scottish and Southern Employee Share Ownership Plan and the Scottish and Southern Energy Irish Share Incentive Plan
SME . . . . .	small and medium-sized enterprise
SSE . . . . .	SSE plc
SSE ADS . . . . .	an ADS representing one SSE Share
SSE DB Schemes . . . . .	the Southern Electric Pension Scheme and the Scottish Hydro-Electric Pension Scheme, each of which is sponsored by SSE
SSE Energy Services . . . . .	SSE’s household energy and services business in Great Britain
SSE Executive Directors . . . . .	SSE’s executive directors whose names appear in the section titled <i>Directors, Company Secretary, Registered Office and Advisers</i>
SSE Group . . . . .	SSE plc and its subsidiaries and subsidiary undertakings from time to time
SSE Non-Executive Directors . . . . .	SSE’s non-executive directors whose names appear in the section titled <i>Directors, Company Secretary, Registered Office and Advisers</i>
SSE Retained Group . . . . .	SSE and its subsidiaries and subsidiary undertakings following the Demerger

SSE Share Scheme . . . . .	each of the SSE Performance Share Plan 2016, the SSE Leadership Share Plan 2016, the SSE plc Deferred Bonus Scheme 2016, the Scottish and Southern Energy plc Sharesave Scheme, the Scottish and Southern Energy plc Irish Sharesave Scheme, the Scottish and Southern Energy Employee Share Ownership Plan and the Scottish and Southern Energy Irish Share Incentive Plan
SSE Shareholders . . . . .	the holders of ordinary shares in the capital of SSE
SSE Shares . . . . .	the ordinary shares in the capital of SSE
SVT . . . . .	standard variable tariffs
Takeover Panel . . . . .	the Panel on Takeovers and Mergers
Transaction . . . . .	the Combination and the Demerger
Transitional Services Agreements . . . . .	the transitional services agreement to be entered into between SSE, SSE Energy Services and MergeCo and the transitional services agreement to be entered into between innogy and MergeCo, each of which will be executed and become binding immediately before Completion
Trustee . . . . .	expected to be Link Corporate Trustees (UK) Limited
US-UK Treaty . . . . .	the income tax treaty between the United States and the United Kingdom
US Holders . . . . .	a beneficial owner of SSE Shares and, following the Demerger, MergeCo Shares that is, for US federal income tax purposes, (i) a citizen or individual resident of the United States, (ii) a corporation or entity treated as such created or organised under the laws of the United States, any State thereof, or the District of Columbia, (iii) a trust subject to the control of a US person and the primary supervision of a US court or (iv) an estate the income of which is subject to US federal income tax without regard to its source
US SSE Shareholders . . . . .	a SSE Shareholder (or any person on whose behalf such SSE Shares are held) located inside the United States
Vulnerable Safeguard Tariff . . . . .	the PPM price cap applicable to around one million customers (of suppliers with more than 250,000 customers) who are on their supplier's default tariff and in receipt of the Warm Home Discount benefit
Waiver . . . . .	a waiver from the Takeover Panel of the obligation which would otherwise arise upon innogy International Participations NV (and persons deemed to be acting in concert with innogy International Participations NV under the City Code) pursuant to Rule 9 of the City Code to make a general offer for the MergeCo Shares not held by innogy International Participations NV following Admission
White Label . . . . .	an organisation that does not hold a supply licence, but instead works in partnership with a licensed 'partner supplier' to offer tariffs under the white label brand
Whitewash Resolution . . . . .	the ordinary resolution to approve the waiver by the Takeover Panel of any requirements under Rule 9 of the City Code for innogy International Participations NV and persons deemed to be acting in concert with innogy International Participations NV under the City Code to make a general offer to MergeCo Shareholders as a result of the issue of MergeCo Shares to innogy International Participations NV in connection with the acquisition by MergeCo of the entire issued share capital of npower as described in the Contribution Agreement

## PART XV NOTICE OF GENERAL MEETING

### SSE PLC

(Company number SC117119)

