Prepared for competition

We are committed builders of businesses, in electricity and utility-related markets, determined to deliver outstanding performance.

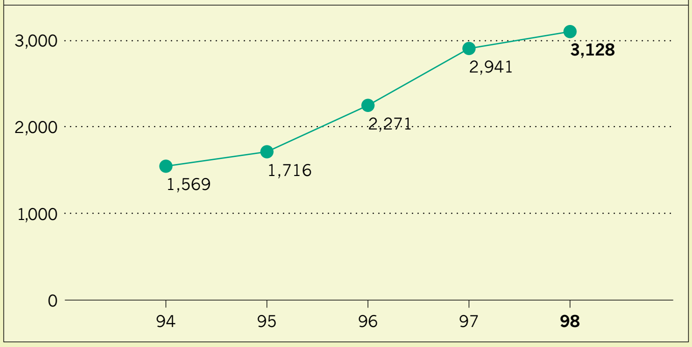
Note
The company is required to prepare and publish separate accounts for its regulated businesses in accordance with its Licences. Copies of the Scottish Power plc, Manweb plc and Southern Water Services Limited regulatory accounts may be obtained on request from the Company Secretary at the company's registered office.

Financial Highlights 1997-98
Another year of very satisfactory operating and financial performance.

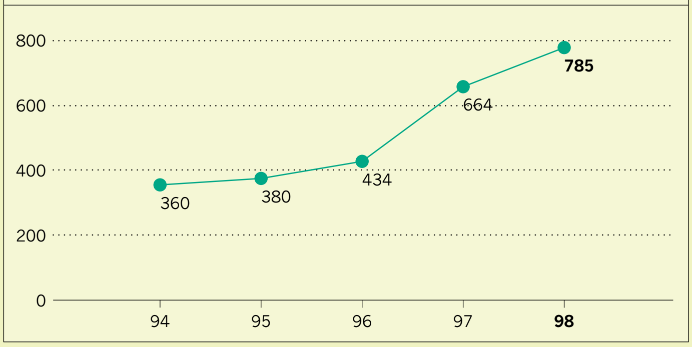
	1998 £m	1997 £m
Turnover	**3,128**	2,941
Operating profit	**785**	664
Profit before tax	**640**	558
Free cash flow*	**707**	573
Earnings per share*	**41.28p**	38.11p
Dividend per share	**20.40p**	18.50p

* 1998 figure quoted before windfall tax

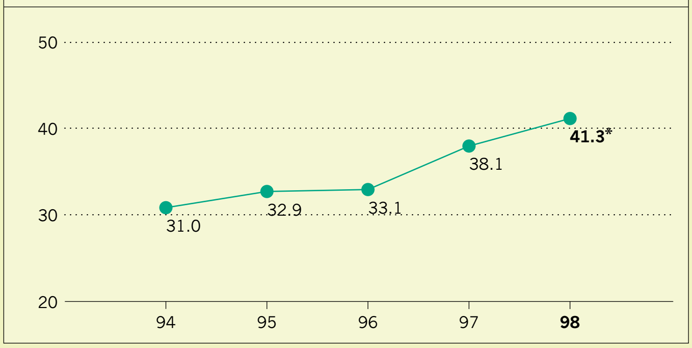
Turnover £m — Increase over five years **99%**



Operating Profit £m — Increase over five years **118%**

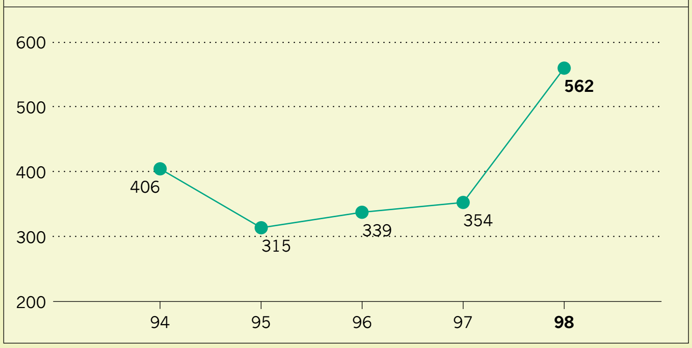


Earnings per share pence — Increase over five years **33%**



* 1998 figure quoted before windfall tax

Share price pence* — Increase since 31 March 1994 **38%**



* Price at 31 March. Share prices prior to 1997 have been adjusted to reflect the rights issue in August 1996

– Good financial performance.

– Delivering efficiency savings and value from acquisitions.

– Growing the business.

Chairman's Statement

ScottishPower is now a substantial multi-utility group, with a customer base of five million homes across the UK, strongly positioned both operationally and financially, delivering benefits for customers and enhanced returns for shareholders.

Murray Stuart
Chairman

In my statement last year I referred to the challenges created by rapid change affecting the utility sector. In the year ended 31 March 1998 ScottishPower has met these challenges strongly, in each and every part of its wide-ranging business. We have also substantially completed the transition plans designed to deliver value from both Manweb and Southern Water.

We have created one of the largest investor-owned electricity companies in the world, with a market capitalisation of around £6 billion and a customer base of five million homes in the United Kingdom. Across the group there is a wide range of skills. In addition to our energy and water activities, our other businesses – ScottishTelecom, Retail, Contracting Services and Technology – have now grown into significant businesses in comparison with competitors in their own sectors.

The new enlarged scale and scope of our business has been recognised in the success of our listing during the year on the New York Stock Exchange.

As well as continuing to drive for growth in our UK businesses, we are exploring international opportunities in the electricity sector. We are focusing in particular upon the United States, where we believe the cultural fit and the likely development of UK-style industry restructuring and convergence may offer opportunities to deliver value by applying our core skills. We shall only proceed if we see the opportunity to add substantial value for ScottishPower shareholders.

Financial results

I am pleased to report another very satisfactory year of operating and financial performance, as reported before deducting the provision for windfall tax. Group turnover increased from £2.9 billion to £3.1 billion, an increase of 6.4%. Pretax profits were £640 million, an increase of 14.5% over the previous year. Earnings per share, before windfall tax, at 41.28p were up 3.17p or 8.3%.

In the year, we further increased our investment to build the business, with capital expenditure totalling £630 million compared with £460 million in the preceding year, a growth of 37%.

Southern Water accounted for £295 million of the overall group investment. This is part of an ongoing £1 billion plus investment programme in the five years to March 2000. In addition, we are continuing to make very significant investments throughout ScottishPower and Manweb, particularly in the Generation, Power Systems and Information Systems businesses. A notable feature of investment in the year was a £58 million investment in growing ScottishTelecom. We expect to continue our major investment programme in the years ahead.

We are recommending a final dividend of 13.6p net per share which, together with the increased interim dividend, will result in a full year payment of 20.4p net per share, an increase of 10%. This increase is in line with our stated aim of growing dividends at 7% to 8% real per annum, until at least the regulatory reviews in the year 2000. This dividend is covered just over two times by earnings before windfall tax.

At the year end, interest cover remained prudent at 5.3 times and our net borrowing was £1,953 million, giving gearing of 114% compared with 118% in the previous year. The borrowings at the year end were calculated after paying £158 million in windfall tax.

Value from acquisitions

We are very pleased with the progress of our programme to deliver value from Southern Water. We set ourselves an ambitious plan to achieve the operational efficiencies and customer service requirements we had in mind at the time of acquisition. I am pleased to say that this has resulted in operating cost savings of £28 million, some £3 million ahead of plan. We have also completed a disposal programme for the businesses we no longer require in Southern Water. This will realise £90 million, some £20 million ahead of our original target. The sale of surplus property has already reached just under the target of £30 million, with further sales scheduled in the year ahead.

In Manweb operational efficiency and customer service targets have continued to exceed our expectations. Operating cost savings post-acquisition total £98 million, some £6 million ahead of plan. The electricity operations of Manweb and ScottishPower have now been combined into an integrated energy business.

Energy markets

The UK electricity industry leads the world in electricity market liberalisation. The electricity supply market is scheduled to open to full competition in stages beginning in September 1998. This is a complex and demanding challenge for the businesses involved, as it provides energy competition for every home. It is a task which has created very significant pressures for the companies involved and for the regulators. The investments required of the industry have been substantial.

Our strategy as a multi-utility supplier is founded upon cross-selling electricity and gas, and in Scotland telecommunications, to our franchise customers. We are also seeking to grow outside our existing areas of operation both directly and in partnership with others.

The challenges of competition have resulted in the adoption of a common group identity, a substantial increase in our marketing activity and very significant investments in both customer capture and information technology infrastructure.

I am pleased to say that both ScottishPower and Manweb have been among the leaders in the industry in terms of systems development and, as a consequence, will be two of the first companies ready for the competitive market opening from September 1998 in electricity. We are also in the forefront of gas liberalisation. At the end of March 1998 we had 320,000 domestic gas customers and 15,000 industrial and commercial gas customers.

Water

Southern Water has not only succeeded in reaching our transition targets, it has also devoted great attention to strengthening its customer focus and improving services throughout the year. In terms of water supply we are one of the industry leaders for our low leakage rates and we responded positively to the Government's Water Summit targets.

We continue our major waste water investment programme and have completed, and commenced, large new capital projects during the year to improve bathing water quality along the south coast. There has also been significant upgrading and expansion of our existing systems and further investment to improve the capacity and flexibility of our water supply capability.

Telecommunications

ScottishTelecom has continued to grow rapidly. Our telecommunications network was developed during the year to extend our coverage from Central Scotland to Perth, Dundee and Aberdeen. Network build to cover the Highlands & Islands has also been started. Following the success of our growth in the corporate sector, we have successfully launched a residential service to domestic customers in Central Scotland and extended our mobile telecommunications business. Several focused acquisitions have led to the successful development of call centre and information services. The post year end acquisition of Demon Internet, the UK's largest independent Internet Service Provider, further enhances our comprehensive range of services for our customers.

Windfall tax

As noted previously, the results for the year, after providing £317 million for windfall tax, are significantly affected in their comparison with previous years. Gearing at the year end was 114% compared to 100% prior to the tax. The company will continue to bear the impact of the tax through higher interest costs in the coming years.

As your Board commented in the Interim Report published in November, we do not believe that our Scottish businesses achieved windfall profits on which such a tax was chargeable; however, after taking professional advice, the Board was satisfied that it should provide fully for the tax which was assessed at £317 million for the group as a whole.

Regulation

In the next two years our electricity and water businesses will be subject to major regulatory review. The Government's Green Paper on utility regulation, published in March 1998, put forward proposals for changes in relation to regulation and invited consultation. We are actively participating in this process.

Devolution

Your company continues to contribute actively to the devolution processes in both Scotland and Wales. We are convinced that devolution offers positive opportunities for your company. However, it is critical for the operational future of all businesses in Scotland and Wales that a 'level playing field' – particularly in areas of local planning, environment, regulation and business rates – is maintained across the UK.

Board and senior management changes

During the year it was announced that Mike Kinski, the executive director responsible for Power Distribution and Water Operations would be leaving to become Chief Executive of Stagecoach Holdings plc. Mike has made an effective contribution to our operations during his five years with us. Ian Russell and Duncan Whyte have become Chairman of Southern Water and Manweb respectively. They are supported by two very experienced operational Managing Directors, Ronnie Mercer at Southern Water and Bill Landels at Manweb. Charles Berry has assumed responsibility for Energy Supply.

In April 1998 Mair Barnes joined us as a non-executive director. Mair has a strong commercial background and significant experience in running customer focused businesses, including Vantios plc, the parent company of Dollond & Aitchison where she is Executive Chairman. We look forward to receiving the benefit of her counsel.

Customer service

During the year we have continued to invest in the development of systems which will enable us to deliver further improvements to customer service. We have also continued our focused programmes of training so that our

ScottishPower's Impact in the UK
Business Strategies Limited reviewed the 1996-97 activities of the ScottishPower group. Key findings of this report highlighted:
The group supports 1% of the UK economy, 153,000 full time equivalent jobs and contributes £5.6 billion in total annually into the UK economy
In Scotland the company supports 24,000 full time equivalent jobs and £1.2 billion annually into the Scottish economy
In the Manweb area the company supports 7,000 full time equivalent jobs and contributes £389 million annually into the local economy
In the Southern Water* area the company supports 8,500 full time equivalent jobs and contributes £475 million annually into the local economy
* estimates pre-disposal of non-core businesses
Source: 'Impact of ScottishPower' – Business Strategies Limited (December 1997)

employees are in a better position to offer enhanced service to customers. Our commitment to putting customers first is comprehensively sustained in each and every part of the business.

We experienced severe weather conditions in parts of our operations last Winter, when hurricane force winds caused extensive damage. This resulted in significant interruption of electricity supplies to customers, particularly in Wales and North West England. We are grateful for our customers' understanding of the difficulties and for the tremendous dedication shown by our staff to restoring service.

Again I would like to thank all our employees and management for their contribution to the success of the group during the year and in their commitment to customers.

Environment

The ever increasing drive towards making energy and water usage more sustainable presents many challenges for the group. Achieving the balance between affordable supplies whilst increasing the level of environmental protection will not be easy. The Government's target of reducing carbon dioxide emissions by 20% and the forthcoming revision of the Sustainable Development Strategy will alter the shape of our industry. ScottishPower is well placed to deliver the kind of solutions that the Government seeks. We are a major player in the renewable energy field and we have a strong track record in achieving energy efficiency in partnership with our customers.

Community involvement

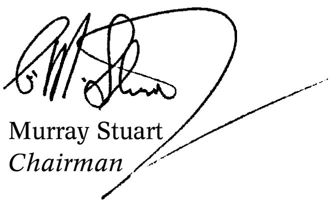
The company continues to be closely involved with the communities we serve, particularly through support and sponsorship in the fields of education, sport and the arts. ScottishPower Learning, a major commitment to education in partnership with the Trade Unions, has now extended its operations in association with the Government's programme of Welfare to Work. Our Chief Executive, Ian Robinson, is Chairman of the Scottish Advisory Task Force on the Welfare to Work programme.

Outlook

ScottishPower has established itself as a substantial multi-utility group, with a customer base of five million homes across the UK. We are strongly positioned in both operational and financial terms.

In the next year, we will be investing significant capital and revenue in the company to build long-term value for our shareholders.

Looking ahead, we foresee further changes in the utility industry, both at home and abroad, and continued challenges in terms of regulation and competition. The quality of our staff, and our experience to date in dealing with these issues, give us confidence that we will be able to turn these challenges into opportunities.



Murray Stuart
Chairman

Chief Executive's Review

ScottishPower and Manweb will be among the first to be ready for the opening of the domestic electricity supply markets. We are established as a leading competitor to British Gas in domestic gas supply in our three territories.

Ian Robinson
Chief Executive

The utility sector has entered a period of great change, not just here in the UK, but on a global scale. Liberalisation of energy and telecommunications markets provides choice for even the smallest customer. The resulting competition will produce winners and losers.

It is ScottishPower's aim to ensure that it emerges among the winners.

We believe that ScottishPower, already a leading UK utility, and ranked in the world's top 25 electricity companies by market capitalisation, can develop to become one of the world's foremost investor-owned companies in its sector.

To do so will demand an unequivocal commitment to quality, focus on our customers, and an agile management team determined to succeed in the developing market environment. ScottishPower has achieved great progress towards its declared aim of becoming a full multi-utility operator, delivering energy, water and telecommunications services to a growing customer base. We have succeeded in creating value from the acquisitions of Manweb and Southern Water. Today, ScottishPower supplies one or more of its services to some 20% of UK homes.

The group is on target to achieve 15% of the UK domestic electricity market, 12% of the gas market in our three main operating regions, as well as 10% of the Scottish telecommunications market, all by the year 2000.

Success will be measured not only in winning new customers, but also from the profitability of this new business. Technology, efficiency and customer service will play a major part in that success.

It will also depend on successful investment in our assets and new businesses. Capital investment is running currently at more than £600 million per annum, much of it on renewing and upgrading our infrastructure across the group, with significant investments being made to build the businesses and grow future earnings.

The Government has delayed the launch of electricity liberalisation until September 1998 to allow the industry to complete preparations for the complex systems required to achieve the free market. However, ScottishPower and Manweb were well advanced ahead of the original date of April, and were the first of 14 existing distributors to test and trial those systems. That is a tribute to the skills and effort of our key staff across the businesses.

The multi-utility strategy will help us grow our business and build greater value from our assets and activities. The company will continue to watch for acquisition opportunities both within the UK and abroad, where we can apply the skills developed in our existing businesses to add shareholder value.

Energy businesses

Energy Supply

A great deal of effort is aimed at improving our understanding of our customers and their needs. Electricity prices have come down in real terms over the last year. In Scotland, domestic customers have seen real price reductions with new electricity tariffs lower than those in 1974. In Manweb domestic tariffs are 6.7% lower in real terms compared with last year.

Customer service continues to be a high priority. Whilst complaints to OFFER in Scotland rose in May last year due to initial difficulties with the new call centre, performance since then has improved and the underlying trend from August 1997 is downwards. Manweb has improved its performance in this area by 38%.

In addition, both ScottishPower and Manweb achieved ISO9002 accreditation for reporting guaranteed standards.

Opportunities offered by energy market liberalisation are key to the group's strategy. The gas market throughout Great Britain was fully liberalised by May 1998, with electricity now scheduled to be completed by June 1999.

In domestic gas supply ScottishPower is established as a leading competitor to British Gas in its three territories. Total domestic customers acquired were 320,000 at 31 March 1998. The company's target is to establish a 12% market share in our three main operating territories by the year 2000.

Call centres for gas customers have been established in Glasgow and Warrington, and their activities are extending to cover competitive electricity supply later this year.

In the business sector, our target is to win large, multi-site customers and small and medium sized enterprises. One typical multi-site deal was with the leisure chain Bass plc, which has agreed to take ScottishPower gas at 2,700 sites nationwide.

'PowerSave' projects, involving shared savings schemes for small and medium sized businesses, were piloted in Merseyside and are now being rolled out to areas across the UK.

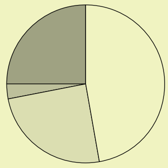
As domestic electricity markets open up in Autumn 1998, ScottishPower will adopt both defensive and offensive market strategies to protect sales in its existing marketplaces and to build new business elsewhere. Those companies that will succeed will differentiate themselves by providing innovative products and excellent customer service. The successful launch of the ScottishPower VISA card, the future development of 'lifestyle tariffs' and the introduction of a security scheme, whereby customers identify meter readers with a pre-arranged password, are examples of the many ways in which we are meeting the challenge both in our home territories and elsewhere.

Joint marketing initiatives provide access to new and untapped markets. During the year, affinity agreements were reached with Union Energy, the energy affiliate of the Trade Union Congress (TUC) representing Britain's seven million Trade Union members, and with the National Farmers Unions in Scotland and in England and Wales, offering competitively priced domestic gas and electricity to their 135,000 members.

Energy business facts

Contribution to group operating profit

Power Systems	£249.5m
Generation	£130.8m
Energy Supply	£15.1m
Manweb	£131.3m
Energy business total	£526.7m
Group total	£785.1m



Energy Supply
Customer base: electricity 3.2 million; gas 320,000 domestic, 15,000 business

Power Systems
Geographic area: ScottishPower and Manweb franchise territories
62,000 km of underground cables
50,000 km of overhead lines

Generation
Owned capacity: 3,570 MW
Available capacity: 6,400 MW

Ian Robinson with The Rt Hon Gordon Brown MP, Chancellor of the Exchequer, at the inauguration of the multi-utility infrastructure project in Fife.

Main Picture: The coal arriving at Longannet power station by rail.
Bottom left: Scottish coal arriving at Longannet power station from Longannet Mine.
Bottom right: Euclid vehicle moves coal from Longannet's reserve coal stocks.

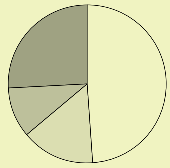
Power Systems

The group's Power Systems business is responsible for the distribution and transmission network in the ScottishPower franchise area and the distribution network in the Manweb area. Its prime business activities involve the provision of new connections and the development of the networks as well as refurbishment, maintenance and fault repair.

Energy business facts

Capital expenditure of Energy businesses

Power Systems	£142.1m
Generation	£43.7m
Energy Supply	£29.6m
Manweb	£74.7m
Energy business total	£290.1m
Group total	£630.1m



Below: Manweb's Power Systems engineers check power lines in Snowdonia

The integration of activities between ScottishPower and Manweb has contributed towards £10 million of greater efficiencies, as well as moving the company closer to the customer. The business accounts for a great deal of the group's overall investment programme, particularly as it prepares for full liberalisation of domestic electricity supply.

Much of this new infrastructure will be crucial to the company's multi-utility ambitions.

Apart from delivering electricity to its own customers, ScottishPower will also carry electricity and provide metering services for other suppliers in both territories, and significant progress has been made in training staff and completing appropriate new systems for 1998.

The Metering business has been re-structured in readiness for the removal of franchise markets and full liberalisation of supply. From the year 2000 onwards, the business will be open to competition. New terms and conditions were negotiated with staff, and the business achieved ISO9002 accreditation for its data collection system.

Investment projects include greater network automation, the installation of remote control and alarm systems at all main substations, and a new work and asset management system to improve inventory control and materials management. A business-wide bench-marking initiative, covering many areas common to ScottishPower and Manweb, reaped further savings in areas such as procurement and working practices.

The business has continued to target major inward investors. In addition, Power Systems succeeded in winning the contract to provide the connections to the LG electronics and semi-conductor plants in South Wales. In a joint venture with Rolls Royce, ScottishPower installed a Dynamic Voltage Restorer at the Caledonian Paper Mill in Irvine, Ayrshire. The system protects against supply anomalies which might jeopardise production. The first of its kind to be installed in Europe, it is also the largest in the world.

Supplies were disrupted over Christmas 1997, especially in the Manweb area, where hurricane force winds struck. We recognised the inconvenience that this caused our customers and pooled resources from across the group to minimise the period during which customers had no power.

Generation

ScottishPower benefits from a diverse range of power sources, including our own thermal and renewable generation, as well as nuclear, gas and hydro-electric capacity obtained via long-term contracts. The key aim is to reduce costs and maximise utilisation by increasing sales outside Scotland. The links to England and Northern Ireland are important for this. Final approval from the President of the Board of Trade for the upgrade of the North Yorkshire transmission line, clears the way for the upgrade of the Anglo-Scottish interconnector. In addition, approval for the construction of a link to Northern Ireland has been announced. Construction work on both links will begin as soon as possible. Once the two interconnectors are fully operational our electricity exports from Scotland are forecast to increase by 50%. This increased output will be provided from our existing low cost plant at marginal cost and without any significant new generation investment.

The company has awarded long-term contracts to its major Scottish coal suppliers for over three million tonnes per annum of low-sulphur, deep-mined and opencast coal, commencing on

The integration of activities between ScottishPower and Manweb has brought great efficiencies, as well as moving us closer to our customers. This has involved major investment in staff training and new technology.

Southern Water has improved its customer focus significantly since acquisition, a fact recognised by its achievement of the Charter Mark. Our customer base in the Southern Water area has enabled us to win 90,000 gas customers.

1 April 1998. These provide a significant reduction in costs which will assist in offsetting the downward pressure on customer prices and are key to extending the working lives of Longannet and Cockenzie stations to 2020 and 2010 respectively.

Our Energy Trading Centre manages the gas and electricity portfolio, enabling successful competition in wholesale markets. Our approach is to optimise an energy portfolio to create value from our generation and supply activities, maximising the benefits from our vertically integrated businesses.

This is a key competitive advantage for ScottishPower, which will be further strengthened by increasing our capability to store gas during periods of low demand. The proposed conversion of Hatfield Moors underground gas reservoir in Yorkshire for storage of approximately 4.1 billion cubic feet of gas, will provide a staging facility between ScottishPower's North Sea supplies and our customers.

New generation projects include a 400 MW Combined Cycle Gas Turbine station at Shoreham Harbour, a 50:50 joint venture with Central & South-West, the US parent company of SEEBOARD. The project has planning consent and is expected to be operational in the year 2000. Financial close on the project will take place in the Summer, when the final details of the financing, estimated at some £200 million, will be confirmed. A 59 MW Combined Heat and Power station at Blackburn, Lancashire, to supply the SAPPI UK Ltd paper mill, is awaiting planning approval.

Regulatory matters

During 1997-98 the electricity supply price review was successfully concluded with agreement on price protection for the next two years for ScottishPower's and Manweb's domestic customers. ScottishPower also reached agreement on the wholesale price for electricity in Scotland for the next two years. This maintains the linkage with the price for buying energy from the Pool in England and Wales, and restores allowances for system operation and security which were temporarily removed in 1997-98.

The company has also agreed with the regulator a delay of one year in the Scottish Transmission business price review, with transmission revenue for that year being allowed to increase at the rate of inflation.

ScottishPower is confident that the company's track record as an efficient, low cost operator will stand it in good stead in the developing regulatory environment.

Southern Water

Customers at Southern Water are benefiting from a range of new initiatives. Capital investment is averaging more than £5 million a week, reflecting our commitment to improve services to our customers in the one million premises for which we provide water and the 1.7 million premises for which we treat waste water. Improved customer service was recognised with the award of the Government's Charter Mark.

For the second successive year, Southern Water restricted price increases, resulting in a level 3% below that set by the regulator OFWAT for 1998-99. Our new 'Customer Charter' offers service level standards above those sought by OFWAT.

Southern Water will have delivered over £1 billion worth of investment in the five years to the year 2000. Customers have experienced a sustained improvement in services already.

Around 130 miles of water mains are being replaced or re-lined each year, and long-term planning includes the potential for expansion of reservoir capacity.

Among the UK water operators, the company has one of the lowest levels of water lost through leaks: 12.4% in 1996-97 with the target being to reduce this further to 10% by the year 2000. Last year 27.9 million gallons of water were saved each day – enough to supply two cities the size of Southampton – by plugging leaks.

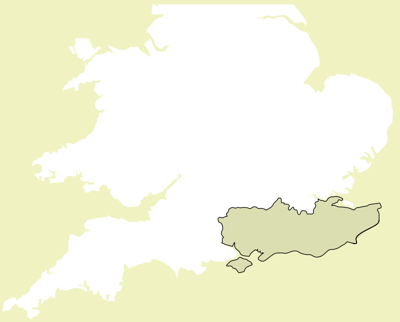
In May 1997, a £2 million state-of-the-art call centre, which now handles an average of 4,500 calls per day, was established at Worthing, West Sussex.

Waste water treatment

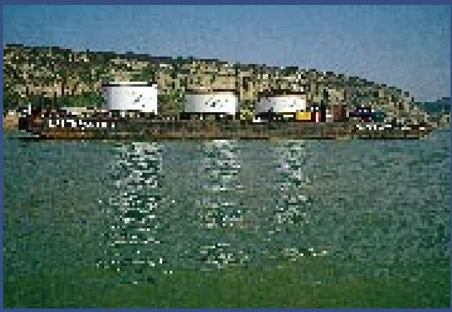
Investment continues to replace and upgrade waste water systems along the south coast. The number of beaches reaching European Union bathing standards has risen from 41% to about 90% since privatisation. In more than 1,500 independent tests during Summer 1997, 70% of bathing water tested 'excellent' and 28% 'good'.

The £42 million underground treatment works at Eastbourne was completed, in addition to works at Pennington in Hampshire and Hythe, Queenborough, Swalecliffe and Morestead in Kent. Improvements are under way at Dover and Folkestone, Hastings and Millbrook. One of Europe's largest storm water tunnels, three miles long, was completed under Brighton seafront.