### NOTICE OF GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that a General Meeting of SSE plc (the *Company*) will be held at 2.00 p.m. on 19 July 2018 at Perth Concert Hall, Mill Street, Perth, PH1 5HZ for the purpose of considering and, if thought fit, passing the following resolutions (the *Resolutions*), each of which are proposed as ordinary resolutions:

#### Ordinary resolutions

**1. THAT** upon the recommendation of the board of directors of the Company (the *Directors*) and subject to and conditional upon: (i) the satisfaction or waiver of the applicable conditions set out in the contribution agreement dated 8 November 2017 entered into between the Company, innogy International Participations NV, innogy SE and ShiftMCo123 Ltd in connection with, amongst other things, the demerger of the Company's household energy and services business (the *Demerger*); and (ii) interim accounts of the Company being prepared, approved by the Directors and filed with the Registrar of Companies for the purpose of the Demerger Dividend (as defined below) which accounts show that the Company has at such time sufficient profits available for distribution to pay the Demerger Dividend (as defined below); a dividend in specie equal to the aggregate book value of the Company's interest in its subsidiary, SSE Energy Services Group Limited (the *Demerger Dividend*) be and is hereby declared payable to holders of SSE Shares who are recorded on the register of members of the Company at 6:00 p.m. UK time on the business day before Admission (the *Demerger Record Time*), such Demerger Dividend to be satisfied by the transfer by the Company to MergeCo on the day preceding Admission of the entire issued share capital of SSE Energy Services Group Limited, in consideration for which MergeCo has agreed to allot and issue the MergeCo Shares effective on the day preceding Admission and credited as fully paid, to such shareholders in the proportion of one MergeCo Share for each SSE Share then held by such shareholders (save that, in respect of the two initial subscribers in MergeCo (each of whom is, and will at the Demerger Record Time continue to be, a shareholder in the Company), the number of MergeCo Shares to be allotted and issued to each of them will be reduced by the number of MergeCo Shares already held by them at the Demerger Record Time) so that at Admission all holders of SSE Shares (including the two initial subscribers in MergeCo) will hold one MergeCo Share for each SSE Share held at the Demerger Record Time;

**2. THAT** subject to the passing of Resolution 1, the waiver by the Panel on Takeovers and Mergers of any requirement under Rule 9 of the City Code on Takeovers and Mergers (the *City Code*) for innogy International Participations NV and persons deemed to be acting in concert with innogy International Participations NV under the City Code to make a general offer to shareholders of MergeCo (such shareholders being also existing holders of ordinary shares of the Company and who would, following completion of the Demerger, be entitled to vote as independent shareholders of MergeCo to approve such waiver) as a result of the issue of MergeCo Shares to innogy International Participations NV in connection with the acquisition by MergeCo of the entire issued share capital of Npower Group Limited as described in the contribution agreement dated 8 November 2017 entered into between the Company, innogy International Participations NV, innogy SE and ShiftMCo123 Ltd, be and is hereby approved.

By order of the Board

Sally Fairbairn  
Company Secretary  
27 June 2018

Registered Office  
Inveralmond  
House, 200  
Dunkeld Road,  
Perth, Perthshire,  
PH1 3AQ

## **Notes:**

### **1. Issued share capital and total voting rights**

As at 21 June 2018 (being the latest practicable day prior to the printing of this Notice) the issued share capital of the Company consisted of 1,023,008,915 ordinary shares, with a nominal value of 50 pence each and carrying one vote each (*SSE Shares*). This figure includes 7,820,895 ordinary shares which are held in treasury. The voting rights on treasury shares are automatically suspended. Accordingly, the total voting rights in the Company as at 21 June 2018 are 1,015,188,020.

### **2. Entitlement to attend and vote**

Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, and section 360B(2) of the Companies Act 2006, the Company specifies that only shareholders registered in the Register of Members of the Company at 2:00 p.m. on 17 July 2018 or, in the event that the General Meeting is adjourned, registered in the Register of Members of the Company 48 hours before the time of the adjourned meeting(s), shall be entitled to attend and vote at the General Meeting in respect of the number of SSE Shares registered in their name at that time. Save in relation to any adjourned meeting(s), changes to entries on the Register of Members of the Company after 2:00 p.m. on 17 July 2018 shall be disregarded in determining the rights of any person to attend and vote at the General Meeting.