Water facts



Territory
Kent, Sussex, Hampshire, Isle of Wight
Customer base
1.7 million premises
Services
Water supply for 2.2 million people, nearly one million premises.
Waste water treatment for 4.2 million people, 1.7 million premises.
Capital expenditure 1997-98
£295 million



Main picture: Giant tunnelling machine used to drill the mile long underground stormwater tunnel at Hastings arrives in sections at Hastings beach.
Far left: Barge carrying the drill from Germany arrives at Hastings.
Left: Welding the outfall pipe for the new Dover and Folkestone waste water treatment plant.

Telecommunications facts

Customer base
6% of Scottish corporate sector
18,000 residential customers in Scotland
60,000 mobile phone customers

Services offered
Fixed voice and data, mobile services, call centres, on-line and Internet access, residential packages, audiotext and personal numbering

Awards
ScottishPower group Business Commitment to the Environment Award 1997
Energy Supply Best TV Commercial in Scottish Advertising Awards 1997
Power Systems UK National Lighting Award 1997, Scottish Environmental Regeneration Award 1997, Environment Award for Engineers 1997
Generation RoSPA's Safety Professional of the Year Award
Southern Water Charter Mark for customer service excellence
ScottishTelecom Prestel won Internet Service Provider of the Year
Contracting Services British Safety Council National Safety Award, Royal Mail Gold Award for Cathcart Mail Room

New projects have been approved for the Isle of Wight, Portsmouth, Havant, Margate and Broadstairs.

Transition plan
Southern Water's activities have been restructured into the core areas of operations, technology and customer services. This has resulted in £28 million of operating cost savings in 1997-98, with a further £9 million forecast in the next year.

ScottishPower has now sold all of Southern Water's enterprise businesses due for disposal, which will realise £90 million, against a target of £70 million. The sale of surplus property has already reached just under the target of £30 million, with further sales scheduled in the year ahead.

Regulation
OFWAT's report for 1996-97 showed the company to be the only major water operator to have average or above average performance across all services. In the Autumn of 1999 the Water Regulatory Review will set prices for the period from April 2000 to 2005. A constructive relationship with OFWAT has been established following Southern Water's takeover by ScottishPower and is underpinned by the delivery of outputs, significant improvements in efficiency and a high quality of customer service.

In March 1998 Southern Water issued a £100 million variable rate bond to help fund capital expenditure and to provide a form of Stock Exchange listing. This had been requested by OFWAT at the time of the acquisition of Southern Water by ScottishPower. The Director General of Water Services has confirmed that the issue of the bond satisfies the undertaking given by ScottishPower and Southern Water at the time of the acquisition.

ScottishTelecom

Our telecommunications business has grown quickly since 1994. Organic growth, coupled with a focused acquisitions policy, has positioned ScottishTelecom strongly across the breadth of the communication business.

We now provide a wide portfolio of communication services ranging from fixed voice, data and mobile services to call centre services, on-line information and Internet access. We are leading the market with innovative tariff packages for these services.

The business moved into profit during 1997-98, meeting its target of £4 million. This figure is anticipated to increase during the year ahead.

The company has won the contract to service the 'virtual' University of the Highlands & Islands, connecting multiple remote sites, and will significantly develop the network around the Scottish Highlands & Islands at a cost of £35 million. The company is to expand its commercial business into the Manweb territory, beginning in Merseyside, and extending to Manchester and Staffordshire.

Telecommunications Services
The company has achieved a 6% share of the Scottish corporate sector, and growth is proving exponential. The company is winning a greater share of existing clients' telephony and data business. A campaign among small and medium sized enterprises has won 1,000 customers, each taking an average of five lines. More than 18,000 residential customers have signed up with ScottishTelecom and expansion of the fixed radio access (FRA) network continues in Edinburgh, Aberdeen, Stirling and Falkirk. The company provides packages of fixed and mobile telephony for domestic customers.

The merger with the Scottish interests of Martin Dawes Telecommunications Ltd. under the ScottishTelecom brand in September 1997 was followed by the acquisition in February 1998 of the Vodafone dealer Pinnacle Cellular. We now have some 60,000 mobile phone customers, making ScottishTelecom the largest independent mobile service provider in Scotland.

Main picture: ScottishTelecom is laying fibre optic cables across Kessock Bridge, Inverness as part of the project to significantly develop the network around the Scottish Highlands & Islands.
Bottom left: Dunain Hill transmitter overlooking Inverness.
Bottom right: New customers can sign up for ScottishPower gas via the Internet.

Main picture: New Retail distribution centre at Mossend in Lanarkshire.
Bottom left: ScottishPower is already successfully marketing gas in its three operating regions and from June 'dual fuel' packages will be on offer to our customers.
Bottom right: Contracting Services upgrading lighting at British Aerospace, Broughton near Chester.

The group has invested heavily in staff training and development of new systems in readiness for the competitive energy market. ScottishPower has raised its profile throughout Britain with 174 electrical retail stores now trading.

The CallCentre Service
The Teledata acquisition in 1996 provided a platform in the call centre sector, and the company intends to grow by acquisition as well as building on existing strengths.

The company designs and manages a variety of services, including telesales, technical help desks, information and enquiry lines.

This is a growing market sector. Many companies, especially in financial services, computer hardware and software, are turning to third party providers like ScottishTelecom to manage call centre services. Our clients include Microsoft, Compaq and the US Embassy.

The Information Service
Scotland On-Line, our joint venture with publisher D.C. Thomson & Co. Ltd, is now established as the largest Scottish-based provider of information services. It should move into profit during the year ahead.

Commercial services include Scottish Golf which will, among other things, allow tourists to book golfing holidays via the World Wide Web.

The post year end acquisition of Demon Internet, the largest independent Internet Service Provider in the UK, for £66 million puts ScottishTelecom into a leading position in the rapidly expanding Internet market.

The acquisition of Megafone UK Ltd further strengthens our position as the UK's largest operator of automated call handling facilities. Other services in this area include the provision of branded services such as WeatherCall, CityCall, RaceCall, MarineCall and the football ClubCall Service.

Retail
The Retail division has opened 18 new superstores, increasing selling space by 132,000 square feet and broadening its presence across the UK.

A new Scottish distribution centre at Mossend in Lanarkshire will improve delivery service, complementing the existing centre at Castleford in Yorkshire. Our network of 174 stores is being supported by a vastly improved infrastructure. New technology is enabling faster point-of-sale procedures and better management information across the network.

Looking ahead, we are consolidating our position as the UK's third largest electrical retail chain.

Technology
The Technology business provides engineering and technical services to a range of internal and external customers. Internal activities have varied from assisting the creation of ScottishTelecom's FRA system, to gas power station projects and refurbishment of retail stores.

External business has included the transfer of a 20 MW steam turbine from British Steel's former Ravenscraig works to Scunthorpe and the re-design of a pumping scheme for the Royal Docks in London.

Contracting Services
The Contracting Services business has completed the integration of its activities with those of Manweb Contracting. The operation is one of the biggest and most profitable of its kind in the industry, employing over 900 staff.

Key projects include a new sub-station and distribution network at ICI Films Melinex plant (since acquired by DuPont) in Dumfries and several upgrading contracts at British Aerospace, Broughton, plus the illumination of the apron for the so-called 'Beluga' transporter which carries completed Airbus wing-sets to France for assembly. A major lighting refurbishment was also undertaken at Rolls Royce Motors, Crewe.

The business has continued to provide services to local authorities, including various projects for West Dunbartonshire, Dumfries & Galloway, and Borders Councils.

Information Systems
Integrated information systems are vital to our ambitions to develop as a multi-utility group.

The Information Systems Division is heavily involved in helping the group's other businesses prepare for energy supply liberalisation, especially in the creation of the multi product billing, energy trading and 1998 systems. Asset management systems have also delivered significant savings for the Power Systems business.

The group has invested £21 million in its IT infrastructure which now delivers 40 times more computing power than that available three years ago.

The group has already made substantial progress towards achieving Year 2000 compliance and expects to be ready in good time, ensuring that its systems avoid the pitfalls of the so-called 'millennium bomb' affecting computers and other machinery.

ScottishPower has achieved the IBM 'e-business mark', a fast developing standard for electronic commerce. It will be one of the first UK utilities to offer customers the opportunity to pay power, telephone and water bills via the

ScottishPower Retail
174 outlets, including 18 new superstores opened in 1997-98

Main picture: Southern Water last year helped around 40,000 children learn to swim.
Left: ScottishPower is making pioneering use of the Internet to enable organisations who dig up roads to log onto a new £6 million 'electronic map' of the company's electricity network.

Internet. New gas customers can already sign up via the World Wide Web.

Multi-utility

We have extended the range of utility services we offer our customers and have continued to build on the combined strengths of our energy and telecommunications businesses. These factors have enabled us to build a supply business, offering multi-utility services to the domestic market and to take advantage of multi-utility infrastructure projects.

Our infrastructure projects, which bring together our experience in electricity, gas, telecommunications and water, are proving attractive to developers of new industrial and commercial sites throughout the UK.

Gas competition has been achieved throughout Great Britain, and the electricity market should open in tranches from this September. We are already successfully marketing gas in our three operating regions and we will be marketing 'dual fuel' packages to customers from June of this year.

Good progress has been made in the areas which support the delivery of our multi-utility strategy. The initial phase of our multi product billing system which will meet our billing requirements into the next century, was rolled out in April 1998. ScottishPower will be one of the first utilities to offer fully integrated billing, account management, credit management and customer service systems.

A work management system will be implemented from June to allow us to read both electricity and gas meters on a single visit. The Metering business is already providing the Energy Supply business with opening readings for its new domestic gas customers in Scotland. We now have one of the most efficient metering businesses in the UK, with other organisations benchmarking against us.

Another future development will be the 'Virtual Customer Service Centre' which will enable customer service enquiries to be received and dealt with by any of Energy Supply's three Customer Service Centres at Glasgow, Warrington and Rhostyllen, through an integrated IT and telephony system.

Using the skills acquired in waste water treatment from Southern Water, combined with our extensive asset base in Scotland, we have been chosen as preferred bidder for two planned waste water treatment centres serving most of Glasgow. The centres, which are to be built and operated under the Government's Private Finance Initiative, will de-water and dry the sludge to form granules which we intend to burn with coal at Longannet power station.

Looking towards building business for the future, a 'Smart Home' was created to provide customers with a practical demonstration of energy management and utility transaction services. The 'Smart Home' concept further supports our objective of providing customers with new services which engender loyalty and deliver value.

Employees

If ScottishPower is to achieve its ambitious goals, it will do so as a result of the high quality of its management at every level of activity, and of a workforce which understands the company's aims and perceives the value of participation. Our staff are key stakeholders in ScottishPower's future success.

Our Open Learning facility supports personal development across the group. Established partly to encourage the concept of 'life long learning', it is in its fifth year, providing support for thousands of staff in 46 centres in the group's territories. It offers around 700 programmes, ranging from languages to vocational qualifications to degrees. Around 50% of our 15,000 employees and over 1,000 family members have participated. Other activities range from encouraging participation in The Prince's Trust volunteer projects through external links and secondments, to a business leadership programme developed with the renowned Wharton School at the University of Pennsylvania.

Nearly 200 senior managers have taken part in 'values' workshops, which develop an understanding of the company's 'values' programme. Over 30 staff have graduated from the group's MBA programme, with a further 56 currently participating in the course.

We take the health of our staff seriously and our occupational health team provide a leading edge service across the group. We encourage staff to use the company's Wellscreen service with its voluntary, confidential health screening facility. To date this service has only been available to ScottishPower and Manweb employees, 40% of whom have taken advantage of this facility. In addition, we have introduced a state-of-the-art fitness centre at Cathcart, Glasgow, with similar centres already in operation or planned in our regions.

Community

ScottishPower's publicly stated values include a commitment to earn the trust and respect of communities in which we operate.

Our programme includes supporting education and employment initiatives, charities and caring organisations representing children and young people, people with disabilities, older people, and the disadvantaged. In addition, we sponsor the performing arts, sport and recreation.

ScottishPower Learning is a separate business and is managed as a joint venture with the Trade Unions to provide personal development opportunities for staff and the communities in which we operate.

Over the past year, ScottishPower Learning has supported over 350 young and adult unemployed people nationwide on a variety of training programmes including areas as diverse as customer service and water leak detection.

Young people aged 16 to 25 have participated in pre-vocational training courses run by ScottishPower Learning

ScottishPower's commitment to the communities it serves spans a broad range of activities, helping both young and old.

in partnership with a number of community organisations, including The Prince's Trust.

Through ScottishPower Learning, the company is an active participant in the Government's Welfare to Work programme.

There are many examples of how ScottishPower 'lives its values'. In Power System's Southern Region, 240 staff gave over 2,000 hours of service to the community during the year.

Manweb is working closely with local groups in Shropshire, recruiting volunteer Power Wardens who become the communication link to the company's emergency team in the event of serious loss of supply in bad weather.

ScottishTelecom developed a web site for the Scotland Against Drugs campaign, whose programme in Scotland's 2,400 primary schools is being supported by ScottishPower. Company teams are working with emergency services in a nationwide project, which seeks to make children more aware of personal safety and to foster good citizenship.

The introduction of a Welsh language scheme within Manweb in May 1997 was approved by the Welsh Language Board and is attracting interest from other organisations.

Environment

ScottishPower believes firmly that a sustainable energy strategy must involve a balanced fuel mix, further development of renewable energy, active encouragement of energy efficiency and adoption of clean-up technologies.

Each area of activity has strict targets for environmental improvements, varying from the recycling of packaging in Retail to reductions of waste in engineering operations.

These challenging targets, which are detailed in our 1998 Environment Report, have been set to reflect the continued move towards sustainable development.