### **3. Notice addressees who are no longer shareholders**

If all SSE Shares have been sold or transferred by the addressee, this Notice and any other relevant documents (but not any personalised Form of Proxy) should be passed to the person through whom the sale or transfer was effected for transmission to the purchaser or transferee. A shareholder who sold or otherwise transferred only part of their holding of SSE Shares should retain these documents and contact the person through whom the sale or transfer was effected. However, the distribution of this Notice and any other relevant documents into jurisdictions other than the United Kingdom may be restricted by law and therefore persons into whose possession this Notice comes should inform themselves about and observe any such restrictions. Any failure to comply with any such restrictions may constitute a violation of the securities laws of such jurisdictions.

### **4. Voting at the General Meeting**

Voting on each of the resolutions to be put to the General Meeting will be taken on a poll demanded by the chairman of the meeting, rather than a show of hands, to reflect the number of SSE Shares held by a shareholder, whether or not the shareholder is able to attend the meeting. As soon as practicable following the General Meeting, the results of the voting will be announced via a Regulatory Information Service and also placed on the Company's website [www.sse.com](http://www.sse.com).

### **5. Proxies**

A shareholder entitled to attend, speak and vote at the General Meeting may appoint one or more proxies to attend, speak and vote at the General Meeting on their behalf provided that (if more than one) each proxy is appointed to exercise the rights attached to different SSE Shares held by the shareholder. A proxy need not be a shareholder of the Company but must attend the meeting to represent his/her appointing member. Appointing a proxy will not prevent a member from attending in person and voting at the General Meeting, and any votes cast by a member at the General Meeting will take precedence over votes cast by its proxy in respect of the same SSE Shares. A proxy must vote in accordance with any instructions given by the shareholder by whom the proxy is appointed. A shareholder can only appoint a proxy using the procedures set out in these notes and in the notes to the Form of Proxy. If a shareholder submits more than one valid proxy appointment in respect of the same SSE Shares, the appointment received before the latest time for receipt of proxies will take precedence.

A vote withheld is not a vote in law, which means that the vote will not be counted in the calculation for or against the resolution. If no voting indication is given, a shareholder's proxy will vote or abstain from voting at their discretion. A shareholder's proxy will vote (or abstain from voting) as they think fit in relation to any other matter which properly comes before the General Meeting.



## **6. Appointment of proxy by joint shareholders**

In the case of joint shareholders, the vote of the first named in the Register of Members of the Company who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of other joint holders.

## **7. Appointment of proxy using the hard-copy Form of Proxy**

The Form of Proxy which may be used to make such appointment and give proxy instructions accompanies this Notice.

To be valid, the appointment of a proxy, and the original or duly certified copy of the power of attorney or other authority (if any) under which it is signed or authenticated, should reach the Registrar, Link Asset Services, 34 Beckenham Road, Beckenham BR3 4TU by post or by hand no later than 2:00 p.m. on 17 July 2018 (or, if the meeting is adjourned, 48 hours before the time fixed for holding the adjourned meeting). If you appoint more than one proxy, additional Form(s) of Proxy can be obtained by contacting the SSE Shareholder Helpline on +44 (0)345 143 4005. Calls are charged at the standard geographic rate and will vary by provider. Calls outside the United Kingdom are charged at the applicable international rate. The SSE Shareholder Helpline is open between 9.00am—5.30pm, Monday to Friday, excluding public holidays in England and Wales.

## **8. Electronic appointment of proxy**

You can appoint a proxy electronically by accessing [www.sse.com](http://www.sse.com) and clicking on the General Meeting 2018 link on the homepage. You will be asked to enter your Investor Code (IVC) (which can be found on either your share certificate, dividend confirmation or similar documentation as issued by the Registrar) and agree to certain terms and conditions. On submission of your vote you will be issued with a reference number. For an electronic proxy appointment to be valid, it must be received by the Registrar no later than 2:00 p.m. on 17 July 2018. Should you complete your Form of Proxy electronically and then post a hard copy, the form that arrives last will be counted to the exclusion of instructions received earlier, whether electronic or postal. Please refer to the terms and conditions of the service on the website. If you require any assistance with registering on the share portal or voting online, please call Link Asset Services on the Shareholder Helpline on +44 (0)345 143 4005.

## **9. Appointment of proxies through CREST**

CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a **CREST Proxy Instruction**) must be properly authenticated in accordance with Euroclear's specifications, and must contain the information required for such instruction, as described in the CREST Manual (available via [www.euroclear.com](http://www.euroclear.com)).

The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA10) by 2:00 p.m. on 17 July 2018. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST application host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

CREST members and, where applicable, their CREST sponsors, or voting service providers should note that Euroclear does not make available special procedures in CREST for any particular message. Therefore, normal system timings and limitations will apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member, or sponsored member, or has appointed a voting service provider, to procure that their CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where

applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

#### **10. Form of Direction**

Participants in the Company's Share Incentive Plans may direct the trustee of the plans to vote on their behalf by registering their vote electronically. A form of direction (a ***Form of Direction***) may be completed in order to instruct the trustee of the plans to vote on the holder's behalf at the General Meeting by proxy or, if the General Meeting is adjourned, at the adjourned meeting. To be effective, valid Forms of Direction (and any power of attorney or other authority under which it is signed) should reach the Registrar, Link Asset Services, 34 Beckenham Road, Beckenham BR3 4TU by post or by hand no later than 2:00 p.m. on 12 July 2018 (or, if the meeting is adjourned, 48 hours before the time fixed for holding the adjourned meeting).

#### **11. Corporate representatives**

Any corporation which is a shareholder can either appoint a proxy (in the manner described above) or appoint one or more corporate representatives who may exercise on its behalf all of its powers as a shareholder provided that they do not do so in relation to the same SSE Shares. In the case of a shareholder that is a corporation appointing a proxy, the proxy form must be executed under its common seal or signed on its behalf by an officer of the corporation or an attorney for the corporation. Shareholders considering the appointment of a corporate representative should check their own legal position, the Company's articles of association and the relevant provisions of the Companies Act 2006.

#### **12. Revocation of proxy notice**

In order to revoke a proxy instruction a shareholder will need to inform the Company by sending a signed hard copy notice clearly stating their intention to revoke their proxy appointment to the Registrar, Link Asset Services, 34 Beckenham Road, Beckenham BR3 4TU. In the case of a member which is a corporation, the revocation notice must be executed under its common seal or signed on its behalf by an officer of the corporation or an attorney for the corporation. Any power of attorney or any other authority under which the revocation notice is signed (or a duly certified copy of such power or authority) must be included with the revocation notice. The revocation notice must be received by no later than 2:00 p.m. on 17 July 2018 (or, if the meeting is adjourned, 48 hours before the time fixed for holding the adjourned meeting).

#### **13. Nominated persons**

Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a ***Nominated Person***) may, under an agreement with the shareholder by whom they were nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the General Meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, they may under such an agreement, have a right to give instructions to the shareholders as to the exercise of voting rights. The statement of the rights of shareholders in relation to appointment of proxies in paragraph 5 of these notes does not apply to Nominated Persons. The rights described in this paragraph can only be exercised by shareholders of the Company.

#### **14. Right to ask questions**

Any shareholder or appointed proxy/proxies attending the General Meeting has the right to ask questions. Shareholders may also submit questions in writing in advance of the General Meeting to the Company Secretary at the Company's registered office. The Company must cause to be answered any such question relating to the business being dealt with at the General Meeting but no such answer need be given if: (a) to do so would interfere unduly with the preparation for the General Meeting or involve the disclosure of confidential information; (b) the answer has already been given on a website in the form of an answer to a question; or (c) it is undesirable in the interests of the Company or the good order of the General Meeting that the question be answered.