The company's energy efficiency programme has contributed to saving several hundreds of thousands of tonnes of emissions of the 'greenhouse gas', carbon dioxide. An integral part of the company's environmental position, the effort includes campaigns to raise awareness among staff and customers. Research will continue to play an important role. One example is the 'gas reburn' project at Longannet power station in Fife. A £28 million initiative backed by the European Union, it was commissioned formally by The Rt Hon Donald Dewar MP, Secretary of State for Scotland, in November 1997.

Combined Heat and Power schemes, involving the creation of local power supplies to large premises, for example large manufacturing plants with heavy energy needs, represent a decentralising of bulk power and significant energy and cost savings.

ScottishPower believes that 'renewables' such as wind power, small scale hydro plant, farm waste, forest residues and waste combustion provide substantial promise as supplementary power sources.

Southern Water's considerable investment expenditure has important environmental implications, whether in improving waste water treatment, repairing leaks or other infrastructure projects.

A major programme of regional sewage sludge centres is under way, delivering high quality compost for agriculture. Southern Water opened a farm to demonstrate the value of recycling sewage sludge as a soil conditioner and fertiliser.

The company is on target to phase out sea disposal of sludge by the end of 1998, and end landfill and liquid disposal and the production of untreated sludge by the year 2000.

The company's 10th annual 'Pond Week' saw more than 1,200 volunteers clean, restore or create more than 100 ponds. Over the last 10 years 600 ponds have been worked on. Salmon have been found in the River Medway for the first time in more than 100 years, an indication of the improving state of our local waters.

ScottishPower's environmental record was recognised in the Business in the Environment Survey of FTSE 100 companies, where again we secured a position in the top quintile for our environmental performance and communications.

Safety

Safety is of paramount importance to the company, and several initiatives have been introduced throughout the business to encourage best practice. We met our annual target of a 25% reduction of lost-time accidents during 1997-98.

The company received 12 gold awards from the Royal Society for the Prevention of Accidents in 1997, as well as the Eagle Star Training Award in recognition of our commitment and high levels of staff training. We are extending the number of Trade Union appointed safety representatives, 59 of whom were trained this year.

ScottishPower publishes separate reports on the Environment and the Community. These are available on request from the Company Secretary.

The way ahead

ScottishPower is well positioned to become a world-class multi-utility, and we are committed to building value for shareholders. The benefits of our success apply to all our other stakeholders, including customers, employees and the communities we serve. The company has undergone sweeping change since privatisation, and we can look forward with confidence to the challenges ahead.

Ian Robinson

Ian Robinson
Chief Executive

Main picture: Porthdinllaen National Trust village in North Wales where overhead lines were replaced by underground cables. **Left:** Testwood Lakes Reservoir near Southampton, building and landscaping project for two reservoirs, one already complete.

Financial Review

The results demonstrate yet again a satisfactory financial performance for the group. We have achieved good profit and cash growth, before the windfall tax. Interest cover and dividend cover remain prudent.

Ian Russell
Finance Director

Group financial results
Group turnover grew during the year by £187 million to £3,128 million, an increase of 6.4%. This was due mainly to a full year's revenue from Southern Water and growth in our developing businesses, especially ScottishTelecom where sales more than doubled. Sales in our energy businesses were maintained, despite lower prices to our customers due to tariff reductions, competitive pricing in the second tier market and lower volumes which resulted from the exceptionally mild winter. Offsetting this, gas sales were up by over 200% to £60 million, reflecting our continuing success in gaining new customers in that market.

The rise in overall turnover together with continued strong control over operating costs led to good growth in earnings before interest, tax and depreciation ('EBITDA') up £142 million to £932 million, and higher operating profit of £785 million, up £121 million.

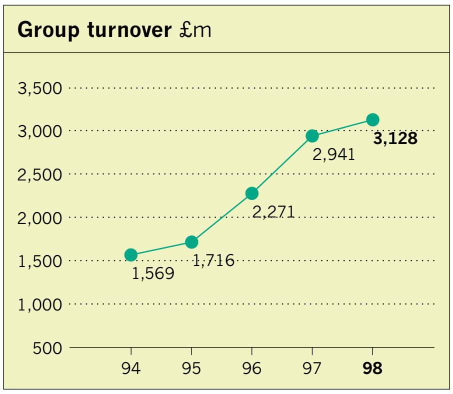
The net interest charge increased by £39 million to £147 million, mainly due to the full year effect of additional borrowings associated with the acquisition of Southern Water in August 1996 and the payment of the first instalment of the windfall tax in December 1997.

Profit before tax grew by 14.5% to £640 million. At £152 million, the ordinary tax charge represented an effective tax rate of 23.7%, down from 24.5% in the previous year. Provision has been made in full for the windfall tax on utilities announced in the July 1997 budget; the liability for the group has been assessed at £317 million.

Earnings per share before the windfall tax amounted to 41.28p, a rise of 8.3% on the equivalent figure last year. The recommended final dividend of 13.60p net per share brought the total dividend per share for the year to 20.40p net, an increase of 10.3%, in line with our stated aim of 7% to 8% real dividend

Financial Highlights	1997-98 £m	1996-97 £m
Turnover	**3,128**	2,941
Operating profit	**785**	664
Profit before tax	**640**	558
Free cash flow*	**707**	573
Earnings per share*	**41.28p**	38.11p
Dividend per share	**20.40p**	18.50p

* 1998 figure quoted before windfall tax



growth per annum, until at least the regulatory reviews in the year 2000, whilst maintaining a prudent level of dividend cover. The dividend cover remained at just over two times before the windfall tax.

Free cash flow for the year before windfall tax was £707 million, an increase of £134 million, reflecting the improved operating performance and good control of working capital. The group invested £630 million in capital projects during the year, £170 million more than in the previous year. This investment was primarily to improve the quality of the infrastructure assets in our electricity and water and waste water services businesses, and to grow our telecommunications business. The figures also reflect a full year of expenditure at Southern Water.

Net debt increased from £1,790 million to £1,953 million, mainly due to payment of the first instalment of the windfall tax of £158 million.

Gearing at 31 March 1998 reduced to 114% compared to 118% a year ago, despite the impact of part of the windfall tax. Excluding the effect of the windfall tax, gearing would have been 100%. Interest cover remained prudent at 5.3 times.

Group turnover

Group turnover of £3,128 million was £187 million higher than 1996-97, an increase of 6.4%. Total energy sales across the group were £2,280 million, the same as in the previous year. Lower sales as a result of the exceptionally mild winter, combined with competitive pricing in the second tier market and lower prices in the domestic market, were offset by increased sales in the emerging gas markets. Southern Water's contribution to group turnover increased by £136 million, mainly reflecting the inclusion of the first full year's trading. The group's developing businesses increased their turnover by £51 million, the majority of this in ScottishTelecom.

ScottishPower energy sales are shown in Table 1 in four market segments: first tier sales which represent the sale of electricity to customers in the Scottish franchise area; second tier sales by ScottishPower to customers outside the Scottish franchise area; wholesale, which is the sale of electricity to other electricity companies and to the Pool in England and Wales; and other energy sales, which include the sale of gas by ScottishPower in both the established commercial and industrial market and in the emerging domestic gas market in the UK.

First tier sales were £1,111 million, down £39 million on the previous year. Volumes were reduced (down 3.0% to 19,622 GWh) by the unusually mild winter in 1997-98 and lower sales in the competitive part of this market. In addition, prices were lower due to tariff reductions in the domestic sector and competition in the commercial and industrial sector.

Sales of electricity in the second tier market sector continued to grow with volumes increasing by 54%; turnover was £51 million higher at £153 million, reflecting our success in winning new customers. In addition, the further

Table 1 Energy external turnover	1997-98 £m	1996-97 £m	Change £m	Change %
ScottishPower				
First tier electricity	**1,111**	1,150	(39)	(3)
Second tier electricity	**153**	102	51	50
Wholesale electricity	**199**	196	3	2
Other energy sales	**163**	94	69	73
Manweb	**654**	738	(84)	(11)
Total	**2,280**	2,280	–	–

Table 2 Group operating profit		1997-98 £m	1996-97 £m	Change £m
Generation Wholesale	Generation	**122.9**	132.0	(9.1)
	Wholesale	**7.9**	14.1	(6.2)
Power Systems	Transmission	**80.1**	77.3	2.8
	Distribution	**169.4**	150.7	18.7
Energy Supply	First tier electricity	**38.0**	39.4	(1.4)
	Second tier electricity	**(3.8)**	(3.2)	(0.6)
	Other energy sales	**(19.1)**	(3.8)	(15.3)
Scottish energy businesses		**395.4**	406.5	(11.1)
Manweb		**131.3**	135.0	(3.7)
Southern Water		**240.7**	114.4*	126.3
Developing businesses		**17.7**	8.0	9.7
Total		**785.1**	663.9	121.2

* 8 months from date of acquisition and after reorganisation costs of £21.2 million

combination of the ScottishPower and Manweb sales forces led to all new customers contracting with ScottishPower.

Wholesale turnover also increased in the year, up 2% to £199 million where the effect of lower export volumes, down 4% to 5,607 GWh due to system constraints in the first half of the year, was offset by higher agency sales.

Other energy sales increased by £69 million to £163 million, mainly as a result of our success in winning customers in the new domestic gas markets.

Manweb's energy turnover for the year was £654 million, a fall of £84 million or 11% compared to the previous year. Distribution income reduced as a result of the regulatory pricing formula, and the benefits of lower costs were passed on to domestic and business customers through reduced tariffs. In addition, the combination of the ScottishPower and Manweb sales forces led to all new industrial and commercial customers contracting with ScottishPower.

Southern Water's contribution to group turnover increased by £136 million to £453 million primarily as a result of the full year effect. Turnover in the core business increased to £420 million, an increase of £21 million compared to the equivalent full year in 1996-97, due to higher prices to fund the capital expenditure programme. In the non-core businesses, turnover for the full year fell by £43 million, as expected, due to the business disposals achieved during the year.

The group's *developing businesses* increased their turnover by £51 million to £396 million. Most of the increase reflected the continued expansion of ScottishTelecom through further organic growth and acquisitions. External turnover in ScottishTelecom increased by 122% to £82 million and total turnover by 111% to £113 million. The Retail business, despite the poor market conditions during the year, increased its turnover by £7 million to £274 million due to new store openings and increased sales of multimedia; however like-for-like sales fell by 4%.

Group operating costs

The 6.1% increase in cost of sales to £1,851 million compared favourably with the 6.4% increase in turnover, reflecting the continued focus in the group on cost control and improved efficiency. Cost of sales in the energy businesses increased due to the higher gas and second tier sales volumes, offset by reduced other costs arising from benchmarking and cost initiatives.

Operating costs at Manweb were £24 million less than the previous year, beating our original target by £6 million. In Southern Water on a full year basis, after allowing for higher costs from new environmental obligations and capital schemes, operating costs fell by £28 million, £3 million better than target.

Costs in the developing businesses increased due to business expansion, especially in ScottishTelecom.

Transmission and distribution costs fell by £3 million year on year despite the impact of initial domestic gas customer capture costs in the gas business and the repair costs necessary as a result of the severe winter storms.

Allowing for restructuring costs in the prior year arising on the acquisition of Southern Water, administrative expenses reduced due to savings which offset increases arising through the expansion in our developing businesses, especially telecommunications. As with cost of sales, there is a continued drive on improving cost efficiency across all areas of our business.

Group operating profit

Group operating profit, as shown in Table 2, amounted to £785 million, an increase of 18% compared with 1996-97. Operating profit in the Scottish energy businesses fell by £11 million to £395 million, due mainly to reduced generation profits and customer capture costs in the emerging gas markets. These were offset in part by lower costs and increased profit in Power Systems, mainly due to lower costs and increased distribution revenues.

The profit in *Generation Wholesale* was £131 million in the year, down £15 million compared with 1996-97. The generation profitability was down £9 million due to reduced volumes, higher depreciation and a greater volume of 'must take' nuclear purchases. In wholesale, profit fell by £6 million reflecting lower export volumes, as a result of system constraints, and reduced margins.

The *Power Systems* business increased profit by £22 million to £250 million. Within this business, transmission increased operating profit by £3 million to £80 million with higher National Grid costs being more than offset by increased exit charges and savings from operating cost initiatives. The distribution profit increased by £19 million as a result of higher distribution revenues and operating cost savings.

In *Energy Supply*, first tier profit fell by £1 million due to reductions in prices and the impact of lower volumes as a result of the mild winter. Losses in the second tier market increased modestly to £4 million due to the competitive pressures in this sector. Actions to stem further second tier losses have been taken and much of the unprofitable business has now been surrendered. In other energy sales, the operating loss of £19 million reflects initial domestic customer gas capture costs of approximately £12 million, principally in the second half of the year.

Operating profit in *Manweb* decreased slightly by £4 million to £131 million. A fall in turnover was offset by a reduction in costs due to the implementation of the last stage of the acquisition transition plan. Total operating cost savings arising from the acquisition of Manweb now total £98 million compared to cost levels pre-acquisition of £176 million, and ongoing cost savings are £6 million better than the transition plan target.

Southern Water contributed an additional £126 million of operating profit arising mainly from the inclusion of results for a full year and cost savings of £28 million delivered by the acquisition transition plan in 1997-98, £3 million ahead of plan. Year-on-year, Southern Water's operating profit increased by 21% to £241 million from £200 million. All enterprise businesses are now sold and will realise £90 million, £20 million ahead of target. Property disposal proceeds have already reached just under the target of £30 million, with further sales scheduled in the year ahead.

Profits in the *developing businesses* were £18 million for the year, an increase of £3 million after removing the effect of £7 million of gas capture costs included in this segment last year. ScottishTelecom met the previously announced target of £4 million for the year from a break-even position last year. Retail's profit fell from £14 million to £9 million due to the difficult market conditions in this sector throughout 1997-98. The operating profits of the Contracting, Technology and other businesses improved from the prior year.

Interest and taxation

The net interest charge of £147 million was £39 million higher than in 1996-97 due mainly to the full year effect of increased debt following the acquisition

Group operating profit amounted to £785 million, an increase of 18% compared with 1996-97. Earnings per share before windfall tax were 41.28p, an increase of 8.3%.

of Southern Water in 1996 and the payment of the first instalment of the windfall tax of £158 million in December 1997. Changes to the group's debt portfolio were made during the year to manage the increasing trend of interest rates and extend the maturity profile of the group's borrowings. As a result, the average interest rate for the group during the year was 8.4%, slightly below that for 1996-97. Interest cover remained prudent at 5.3 times.

Profit before tax grew by 14.5% to £640 million, while the effective tax rate was reduced to 23.7% from 24.5% in the previous year. The decrease was mainly due to the reduction in the corporation tax rate arising from the July 1997 budget and the write back of Advance Corporation Tax, offset in part by the previous Chancellor's decision to reduce capital allowances on long life assets. Provision has been made in full for the windfall tax on utilities announced in the July 1997 budget. The liability for the group has been assessed at £317 million.

Earnings and dividends

The profit after ordinary tax for the year amounted to £488 million, an increase of £66 million or 15.7%. With a weighted average 1,180 million shares in issue and ranking for dividend during the year, earnings per share before windfall tax were 41.28p, an increase of 8.3%.

The recommended final dividend of 13.60p net per share brings the total dividend per share for the year to 20.40p net, an increase of 10.3%. The full year dividend was covered just over two times by earnings excluding the effects of the windfall tax. This increase in dividend is in line with our stated aim of achieving 7% to 8% real dividend growth per annum until at least the regulatory reviews in the year 2000, whilst maintaining a prudent level of dividend cover.

Capital expenditure

The group continued to increase investment in its businesses with net capital expenditure for 1997-98 of £630 million, an increase of £170 million over 1996-97. This reflected a full year's expenditure in Southern Water and the continued emphasis on development of infrastructure assets and growth in developing businesses.

Capital expenditure in *Generation Wholesale* was £44 million, with investment directed towards efficiency and environmental improvements and development of renewable energy resources. Further expenditure was incurred at Longannet and Cockenzie power stations to extend station lives.

In *Power Systems* Scotland, net capital expenditure for the year amounted to £142 million, an increase of £40 million.

£40 million was spent on modernisation of the distribution network and to improve quality of electricity supply to customers. Net expenditure on expanding the network to meet demand growth and on providing new connections to customers was £32 million. Over £35 million was invested in new systems for improving network management, the opening up of the electricity market to full competition and on enhancing customer service.

In transmission, over £34 million was invested on network modernisation and on expanding the network to support new business opportunities and inward investment in Scotland.

In *Energy Supply*, capital expenditure of £37 million mainly reflects further investment in new systems in preparation for the liberalisation of the electricity market later in 1998.

In *Manweb* net capital expenditure was £75 million. £36 million was spent on modernising the network to improve reliability and quality of electricity supply to customers. Net expenditure on expanding the network to meet demand growth and on providing new connections to customers was £15 million. The balance was invested in enhancing customer service and business systems for the competitive market.

Capital expenditure in *Southern Water*, including infrastructure renewals expenditure, amounted to £295 million. This compared with £212 million in the previous full year, of which £137 million was spent post-acquisition. The amount included £140 million as part of the ongoing programme to ensure compliance with the higher standards set by European Union Directives on the quality of bathing water, urban waste water discharges and sludge disposal. Investment was also undertaken to improve security of supply, increase the availability of water resources and reduce leakage.

In *developing businesses*, ScottishTelecom continued with its business development and during the year spent £58 million in total. Projects included the extension of its fixed radio access network and further development of its fibre optic network.

Cash flow

Net cash inflow from operations increased from £791 million to £987 million. This reflected the group's improved operating performance together with continued effective control over working capital.

Net interest paid was £45 million higher due to the acquisition of Southern Water in August 1996 and the payment of the first instalment of the windfall tax. This, together with an increase of £17 million in ordinary tax paid, resulted in free cash flow for the group before windfall tax of £707 million, £134 million higher than in 1996-97. From this was funded payment of windfall tax of £158 million and capital expenditure of £566 million, up £185 million on last year.

The disposal of non-core businesses and properties following the acquisition of Southern Water realised £89 million in cash during the year. Dividends paid to shareholders amounted to £226 million, up from £170 million last year.

Net debt at 31 March 1998 was £1,953 million, an increase of £162 million compared with a year ago, due mainly to the impact of the first instalment of the windfall tax. Gearing at 31 March 1998 was lower at 114%, down from 118% at 31 March 1997. Without the payment of the windfall tax, gearing would have fallen to 100%.

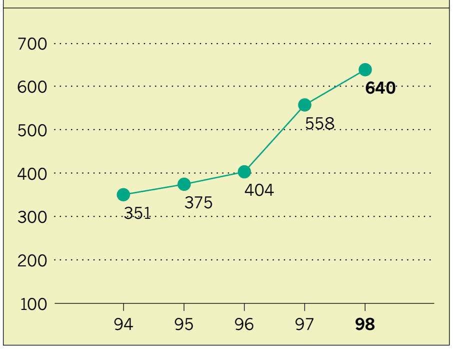
Treasury

The treasury focus during the year has been on refinancing the group's debt to extend maturities and protect the group's interest charge from adverse interest rate movements.

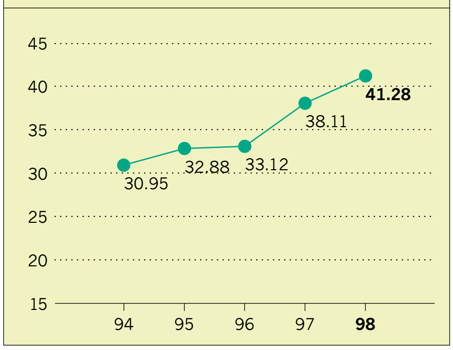
The group continues to ensure that net borrowings are financed from a range of competitive sources and that committed facilities are available both to cover uncommitted borrowings and to meet the financing needs of the group in the future. The group's credit quality is confirmed by long term credit ratings of Aa2/A+ and short term ratings of P1/A1 from Moody's Investors Service and Standard & Poor's respectively.

A number of changes were made to the group's debt portfolio during the

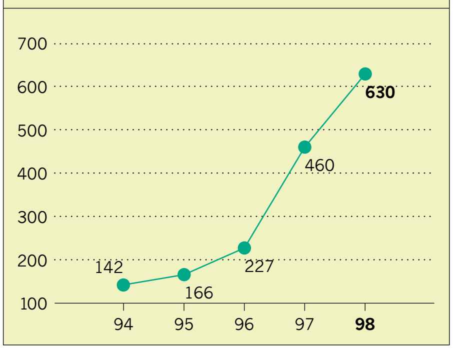
Group profit before tax £m



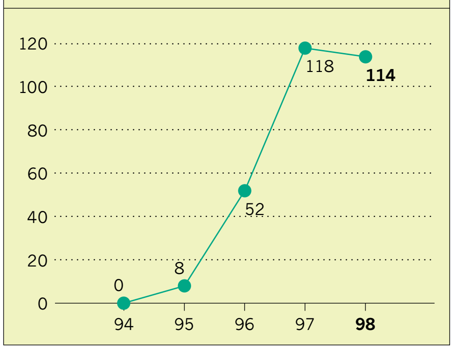
Earnings* per share p



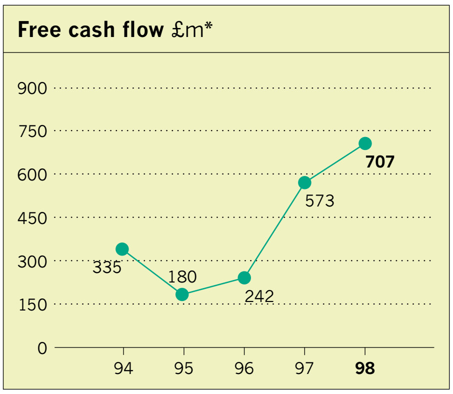
Net capital expenditure £m

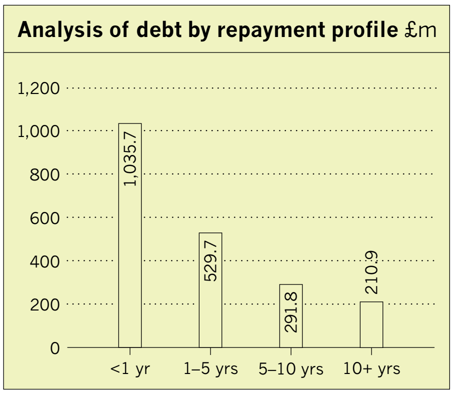


Gearing %



* 1998 figure quoted before windfall tax





year in order to extend the maturity profile of the group's borrowings. A $2,000 million Euro-Medium Term Note (EMTN) Programme was set up in November 1997. Under this mechanism a $300 million five year bond issue was launched in January 1998 providing a fixed rate in sterling of 6.95% and a number of smaller issues totalling £258 million had also been completed by the year end. In addition, two private placements totalling £45 million were arranged and a further £30 million was drawn from the European Investment Bank.

An issue of £100 million variable coupon notes due 2008, at an initial rate of 6.842%, was launched in March 1998. It is the first UK sterling bond of its kind and the Director General of Water Services has confirmed that its issue satisfies the undertaking given by ScottishPower and Southern Water at the time of the acquisition.

In order to manage the risk of exposure to fluctuating interest rates, the group maintains the majority of its debt at fixed rates of interest. This is achieved by a combination of fixed rate debt issues and the conversion of floating rate issues into fixed rate obligations by the use of interest rate swaps, interest rate caps and forward rate agreements. The group's use of such financial instruments relates directly to underlying indebtedness; no speculative or trading transactions are undertaken. The group treasury operates strictly within policies set out by the Board and is subject to regular examination by internal and external audits. At 31 March 1998, the interest rate on some 81% of debt was fixed and the interest rate on a further 10% of borrowings was capped. As a consequence of these measures, the group's average interest rate reduced during the year to 8.4% at a time when external interest rates increased.

The weighted average period of maturity of year end fixed debt and swaps was seven years, whilst the forward cover on capped debt was for an average period of some four years. Accordingly, changes in floating interest rates will have a limited impact on interest payable by the group for some years ahead.

The group has limited exposure to foreign currencies. Commercial paper and EMTNs issued in currencies other than sterling are fully covered by forward contracts to convert the debt into sterling. Certain limited imports of capital equipment and fuel are denominated in foreign currencies and the sterling cost of these is fixed by means of forward contracts as soon as the company's contractual commitment is known.

Accounting developments

During 1997, the Accounting Standards Board (ASB) issued FRS 10 'Goodwill and Intangible Assets' and this standard will apply to the group's 1998-99 accounts. In addition, the ASB recommendations on 'Interim Reports' will be adopted for the group's September 1998 half-year statements.

Looking further ahead, the ASB has issued a number of exposure drafts and discussion papers, including the accounting for deferred tax, and the group is an active contributor to this process. The impact of recent or proposed changes to accounting standards is generally to reduce reported earnings. However, these changes do not impact on the fundamental value of the group's business.

Year 2000

A group-wide Year 2000 Programme has been established to manage the effects the 'millennium' issue will have on the group's computer-based systems, equipment, services and products. The programme was established in recognition of the size and complexity of the group's operations and the need to maintain the integrity of its systems at all times, particularly those concerning safety and the provision of essential services to its five million customers. It builds on work carried out in 1995 to replace the group's mainframe-based IT infrastructure which anticipated and addressed many potential IT systems issues.

The group expects to achieve year 2000 compliance in good time and is also obtaining assurances on compliance from all critical suppliers, manufacturers and other utilities and operators with whom the group deals.

Compliance has already been achieved across a number of IT applications and the group is well advanced in the key task of identifying its most critical systems, determining solutions and preparing contingency plans to ensure it will be 'business as usual'. All critical systems will be addressed as a priority during 1998.

Our current estimate is that the total cost of the Year 2000 Programme will be approximately £30 million.

Many of the solutions the group is adopting have arisen through pooling experience with other utilities and large companies. The group is a leading player, for example, in the UK Y2K Interest Group and on KPMG IMPACT, which is supported by the major names in the generation, energy supply, telecommunications, manufacturing and finance sectors.

Summary

The financial results demonstrate a further year of satisfactory performance for the group, achieving good profit and cash growth before the windfall tax. The underlying tax rate reduced and interest rates incurred fell. Interest and dividend cover remain prudent and our gearing is lower than last year with debt tightly controlled. This is a good set of results maintaining the financial strength of the group to enable it to take full advantage of emerging opportunities.