#### **15. Information available on the Company's website**

Copies of the Circular, the Notice of General Meeting 2018 and other information required by section 311A of the Companies Act 2006 can be found at [www.sse.com](http://www.sse.com).

#### **16. Documents available for inspection**

Copies of the Circular and the Notice will be available for inspection at the registered office of the Company and at the offices of Freshfields Bruckhaus Deringer LLP at 65 Fleet Street, London, EC4Y 1HT during normal business hours on any weekday (public holidays excepted) from the date of this Notice until the conclusion of the General Meeting, and at the place of the General Meeting from 11.30am until the conclusion of the General Meeting.

#### **17. Communication**

You may not use any electronic address provided in either this Notice or any related documents (including the Form of Proxy and Form of Direction) to communicate with the Company for any purposes other than those expressly stated.

#### **18. Queries**

Except as provided above, SSE Shareholders who have general queries about the General Meeting should contact the SSE Shareholder Helpline (+44 (0)345 143 4005) between 9.00 am to 5.30 pm (UK time) Monday to Friday (except UK public holidays). Calls are charged at the standard geographic rate and will vary by provider. Calls outside the United Kingdom will be charged at the applicable international rate. Please note that calls may be monitored or recorded and the helpline cannot provide financial, legal or tax advice or advice on the merits of the Transaction.

## APPENDIX 1 SSE QUANTIFIED FINANCIAL BENEFITS STATEMENT

### PART A

#### SSE QUANTIFIED FINANCIAL BENEFITS STATEMENT

- The SSE Directors believe that, as a result of the Combination, MergeCo will generate cash cost synergy benefits of at least £175 million by the end of the fourth full year following Completion. Of this, £156 million relates to operating expense savings and £19 million of recurring capital maintenance savings.
- The expected sources of quantified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis.
- The run rate at the end of Year One is expected to be approximately 27 per cent., with 47 per cent. achieved by the end of Year Two, 63 per cent. by the end of Year Three, and the full run rate achieved by the end of Year Four.
- The expected sources of quantified cost synergies comprise:
  - IT system consolidation:** approximately 30 per cent. of full run-rate cost synergies are expected to be generated from the consolidation of both corporate and customer service / billing systems;
  - Procurement:** approximately 15 per cent. of full run-rate cost synergies generated from direct and indirect procurement synergies which are expected to be driven by scale economies, sharing of best practice procurement processes, and removal of duplicate expenditure; and
  - Other Selling, General and Administrative expenses:** approximately 55 per cent. of full run-rate cost synergies are expected to be delivered through functional excellence and the removal of duplicate selling, general and administrative expenses.

<u>£m (run-rate)</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
IT System Consolidation . . . . .	13	13	20	53
Procurement . . . . .	25	25	25	26
Other SG&A . . . . .	9	44	66	96
<b>TOTAL . . . . .</b>	<b>47</b>	<b>82</b>	<b>111</b>	<b>175</b>
<u>£m (in year)</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
<b>TOTAL . . . . .</b>	<b>18</b>	<b>67</b>	<b>100</b>	<b>154</b>

- The benefits are shown pre-tax and net of identified cost dis-synergies.
- SSE estimates that the programme will require net cash one-off costs to achieve of approximately £260 million (including contingency) with around 19 per cent. incurred in Year One, 32 per cent. incurred in Year Two, 27 per cent. in Year Three and the remainder in Year Four. These costs are mainly driven by IT and systems integration, re-branding spend and people-related costs (including training where appropriate) associated with the Combination.
- In addition to the £175 million annualised cost synergy benefits, SSE expects MergeCo to realise approximately £50 million of one-off capex benefits by the end of the fourth year following Completion.
- None of the statements contained in this paragraph is intended as a profit forecast and should not be interpreted as such.

#### Bases of Belief for the Quantified Financial Benefits Statement

In preparing the Quantified Financial Benefits Statement, both SSE and innogy have shared certain operating and financial information to facilitate an analysis in support of evaluating the potential synergies available from the Combination. A synergy working group comprising commercial, metering, customer service, digital, support functions, procurement and IT teams from SSE and innogy (the *Working Group*) was established to assess the potential synergies available for the integration and undertake an initial planning exercise. This has included input from the SSE Energy Services Leadership team and was approved by the SSE Board. A clean team environment was created in order to facilitate the sharing of this information in a manner which limited

the extent to which competitively sensitive information was exchanged between parties and ensure compliance with competition law requirements.

In preparing an agreed synergy case (the ***Announced Case***), including ongoing cost synergies, associated one-off costs and phasing of both the synergies and one-off costs, the Working Group have worked alongside and with the support of external consultants engaged by SSE.

Where possible, estimated benefits and costs have been calculated on a bottom-up basis, however, in circumstances where data has been limited for commercial or other reasons, the SSE synergy team has made estimates and assumptions to aid its development of individual synergy initiatives. The assessment and quantification of the potential synergies have in turn been agreed by the Working Group.

The MergeCo executive team, who will ultimately be responsible for delivering the synergies, have not yet started in their roles and are yet to input into the published synergy numbers.

SSE's management has, where possible, identified a cost and/or FTE baseline from which to base and contextualise the benefits estimates. This is primarily based on FY18 full year forecast.

In seeking to develop an addressable baseline for synergies purposes relating to both SSE Energy Services and npower, the Working Group has made adjustments to reflect non-addressable items including in-flight change programmes, standalone cost adjustments expected upon separation of both SSE Energy Services and npower from their parent companies, future cost increases to both businesses relating to the roll-out of Smart Metering and business units deemed non-addressable due to limited overlap.

Key sources of information used to develop the synergy case include: FY17 financial results for both SSE Energy Services and npower; procurement information, headcount data from payroll systems, management accounts, detailed management information and cost saving initiative programme plans.

Additionally, the Working Group has developed an internal stretch case which estimates incremental potential synergy benefit in excess of the Announced Case.

Potential areas of cost dis-synergy have been considered by the Working Group and where identified as being likely to arise, estimates have been quantified in the Announced Case.

Estimates of ongoing cash cost synergies, one-off capex and opex synergies and one-off costs have been phased over a four year period post Completion.

SSE's management has not included estimates for potential revenue synergies or dis-synergies in the Announced Case.

The benefits are shown pre-tax and net of identified dis-synergies.

The expected sources of qualified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis.

In arriving at the Quantified Financial Benefits Statements, the SSE Directors have assumed:

- there will be no material impact on the underlying operations of either company or their ability to continue to conduct their businesses;
- no material change in macroeconomic, political or legal conditions in which SSE Energy Services or npower operate that materially impact on the implementation or costs to achieve the proposed cost savings;
- no foreign exchange conversions have been made in the development of the synergy case;
- no material change in energy prices; and
- no change in tax legislation or tax rates.

## Notes

1. The statements of estimated cost savings and synergies relate to future actions and circumstances which, by their nature, involve risks, uncertainties and contingencies. As a result, the cost savings and synergies referred to may not be achieved, or those achieved could be materially different from those estimated.

2. No statement in the Quantified Financial Benefits Statement, or this Circular generally, should be construed as a profit forecast or interpreted to mean that MergeCo's earnings in the full first full year following the

Transaction, or in any subsequent period, would necessarily match or be greater than or be less than those of SSE Energy Services and/or npower for the relevant preceding financial period or any other period.

3. Due to the scale of MergeCo, there may be additional changes to MergeCo's operations. As a result, and given the fact that the changes relate to the future, the resulting cost savings may be materially greater or less than those estimated.