Ian Russell
Finance Director

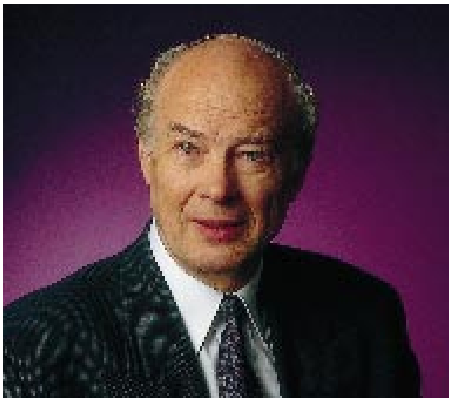
Murray Stuart
Chairman

Mair Barnes

Sir Ronald Garrick
Chairman of Audit Committee

Sir Peter Gregson

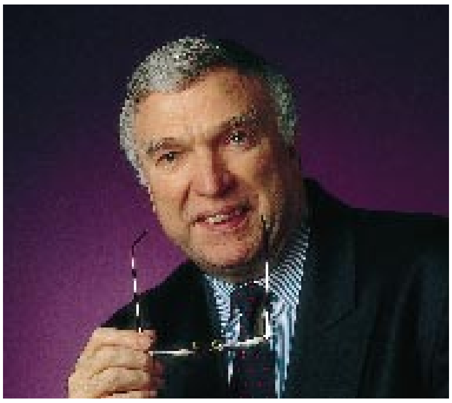
Ewen Macpherson
Chairman of Emoluments and Nominations Committee



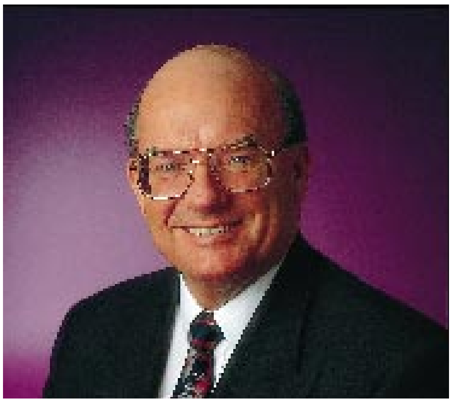
John Parnaby

Ian Robinson
Chief Executive

Ian Russell
Finance Director



Ken Vowles
Executive Director Generation and Energy Trading



Duncan Whyte
Executive Director Multi-Utility

Board of Directors

Non-executive directors

Murray Stuart CBE (64) joined the Board in March 1990 and was appointed Chairman in August 1992. He is a non-executive director of The Royal Bank of Scotland plc, CMG plc and The Royal Scottish National Orchestra Society Limited and Chairman of Intermediate Capital Group plc. He was awarded the CBE in 1995 for his services to the Audit Commission, of which he was latterly Deputy Chairman. He is Chairman of the Hammersmith Hospitals NHS Trust.

Mair Barnes (53) joined the Board in April 1998. She is Executive Chairman of Vantios plc, the parent company of Dollond & Aitchison, the opticians group. She is also a non-executive director of Abbey National plc and George Wimpey plc. She was previously Managing Director of Woolworths plc.

Sir Ronald Garrick CBE (57) joined the Board in February 1992 and is Chairman of the Audit Committee. He is Managing Director and Chief Executive of The Weir Group plc, the Glasgow-based international engineering company, and a non-executive director of Shell UK Limited.

Sir Peter Gregson GCB (61) joined the Board in December 1996. He was previously Permanent Secretary of the Department of Energy from 1985 to 1989 and then Permanent Secretary of the Department of Trade and Industry until his retirement in June 1996. He is a member of the Board of Companions of the Institute of Management.

Ewen Macpherson (56) joined the Board in September 1996 and is Chairman of the Emoluments and Nominations Committee. In July 1997, he retired as Chief Executive of 3i Group plc which he joined in 1970. He is also a non-executive director of Booker plc, Foreign & Colonial Investment Trust plc, The Law Debenture Corporation plc and M&G Group plc.

John Parnaby CBE (60) joined the Board in September 1994. He retired in October 1997 as Group Director and Director Geared Systems Inc. of Lucas Varity plc, having previously been Divisional Managing Director. He is a Past President of the Institutions of Electrical and Manufacturing Engineers, a member of the Council of the Royal Academy of Engineering, a member of the Senate of the UK Engineering Council and a member of the Management Committee of the UK Government Integrated Manufacturing Initiative.

Executive directors

Ian Robinson (56) was appointed Chief Executive in March 1995. He was previously with Trafalgar House plc where he was Chief Executive of John Brown and a main Board director. He is a Fellow of the Royal Academy of Engineering, a Fellow of the Institution of Chemical Engineers and a member of the Senate of the UK Engineering Council; he is a non-executive director of Asda Group plc and also serves as a member of the President's Committee of the Confederation of British Industry. In July 1997 he was appointed Chairman of the Scottish Advisory Task Force on Welfare to Work.

Ian Russell (45) was appointed Finance Director in April 1994. He is a member of the Institute of Chartered Accountants of Scotland, having trained with Thomson McLintock, and has held senior finance positions with Hong Kong and Shanghai Banking Corporation and Tomkins plc. His role encompasses both the financial direction of the company and its corporate strategy, together with responsibility at Board level for the company's information systems and corporate affairs; he is also Chairman of Southern Water plc and ScottishTelecom. He is a non-executive director of Scottish Investment Trust plc and Scottish Knowledge plc.

Ken Vowles (56) joined ScottishPower in September 1990 and was appointed to the Board in September 1994. He is Executive Director Generation and Energy Trading and is responsible in that capacity for the company's Generation Wholesale and Technology businesses, including the Energy Trading Centre, and at corporate level for safety and environmental policy. He has over 30 years' experience of the power generation industry, having previously served with the Central Electricity Generating Board and with National Power plc. He is a Fellow of the Institution of Electrical Engineers, a Fellow of the Institution of Mechanical Engineers and a Member of the Institute of Management.

Duncan Whyte (51) has been a director since March 1990, having previously been appointed Finance Director of South of Scotland Electricity Board in July 1988. In January 1993, he became responsible for the core electricity businesses; then, in November 1995, he was appointed Executive Director Strategic Development and, in August 1996, Executive Director Multi-Utility. In this latter capacity, he is now responsible for the company's multi-utility strategy, including its developing businesses in electrical retailing and contracting; he also retains responsibility at Board level for regulatory matters and is Chairman of Manweb plc. He was appointed as a non-executive director of Motherwell Bridge Holdings Limited in October 1997. He is a member of the Council of the Institute of Chartered Accountants of Scotland, and was formerly a managing partner in Scotland of Arthur Andersen and Finance Director of Kwik-Fit Holdings plc.

Report of the Directors

The directors are pleased to present their ninth Annual Report, together with the audited Accounts for the year ended 31 March 1998.

Results and dividend
The profit of the group for the year amounted to £170.1 million after providing for windfall tax of £317 million, details of which are set out in the Group Profit and Loss Account on page 42.

The directors recommend that a final dividend of 13.6p net per share be paid on 1 October 1998 to those shareholders whose names appear in the register of members on 5 June 1998. Together with the interim dividend of 6.8p net per share, which was paid on 6 March 1998, this makes a total dividend of 20.4p net for the year. These dividends amount in aggregate to £243.3 million and the deficit for the year of £73.2 million has been transferred from reserves.

Activities and review
The principal activities of the ScottishPower group are the generation, transmission, distribution and supply of electricity and the supply of water and waste water services. The group is also involved in wider utility businesses which include gas supply, telecommunications and electrical retailing as well as technology and contracting services.

Research and development
ScottishPower supports research into and development of the generation, transmission, distribution and supply of electricity and continually seeks more innovative and cost effective methods of carrying out its water and waste water activities. It also continues to contribute on an industry-wide basis towards the cost of research into electricity utilisation, distribution developments and water purification and waste water treatment.

Environmental policy
ScottishPower will publish its third Environment Report in July 1998. Throughout its operations ScottishPower will meet, or better, relevant legislative and regulatory environmental requirements and codes of practice. Details of the company's approach to the environment are contained on page 18. Copies of the Environment Report are available on request from the Company Secretary.

Board of Directors
The names and details of the directors of the company are shown on pages 28 and 29.

Mair Barnes joined the Board on 1 April 1998. Baroness Jay of Paddington resigned and Nick Kuenssberg retired as non-executive directors on 13 May and 23 July 1997 respectively. Michael Kinski resigned from the Board on 7 April 1998.

In accordance with the Articles of Association of the company, Mair Barnes retires from office at the Annual General Meeting and, being eligible, offers herself for election. Sir Ronald Garrick, John Parnaby and Ian Robinson retire by rotation at the Annual General Meeting and, being eligible, offer themselves for re-election.

Ian Robinson has a service contract terminable by the company upon two years' notice.

Directors' interests
Details of the directors' remuneration and service contracts are set out in the Report of the Emoluments and Nominations Committee on pages 35 to 37 and in Note 32 to the Accounts on pages 59 to 61.

Other than as disclosed therein, none of the directors had a material interest in any contract of significance with the company and its subsidiaries during or at the end of the financial year.

The directors' interests, all beneficial, in the ordinary shares of the company, including interests in options under the company's Executive and Sharesave Schemes and awards under the Long Term Incentive Plan, are shown on page 31.

Directors' and Officers' Liability Insurance
The company maintains liability insurance for the directors and officers of the company and its subsidiaries.

Share capital and options
As a result of the exercise of options under the employee Sharesave and Executive Share Option Schemes, a total of 5,456,313 ordinary shares of 50p each were issued during the year. The company also established a Qualifying Employee Share Ownership Trust and, on 13 March 1998, 13,930,075 ordinary shares were issued to the trustee (ScottishPower Share Scheme Trustees Limited) to hold in trust; these shares will be transferred on exercise to the holders of options granted under the Sharesave Scheme between 30 June 1993 and 20 June 1996. Accordingly, the number of ordinary shares in issue was 1,196,752,324 as at 31 March 1998.

During the year, options were granted to 5,133 employees under the ScottishPower Sharesave Scheme. No options were granted under the Executive Share Option Scheme, which was replaced in 1996 by the introduction of the Long Term Incentive Plan. Awards in respect of 729,854 shares were made under the Plan during the year, and these awards are subject to the achievement of specified performance criteria. Details are contained in Note 32 to the Accounts on pages 59 to 61.

Between 31 March 1998 and 6 May 1998, being the latest practicable date prior to publication of this report, a further 1,215,017 ordinary shares have been issued as a result of the exercise of options under the Sharesave Schemes.

At the Annual General Meeting of the company last year, shareholders granted authority to the directors to purchase up to 117,869,831 ordinary shares. The directors have not exercised this authority.

Directors' interests in shares	Ordinary Shares as at 31.3.98	Ordinary Shares as at 1.4.97	Share Options (Executive) as at 31.3.98	Share Options (Executive) as at 1.4.97	Share Options (Sharesave) as at 31.3.98	Share Options (Sharesave) as at 1.4.97	* Long Term Incentive Plan as at 31.3.98	* Long Term Incentive Plan as at 1.4.97
Murray Stuart	15,000	11,390	–	–	–	–	–	–
Sir Ronald Garrick	2,204	2,204	–	–	–	–	–	–
Sir Peter Gregson	870	837	–	–	–	–	–	–
Ewen Macpherson	5,000	5,000	–	–	–	–	–	–
John Parnaby	6,536	6,382	–	–	–	–	–	–
Ian Robinson	17,412	16,612	286,457†	286,457	6,581	6,581	105,379	51,533
Michael Kinski (resigned 7 April 1998)	3,125	3,125	–	31,855	5,972	5,972	70,655	36,809
Ian Russell	15,612	6,612	–	156,781	6,300	6,300	75,573	38,650
Ken Vowles	117,327	113,553	–	50,349	3,933	7,728	55,299	27,607
Duncan Whyte	28,612	24,045	–	44,865	2,223	6,018	68,196	35,889

As at 6 May 1998, being for this purpose the latest practicable date prior to publication of this report, there was no change in the interests of the directors then in office. Also as at this date and as at 1 April 1998, being the date of her appointment to the Board, Mair Barnes had no interests in the shares of the company.

* These shares represent, in each case, the maximum number of shares which the directors may receive, dependent on the satisfaction of performance criteria as approved by shareholders in connection with the Long Term Incentive Plan.

† The option for 286,457 shares held by Mr Robinson was exercised on 15 May 1998; Mr Robinson retains an interest in 40,000 of the shares allotted to him on exercise, thereby increasing his interest in ScottishPower shares as at that date from 17,412 to 57,412 shares. Details of all options held and exercised by directors, and details of awards made to directors under the Long Term Incentive Plan, are set out in Note 32 to the Accounts on pages 59 to 61.

Substantial shareholding

As at 6 May 1998, the company had been notified that Prudential Portfolio Managers UK Limited held 91,923,625 ordinary shares representing 7.67% of the issued share capital.

Employees

In order to achieve the objective of 'Working Together to Build Businesses' the group has corporate values under the following headings:

- well-earned customer loyalty
- enhanced shareholder value
- positive working environment
- trust of communities
- teamwork and leadership

The group has continued to strengthen awareness and practical application of its corporate values among staff and management. Within the businesses many initiatives have also been taken with the theme of 'Living the Values'.

Equal opportunity

It is the group's policy to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The group operates a career break scheme and is an active member of the Employer's Forum on Disability. ScottishPower hosted the first Employer's Forum Regional Briefing in Scotland on 16 April 1997 attended by representatives of companies throughout Scotland. The group is also a member of the Equal Opportunities Equality Exchange and the Women's Engineering Society which pursues the aim of promoting the study and practice of engineering among women. Equal opportunities training is an integral part of the overall equal opportunities strategy and specific courses have been developed and implemented in 1997-98.

Employee consultation and negotiation
The group has employee consultation and communication arrangements to encourage the involvement and interest of employees in the group and to develop an awareness of its business plans and objectives. These include local joint bodies, designed to provide regular discussions between management and staff representatives, and local annual conferences. The group's executive and managing directors and the recognised Trade Unions meet informally twice each year to discuss aspects of the business.

Divisional bargaining arrangements have been established to facilitate the development of terms and conditions of employment tailored to the diverse needs of the businesses and, through this, to provide employees with a greater involvement in local employment matters.

Health and safety
The group's safety strategy is based on a system of corporate determination of strategy, policy and standards with devolved responsibility for implementation and active leadership from the highest levels.

The group continues to manage its operations throughout the organisation to the highest health and safety standards in the interest of staff, customers and members of the public.

The group has a well established occupational health service and lifestyle health care programme, the provision of which is managed to the same degree and standards as the other core businesses. The employees therefore benefit from some of the best occupational health facilities in the United Kingdom.

Charitable and political donations
During the financial year donations made by ScottishPower and its subsidiaries for charitable purposes totalled £299,766. There were no contributions for political purposes.

Creditor payment policy and practice
The group's current policy and practice concerning the payment of the majority of its trade creditors is to follow the CBI's Prompt Payers Code. Copies are available upon request from the Company Secretary. For other suppliers, the group's policy and practice is to settle terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in accordance with its contractual and legal obligations. The group's 'creditor days' at 31 March 1998 were 34 days.