**PART B**  
**REPORT FROM KPMG**

The Board of Directors (the “**Directors**”)  
SSE plc  
Inveralmond House  
200 Dunkeld Road  
Perth PH1 3AQ

Morgan Stanley & Co. International plc  
25 Cabot Square  
Canary Wharf  
London  
E14 4QA

Credit Suisse International  
1 Cabot Square  
Canary Wharf  
E14 4QJ

27 June 2018

Dear Ladies and Gentlemen,

**Published Report on Quantified Financial Benefits Statement by SSE plc (“SSE”)**

We refer to the statement (the “**Statement**”) made by the Directors set out in Part A of Appendix 1 to the Circular dated 27 June 2018 in relation to the Project Switch Synergy Case to the effect that:

- *“The SSE Directors believe that, as a result of the Combination, MergeCo will generate cash cost synergy benefits of at least £175 million by the end of the fourth full year following Completion. Of this, £156 million relates to operating expense savings and £19 million of recurring capital maintenance savings.*
- *The expected sources of quantified cost synergies are in addition to previously announced performance improvement programmes within the businesses, and would not otherwise be achieved on a standalone basis.*
- *The run rate at the end of Year One is expected to be approximately 27 per cent., with 47 per cent. achieved by the end of Year Two, 63 per cent. by the end of Year Three, and the full run rate achieved by the end of Year Four.*
- *The expected sources of quantified cost synergies comprise:*
  - i. **IT system consolidation:** *approximately 30 per cent. of full run-rate cost synergies are expected to be generated from the consolidation of both corporate and customer service / billing systems;*
  - ii. **Procurement:** *approximately 15 per cent. of full run-rate cost synergies generated from direct and indirect procurement synergies which are expected to be driven by scale economies, sharing of best practice procurement processes, and removal of duplicate expenditure; and*
  - iii. **Other Selling, General and Administrative expenses:** *approximately 55 per cent. of full run-rate cost synergies are expected to be delivered through functional excellence and the removal of duplicate selling, general and administrative expenses.*

<u>£m (run-rate)</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
<i>IT System Consolidation</i> . . . . .	<i>13</i>	<i>13</i>	<i>20</i>	<i>53</i>
<i>Procurement</i> . . . . .	<i>25</i>	<i>25</i>	<i>25</i>	<i>26</i>
<i>Other SG&amp;A</i> . . . . .	<i>9</i>	<i>44</i>	<i>66</i>	<i>96</i>
<b><i>TOTAL</i></b> . . . . .	<b><i>47</i></b>	<b><i>82</i></b>	<b><i>111</i></b>	<b><i>175</i></b>
<u>£m (in year)</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
<b><i>TOTAL</i></b> . . . . .	<b><i>18</i></b>	<b><i>67</i></b>	<b><i>100</i></b>	<b><i>154</i></b>

- *The benefits are shown pre-tax and net of identified cost dis-synergies.*
- *SSE estimates that the programme will require net cash one-off costs to achieve of approximately £260 million (including contingency) with around 19 per cent. incurred in Year One, 32 per cent. incurred in Year Two, 27 per cent. in Year Three and the remainder in Year Four. These costs are mainly driven by IT and systems integration, re-branding spend and people-related costs (including training where appropriate) associated with the Combination.*
- *In addition to the £175 million annualised cost synergy benefits, SSE expects MergeCo to realise approximately £50 million of one-off capex benefits by the end of the fourth year following Completion.*
- *None of the statements contained in this paragraph is intended as a profit forecast and should not be interpreted as such.”*

The Statement has been made in the context of the disclosures on pages 195 to 197 of the Circular setting out, *inter alia*, the basis of the Directors’ belief (including the principal assumptions and sources of information) supporting the Statement and their analysis and explanation of the underlying constituent elements.

This report is required by Rule 28.1(a) of the City Code on Takeovers and Mergers (the “City Code”) and is given for the purpose of complying with that requirement and for no other purpose.

### **Responsibilities**

It is the responsibility of the Directors to prepare the Statement in accordance with the requirements of Rule 28 of the City Code.

It is our responsibility to form an opinion, as required by Rule 28.1(a)(i) of the City Code, as to the proper compilation of the Statement and to report that opinion to you.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with Rule 23.2 of the City Code, consenting to its inclusion in the Circular.

### **Basis of preparation of the Statement**

The Statement has been prepared on the basis stated in Part A of Appendix 1 to the Circular.