Auditors
Coopers & Lybrand have expressed their willingness to continue in office and a resolution to reappoint Coopers & Lybrand as the company's auditors will be proposed at the Annual General Meeting.

Annual General Meeting
The Annual General Meeting will be held at the Edinburgh Festival Theatre, 13/29 Nicolson Street, Edinburgh, on Wednesday 22 July 1998 at 11.00 a.m. Details of the resolutions to be proposed at the Annual General Meeting are contained in the Notice of Meeting.

One of the proposals to be considered at this year's Annual General Meeting is the amendment of the Memorandum of Association and the adoption of new Articles of Association. The proposed amendment to the Memorandum of Association is with respect to the statement of the company's objects to allow them to reflect more clearly the wider utility businesses. The existing Articles were adopted on 29 May 1991. In view of the entry of the company's shares into CREST, the electronic settlement system for shares in the UK, the directors consider it appropriate to make amendments to the Articles to ensure that they are consistent with the Uncertificated Securities Regulations 1995. The directors have also taken this opportunity to propose certain additional changes to the Articles to reflect current market practice and to bring the Articles into line with the requirements of the revised London Stock Exchange Listing Rules. Given the number of proposed changes to the Articles, the directors have considered that it would be administratively easier to adopt new Articles, based on the existing Articles, rather than to amend the existing ones.

Details of the more important differences between the existing and proposed form of Memorandum and Articles are set out in the Notice of Meeting, including the Explanatory Notes. Copies of the existing Memorandum and Articles and the proposed form of the Memorandum and Articles, highlighted to show the differences from their current form, are available for inspection during normal business hours on each day (other than Saturdays, Sundays and public holidays) until 22 July 1998 at both the company's registered office in Glasgow and at the offices of the company's solicitors, Freshfields, at 65 Fleet Street, London EC4Y 1HS.

By Order of the Board

Andrew Mitchell
Secretary

6 May 1998

Corporate Governance

The company has complied throughout the financial year with all the applicable provisions of the Cadbury Committee's Code of Best Practice.

Board of Directors

There is a well established division of authority and responsibility at the most senior level within the company through the separation of the roles of the Chairman and Chief Executive.

There are currently four executive and six non-executive directors (including a non-executive Chairman) on the Board.

The non-executive directors are from varied business and other backgrounds. Their experience allows them to exercise independent judgement on the Board and their views carry substantial weight in Board decisions. They contribute to the company's strategy and policy formulation, in addition to monitoring its performance and its executive management. The non-executive directors are appointed for a specific term and reappointment is not automatic. Each non-executive director's position is reviewed prior to the expiry of his or her term of office.

The Board meets on a regular monthly basis and has a schedule of matters concerning key aspects of the company's activities which are reserved to the Board for decision. The Board exercises full control over strategy, investment and capital expenditure. In addition, individual executive directors have specific responsibilities for such matters as health, safety, environment and regulation. All directors have access to the Company Secretary who is responsible for ensuring that all Board procedures are observed. Any directors wishing to do so, in furtherance of his or her duties, may take independent professional advice at the company's expense.

Board Committees

The Board has several standing committees: namely, the Audit Committee and Emoluments and Nominations Committee, whose membership is comprised of non-executive directors only, as noted on page 65, and the Chief Executive's Committee and Finance Committee. The purpose and functions of these committees are described below.

Audit Committee

The Audit Committee has a remit to review the company's accounting policies, internal control and financial reporting and makes recommendations on these matters to the Board for decision. It also considers the appointment and fees of the external auditors.

Emoluments and Nominations Committee

The Emoluments and Nominations Committee has a remit to determine the remuneration policy of the ScottishPower group, including the remuneration arrangements for executive directors and other senior executives and the operation of the company's bonus and incentive schemes. It is also responsible for reviewing the company's succession plans and makes recommendations to the Board on the appointment of directors. The Report of the Emoluments and Nominations Committee is set out on pages 35 to 37.

Chief Executive's Committee

The Chief Executive's Committee comprises the Chief Executive and other executive directors, together with the managing directors of the company's Power Systems, Energy Supply, Manweb and Information Systems businesses, the Chief Executive of ScottishTelecom and the Director of Corporate Affairs, Legal Director and Company Secretary. Operational control and implementation of group strategy and policy are responsibilities delegated by the Board to the Chief Executive who is supported by the Committee in the discharge of these functions. The Committee's terms of reference also include monitoring of the performance of the company's businesses against business plans agreed by the Board. Major issues and decisions are reported monthly to the Board.

Finance Committee

The Finance Committee comprises any two directors, one of whom shall be the Finance Director (or, in his absence, the Chief Executive). It is established for the purpose of dealing with certain treasury matters under authority delegated by the Board. The limit of its authority is in respect of borrowings and other obligations not exceeding £100 million.

Internal financial control

The Board of Directors is responsible for the group's system of internal financial control and for monitoring its effectiveness. It must be recognised that any such system can provide only reasonable and not absolute assurance of the safeguarding of assets, the maintenance of proper accounting records and the reliability of financial information. The key features of the control system which has been established, and which is designed to ensure effective internal financial control, are described below.

Control environment

The company is committed to ensuring that a proper control environment is maintained. There is a commitment to competence and integrity, and the communication of ethical values and control consciousness to managers and employees. Human Resources policies underpin that commitment by a focus on enhancing job skills and promoting high standards of probity among staff. In addition, the appropriate organisational structure has been developed within which to control the businesses and to delegate authority and accountability having regard to acceptable levels of risk. Business managing directors report regularly on operating performance to the relevant executive director with line responsibility, and the performance of each business is reviewed monthly by the Chief Executive's Committee.

Risk assessment and control procedures

The company's strategy is to follow a prudent risk policy, effectively managing exposures where appropriate.

The Board has undertaken a specific exercise to review and assess its key risks at a group level and to ensure that it is receiving appropriate information to monitor the management of those risks. The Board has required each of the businesses to complete a similar exercise to define key risks, controls and monitoring procedures utilising a well defined and consistent methodology. It is a key requirement of the procedures that a written certificate is provided annually by the managing director and finance manager of each business confirming that they have reviewed the effectiveness of the system of internal financial controls during the year. Periodic detailed review by the Finance Director of the accounting records of each business reinforces a focused approach to control throughout the group's finance functions.

Audit of controls

Operation of the group's control and monitoring procedures is reviewed and tested by the group's internal audit function under the supervision of the Head of Internal Audit, reporting directly to the Finance Director and with access to the Chairman of the Audit Committee. Internal audit reports and recommendations on the group's procedures are reviewed regularly by the Audit Committee. As part of their external audit responsibilities, the external auditors also provide reports to the Audit Committee on the operation of the group's internal financial control procedures.

The directors confirm that they have reviewed the effectiveness of the system of internal financial controls utilising the procedures set out above.

Directors' responsibility for the financial statements

The directors are required by law to prepare financial statements for each financial year and to present them annually to the company's members at the Annual General Meeting. The financial statements of which the form and content is prescribed by the Companies Act 1985 and applicable accounting standards, must give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the group's profit or loss for the period.

The directors confirm that suitable accounting policies have been used and applied consistently and that reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 March 1998. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis.

The directors are responsible for maintaining proper accounting records and sufficient internal controls to safeguard the assets of the company and the group and to prevent and detect fraud or any other irregularities.

Going concern

The directors confirm that the company remains a going concern on the basis of adequate cash flow forecasts.

Auditors' responsibilities

The company's registered auditors, Coopers & Lybrand, are responsible for forming an independent opinion on the financial statements of the group presented by the directors and for reporting their opinion to the shareholders. The report of the Auditors to the members of Scottish Power plc is set out on page 63. The auditors are also required to report to the shareholders if the following requirements are not met:

- that the group has maintained proper accounting records
- that the financial statements are in agreement with the accounting records
- that the contents of the Directors' Report are consistent with the financial statements
- that directors' emoluments and other transactions with directors are properly disclosed in the financial statements
- that they have obtained all information and explanations which, to the best of their knowledge and belief, are necessary for the purpose of their audit.

In addition, as recommended by the Cadbury Committee and required by the London Stock Exchange, the auditors have considered the directors' statement of compliance in relation to those points of the Code which can be objectively verified. Their report on corporate governance matters is set out on page 63.

Report of the Emoluments and Nominations Committee

Emoluments and Nominations Committee
The Emoluments and Nominations Committee (the Committee) is responsible for determining the remuneration policy for the ScottishPower group, including the remuneration arrangements for executive directors and other senior executives. It is also responsible for making recommendations to the Board on the appointment of directors.

The Committee consists solely of non-executive directors. Its members, who have no personal financial interest other than as shareholders in the matters considered by the Committee, are Ewen Macpherson (Chairman), Sir Ronald Garrick, Sir Peter Gregson and John Parnaby. Mair Barnes joined the Committee in April 1998.

The Committee is advised internally and is also provided with independent advice from external remuneration consultants in order to assist in determining and developing its policies.

Committee members are paid a fee and expenses, but do not receive any other remuneration from the company. Details of the remuneration of all non-executive directors are set out in Note 32 to the Accounts on pages 59 to 61.

The Committee's policy and disclosures on directors and senior management remuneration are set out below. Throughout the period, the company has complied with Section A of the Best Practice Provisions annexed to the London Stock Exchange Listing Rules.

The Committee notes that, following the Hampel Report, there is currently a process of consultation being undertaken by the London Stock Exchange with a view to proposed amendments to the Listing Rules. The Committee will take account of any amendments to the Rules in its future work.

Executive remuneration policy
The aim of ScottishPower's remuneration policy is to ensure that the rewards for executives and directors attract and retain executives of high quality, who are incentivised to achieve performance which exceeds that of competitors. Furthermore, the objective is to ensure that incentive schemes are in line with best practice and promote the interests of the shareholders.

The Committee believes that to attract and retain key executives of high calibre, the remuneration package it offers must be market competitive. The remuneration strategy is to adopt a market median positioning on all senior management remuneration packages and to provide packages above the market median only where supported by demonstrably superior personal performance. This positioning is established by advice received from an independent evaluation of job size and an analysis of the market situation by independent remuneration consultants against a comparator group of selected utilities and the FTSE 100 companies.

The Committee takes a balanced view of remuneration, considering each element relative to the market and, in the past, has realigned elements of the package to reflect market conditions or changes in market practice. In the last three years, annual bonus arrangements have been further strengthened so that targets reflect shareholder value and focus on improvements to business performance. In July 1996 shareholders approved the introduction of a long term incentive plan, which replaced future grants of executive share options.

In determining its remuneration policy, the Committee has given full consideration to the Code of Best Practice recommended by the Greenbury Committee and Section B of the Best Practice Provisions annexed to the London Stock Exchange Listing Rules.

In considering the comparator companies the consultants have included a number of other utilities but have not restricted their study solely to other utilities.

In setting remuneration levels, the Committee commissioned an independent evaluation of the roles of the executive directors and also the next levels of management within the company. The Committee has also continued to take independent advice from three remuneration consultants on market level remuneration based on comparison with companies of similar size and complexity.

In line with its objective of building a multi-utility business, ScottishPower has recruited a number of executives with key business skills, and hence a reward structure broadly equivalent to other large UK listed companies is necessary.

Base salary
The Committee sets the base salary for each executive director by reference to individual performance through a formal appraisal system and external market data, based on the Hay job evaluation system and reflecting similar roles in other comparable companies. In evaluating the roles, Hay takes into account its view of the environment in which the company is operating.

Annual performance related bonus
Executive directors and senior management participate in the company's performance related pay schemes. The schemes provide a maximum total payment of 40% of salary for executive directors and managing directors of the company's energy businesses, 30% of salary for other directors and 20% of salary for senior managers, and focus on corporate and business performance. All payments under the schemes are non-pensionable and non-contractual and are subject to the specific approval of the Committee.

The bonus structure is reviewed annually to ensure that it reflects the priorities of the business. The 1998 review of annual bonus arrangements confirmed that these forms of arrangement are widespread within the UK, and the amounts receivable at the 'on target' and maximum levels of performance are broadly in line with the FTSE 100 comparator group.

The scheme for executive directors provides a bonus of a maximum of 40% of salary, with up to a maximum of 25% of base salary determined by the company's performance. Measurement is by reference to a matrix of performance against targets of earnings per share and return on capital employed to reflect shareholder value. The balance of the bonus, of a maximum of 15% of base salary, is linked to each executive's achievement of key strategic objectives, both short term and long term. Objectives are set annually and performance against these is reviewed on a six monthly basis.

Directors do not participate in the Inland Revenue approved Profit Related Pay Scheme which was introduced in April 1995.

Share option schemes

The company operates an executive share option scheme which applies to executive directors and certain senior managers. The last grant of executive share options to executive directors was in May 1995. Existing options remain exercisable. Future grants under this scheme have been replaced by the company's long term incentive plan.

The company also operates a savings-related share option scheme, which is open to all permanent employees. Under this scheme options are granted over ScottishPower shares at a discount of 20% to the prevailing market price at the time of grant to eligible employees who agree to save up to £250 per month over a period of three or five years.

Long Term Incentive Plan

The company operates a long term incentive plan for executive directors and other senior managers, which was approved by shareholders at the company's Annual General Meeting in July 1996. The plan links the rewards closely between management and shareholders and focuses on long term corporate performance.

Under the plan, awards to acquire shares in ScottishPower at nil or nominal cost are made to the plan participants up to a maximum value equal to 60% of base salary. The award will vest only if the Committee is satisfied that certain performance measures related to the sustained underlying financial performance of the company and improvements in certain OFFER published Customer Service Standards are achieved over a period of three financial years commencing with the financial year preceding the date an award is made. All awards granted under the plan following the acquisition of Southern Water include reference to the OFWAT Customer Service Standards. Assuming that such targets have been achieved, the number of shares that can be acquired on vesting of the award will be dependent upon how the company ranks, in terms of its total shareholder return performance over a three year performance period, in comparison to the constituent companies of the FTSE 100 Index and the Electricity and Water sectors. Half of each award will be measured against the FTSE 100 companies and half against the Electricity and Water companies. A percentage of each half of the award will vest depending upon the company's ranking within the relevant comparator group as follows:-

- 100% if the company ranks in the top decile
- 90% if the company ranks in the second decile
- 80% if the company ranks in the third decile
- 60% if the company ranks in the fourth decile
- 40% if the company ranks in the fifth decile
- nil if the company ranks in the sixth decile or lower.