### **Basis of opinion**

We have discussed the Statement, together with the underlying plans, with the Directors, Credit Suisse International, and Morgan Stanley & Co. International plc. Our work did not involve any independent examination of any of the financial or other information underlying the Statement. We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board of the United Kingdom.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Statement has been properly compiled on the basis stated.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices. We have not consented to the inclusion of this report and our opinion in any registration statement filed with the SEC under the US Securities Act of 1933 (either directly or by incorporation by reference) or in any offering document enabling an offering of securities in the United States (whether under Rule 144A or otherwise). We therefore accept no responsibility to, and deny any liability to, any person using this report and opinion in connection with any offering of securities inside the United States of America or who makes a claim on the basis they had acted in reliance on the protections afforded by United States of America law and regulation.



We do not express any opinion as to the achievability of the benefits identified by the Directors in the Statement. The Statement is subject to uncertainty as described in Appendix 1 to the Circular. Because of the significant changes in the enlarged group's operations expected to flow from the transaction and because the Statement relates to the future, the actual benefits achieved are likely to be different from those anticipated in the Statement and the differences may be material.

**Opinion**

On the basis of the foregoing, we report that, in our opinion, the Statement has been properly compiled on the basis stated.

Yours faithfully,

KPMG LLP

**PART C**  
**REPORT FROM CREDIT SUISSE AND MORGAN STANLEY**

The Board of Directors  
SSE plc  
Inveralmond House  
200 Dunkeld Road  
Perth  
Perthshire PH1 3AQ

27 June 2018

**Quantified Financial Benefits Statement by SSE plc**

We refer to the quantified financial benefits statement, the bases of belief thereof and the notes thereto (together, the “**Statement**”) set out in Part A of Appendix 1 of this Circular dated 27 June 2018, for which the Board of Directors of SSE (the “**Directors**”) are solely responsible under Rule 28.1(a)(ii) of the City Code on Takeovers and Mergers (the “**Code**”).

We have discussed the Statement (including the assumptions, accounting policies, bases of calculation and sources of information referred to therein), with the Directors and those officers and employees of SSE who have developed the underlying plans as well as with KPMG LLP (“**KPMG**”). The Statement is subject to uncertainty as described in Part A of Appendix 1 of this Circular and our work did not involve an independent examination of any of the financial or other information underlying the Statement.

We have relied upon the accuracy and completeness of all the financial and other information provided to us by or on behalf of SSE and/or innogy SE (“**innogy**”), or otherwise discussed with or reviewed by us, and we have assumed such accuracy and completeness for the purposes of providing this letter.

We do not express any view as to the achievability of the quantified financial benefits identified by the Directors.

We have also reviewed the work carried out by KPMG and have discussed with it its opinion addressed to you and us on this matter and which is set out in Part B of Appendix 1 of this Circular, and the accounting policies and bases of calculation for the Statement.

On the basis of the foregoing, we consider that the Statement, for which the Directors are solely responsible, for the purposes of the Code, has been prepared with due care and consideration.

This letter is provided to you solely in connection with Rule 28.1(a)(ii) of the Code and for no other purpose. We accept no responsibility to SSE, innogy or their shareholders or any person other than the Directors of SSE in respect of the contents of this letter. We are acting exclusively as financial advisers to SSE and no one else in connection with the Combination of SSE Energy Services and npower and it was for the purpose of complying with Rule 28.1(a)(ii) of the Code that SSE requested Credit Suisse International and Morgan Stanley & Co. International plc to prepare this report on the Statement. No person other than the Directors of SSE can rely on the contents of, or the work undertaken in connection with, this letter, and to the fullest extent permitted by law, we expressly exclude and disclaim all liability (whether in contract, tort or otherwise) to any other person, in respect of this letter, its contents or the work undertaken in connection with this letter or any of the results that can be derived from this letter or any written or oral information provided in connection with this letter.

Yours faithfully,

Credit Suisse International and Morgan Stanley & Co. International plc