Once the company's total shareholder return performance has been measured over the three year performance period following the grant of the award, the award must be held for a further year before it may be exercised. The plan participant may acquire the shares in respect of the percentage of the award which has vested at any time after the fourth year up to the seventh year after the grant of the award.

Pension

The executive directors, and other senior management of the company, are provided with pension benefits through the company's main pension scheme, and an executive top up pension plan which provides a maximum pension of two-thirds of final salary on retirement at age 63, reduced where service to age 63 is less than 20 years. Pensionable salary is base salary in the 12 months prior to leaving the company.

Individuals who joined the company on or after 1 June 1989 are subject to the Inland Revenue earnings cap introduced by the Finance Act 1989. Entitlement above the cap cannot be provided through the company's approved pension schemes. Arrangements on an unapproved basis have been made to provide benefits for executives affected by the legislation. The total liability in respect of executives and senior employees arising in relation to unapproved benefits accrued for service for the year to 31 March 1998 is £432,676.

The normal retirement age is 63, apart from the Chief Executive who has a planned retirement age of 60 by special agreement at the time he joined the company.

The trustee body of the Executive Top Up Plan is chaired by the Chairman of the company.

The Committee has reported pension expense in accordance with the requirements of the London Stock Exchange. Pension costs detailed in the accounts are calculated as the cost of providing benefits accrued in the 1997-98 year.

Service contracts
All executive directors have service contracts terminable by the company on two years' notice and by the individuals on up to twelve months' notice. Against the need to retain and motivate directors in a competitive environment, the Committee believes that it remains appropriate for the main Board executive directors to continue to be on two year rolling contracts.

None of the executive directors' service contracts provides for pre-determined amounts of compensation in the event of early termination. The Committee's policy on early termination is to emphasise the duty to mitigate to the fullest extent practicable.

Senior managers within the company have notice periods ranging from six months to one year.

External non-executive appointments
The company encourages its directors to become non-executive directors of other companies, provided that these are not with competing companies and are not likely to lead to any conflicts of interest, and do not require extensive commitments of time which would prejudice their roles within ScottishPower. This serves to add to their personal and professional experience and knowledge to the benefit of ScottishPower. Any fees derived from such appointments may be retained by the executives.

Benefits
Executive directors are eligible for a range of benefits on which they are assessed for tax and which include the provision of a company car, fuel, private medical and permanent health insurance. Senior executives depending upon grade are eligible for certain of these benefits.

As with salary, the level of benefits is reviewed annually through surveys from independent consultants. Practice varies as to the composition of these items among the comparator group and the company's benefits are broadly in line with the practice of the group.

The company provides all levels of staff, including directors and certain pensioners, with a discount on merchandise sold by its Retail business.

Remuneration policy for non-executive directors
The remuneration of non-executive directors is determined by the Board and consists of fees for their service in connection with the Board and Board Committees. Additional fees are also payable for chairing Board Committees. The non-executive directors do not have service contracts, are not members of the company's pension scheme and do not participate in any bonus, share option or other profit or long term incentive schemes.

The company provides life assurance cover, up to a limit of £500,000, on the life of the Chairman.

Full details of the remuneration of the directors are contained in Note 32 to the Accounts on pages 59 to 61.

Accounting Policies and Definitions

Business segment definitions
The business segments of the group are defined as follows:
Generation Wholesale
The generation of electricity from the company's own power stations, the purchase of external supplies of energy for sale to other business segments of the company and the sale of electricity to other public electricity suppliers and to the Pool in England and Wales.

Power Systems
The transmission and distribution businesses in Scotland and, specifically, the transportation of units of electricity from the power stations through the transmission and distribution networks to customers in Scotland and to customers in England and Wales through the Anglo-Scottish Interconnector.

Energy Supply
The sale of energy to customers, together with related billing and collection activities for customers contracted to Scottish Power plc.

Manweb
The distribution and supply businesses operating in Merseyside and North Wales and, specifically, the purchase, distribution and sale of electricity to customers, together with related billing and collection activities within that licensed area.

Southern Water
The provision of water and waste water services in the South East of England, together with related billing and collection activities.

Developing businesses and ancillary services
The retailing and servicing of domestic electrical goods and home entertainment appliances, the supply of telecommunication services, the provision of electrical contracting, consultancy and corporate services and the company's other subsidiary and associated undertakings.

In the segmental analyses on pages 44 and 49, all material activities are derived from continuing operations in the United Kingdom.

Revenue cost definitions
Cost of sales
The cost of sales for the group, excluding Southern Water, reflect the direct costs of the generation and purchase of electricity, retail trading, telecommunication services, electrical contracting, consultancy services and the purchase of natural gas. For Southern Water, cost of sales represents the cost of extracting water from underground and raw water surface reservoirs and of its treatment and supply to customers and the subsequent collection of waste water and its treatment and disposal.

Transmission and distribution costs
The cost of transmitting units of electricity from the power stations through the transmission and distribution networks to customers. It includes the costs of metering, billing and debt collection. This heading is considered more appropriate to the electricity industry than the standard Companies Act heading of distribution costs.

Administrative expenses
The indirect costs of businesses, the costs of centralised services and rates.

Other definitions
Company
Scottish Power plc.

Group
Scottish Power plc and its consolidated subsidiaries.

Associated undertakings
Entities in which the company holds a long term participating interest and exercises significant influence.

Joint ventures
Entities in which the company holds a long term interest and shares control with another company external to the group.

Subsidiary undertakings
Entities in which the company holds a long term controlling interest.

Accounting Policies

Basis of accounting
The accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards in the UK and, subject to the treatment of water infrastructure grants and contributions described below, comply with the requirements of the Companies Act 1985.

Basis of consolidation
The group accounts include the accounts of the company and its principal subsidiary undertakings together with the group's share of results and net assets of associated undertakings and joint ventures. For commercial reasons certain subsidiaries have different year ends. The consolidation includes the accounts of these subsidiaries, as adjusted for material transactions in the periods between their year ends and 31 March 1998.

Turnover
Turnover comprises the sales value of energy, goods, water, waste water and other services supplied to customers during the year and excludes Value Added Tax and intra-group sales. Income from the sale of energy and measured water is the value of units supplied during the year and includes an estimate of the value of units supplied to customers between the date of their last meter reading and the year end.

Under/over recovery of regulated income
Under the licences issued to Scottish Power plc and Manweb plc which permit them to operate as public electricity companies, price control formulae determine the regulated allowable maximum unit revenues of the transmission, distribution and supply businesses, as appropriate. If actual revenue for the year exceeds the regulated allowable maximum, the excess is deducted from turnover and included in creditors. Where there is an under recovery compared with the regulated allowable maximum no anticipation of any potential future recovery is made.

Research and development
Expenditure on research and development is charged to the profit and loss account as it is incurred.

Interest
Interest on the funding attributable to major capital projects is capitalised gross of tax relief during the period of construction and written off as part of the total cost over the operational life of the asset. All other interest payable and receivable is reflected in the profit and loss account as it arises.

Financial instruments
Debt instruments
All borrowings are stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds are charged to the profit and loss account at a constant rate over the life of the bond.

Interest rate swaps
Interest rate swap agreements are used to manage interest rate exposures and are accounted for under the hedge accounting method. In order to qualify for hedge accounting, the company's notional amount of interest rate swaps and caps must be less than or equal to existing variable rate debt. Amounts payable or receivable in respect of these agreements are recognised as adjustments to interest expense over the period of the contracts. The cash flows from interest rate swaps and gains and losses arising on terminations of interest rate swaps are recognised as returns on investments and servicing of finance. Where associated debt is not retired in conjunction with the termination of an interest swap, gains and losses are deferred and are amortised to interest expense over the remaining life of the associated debt to the extent that such debt remains outstanding.

Interest rate caps
Interest rate caps are used to limit interest rate exposures. The premiums on these contracts are disclosed as interest expense and are amortised over the period of the contracts.

Forward contracts
The company enters into forward contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates. Unrealised gains and losses on contracts are not accounted for until the maturity of the contract. The cash flows from forward purchase contracts are classified in a manner consistent with the underlying nature of the hedged transaction.

Contracts for Differences (CfDs)
The company uses CfDs to minimise exposure to Pool price variations. The cost or the income attributable to CfDs is recorded in the accounting records when settlement is made. Where delivery under the CfD has taken place prior to the period end, adjustments are made to account for the known variances between the contract strike price and the Pool price on the date of delivery.

Premiums and discounts
Premiums and discounts arising on the early repayment of borrowings are written off to the profit and loss account as incurred.

Goodwill
Purchased goodwill represents the excess of the fair value of the purchase

consideration over the fair value of the net assets acquired. Goodwill arising from the purchase of trading entities in accounting periods ended on, or prior to, 31 March 1998 has been written off against reserves on acquisition in accordance with the current group accounting policy. Goodwill written off to reserves, being all goodwill previously eliminated, has been offset against merger reserve to reduce the merger reserve to zero and thereafter has been offset against the profit and loss reserve.

Tangible fixed assets
Accounting for non-water infrastructure assets
Tangible fixed assets are stated at cost and are depreciated on the straight line method over their estimated operational lives. Tangible fixed assets include capitalised employee costs in respect of work performed solely or principally for the purpose of construction of fixed assets. Certain hydro civil assets, which have infinite lives, and land are not depreciated. Depreciation is, in general, first charged in the year following that in which the expenditure was incurred.

The main depreciation periods used by the company are as set out below:

	Years
Coal and oil-fired generating stations	35-40
Hydro plant and machinery	20-40
Other buildings	40
Transmission and distribution plant	30-40
Towers, lines and underground cables	40-60
Vehicles, miscellaneous equipment and fittings	3-15

Infrastructure accounting
Water infrastructure assets, being mains and sewers, reservoirs, dams, sludge pipelines and sea outfalls are not depreciated because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life. Infrastructure renewals, being the expenditure on maintaining the operating capability of the network, is charged as an operating cost based on the long run average charge implied by an asset management plan agreed with the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets. The required renewals and the related costs are determined from these engineering estimates using indexed historical cost data. The allocation of costs to each period is also determined from the rolling programme of reviews of the condition of the infrastructure assets. Actual costs incurred are charged against the related provision account.

Leased assets
As lessee
Assets leased to the group companies under finance leases are capitalised and depreciated in line with the group depreciation policy. The interest element of the finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding. Rentals payable under operating leases are charged to the profit and loss account as incurred.

As lessor
Rentals receivable under finance leases are allocated to accounting periods to give a constant periodic rate of return on the net cash investment in the lease in each period. The amounts due from lessees under finance leases are recorded in the balance sheet as a debtor at the amount of the net investment in the lease after making provisions for bad and doubtful rentals receivable.

Property clawback
A debenture has been issued to the Secretary of State for Scotland which entitles HM Government to a proportion of any property gain (above certain thresholds and after deducting an amount representing corporation tax thereon) accruing or treated as accruing to ScottishPower as a result of the disposal or deemed disposal after 31 March 1991 of certain property held at 31 March 1990. These arrangements last until 31 March 2001.

In the case of Manweb, if properties are disposed of, or are deemed to have been disposed of prior to 1 April 2000, a part of the gain over the value at 31 March 1990 (as adjusted for inflation and taxation) will become payable to HM Government.

In the case of both companies, a liability for clawback in respect of property disposals is recognised only when an actual or a deemed disposal occurs.

Investments
Investments in subsidiary and associated undertakings and joint ventures are stated in the balance sheet of the parent company at cost, or nominal value of shares issued as consideration where applicable, less provision for any permanent diminution in value. The consolidated profit and loss account includes the group's share of the profits less losses and taxation of associated undertakings and joint ventures. The group balance sheet includes the investment in associated undertakings and joint ventures at the group's share of their net assets. Other fixed asset investments are carried at cost less provision for permanent diminution in value.

Stocks
Stocks are valued at the lower of cost and net realisable value.

Foreign currencies
Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. At the year end, liabilities and monetary assets denominated in foreign currencies are translated at the rate of exchange ruling

at the balance sheet date or, where applicable, at the contracted rate. Any gain or loss arising on the restatement of such balances is taken to the profit and loss account.

Taxation
The charge for ordinary taxation is based on the profits for the year and takes into account deferred taxation, using the liability method, in respect of timing differences to the extent that it is probable that a liability will crystallise in the foreseeable future. Such timing differences arise primarily from the differing treatment for taxation and accounting purposes of provisions and the depreciation of fixed assets.

Pensions
Revaluations of the Pension Schemes are normally conducted by independent actuaries every three years. The regular cost of providing pensions and related benefits and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Any difference between the charge to the profit and loss account and the actual contributions paid to the Pension Schemes is included as an asset or liability in the balance sheet.

Grants and contributions
Capital grants and customer contributions in respect of additions to non-water infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets. The treatment of grants and contributions relating to water infrastructure assets differs, since these assets are not depreciated and therefore no basis exists on which to recognise grants and contributions as deferred income. Accordingly, grants and contributions relating to water infrastructure asset additions are deducted from the cost of water infrastructure assets. This treatment is in accordance with Statement of Standard Accounting Practice (SSAP) 4 and the effect on the value of tangible fixed assets is disclosed in Note 15. This is not in accordance with the Companies Act 1985 which requires assets to be stated at their purchase price or production cost. The departure from the requirements of the Act is, in the opinion of the directors, necessary to give a true and fair view, since water infrastructure assets are not depreciated.

Own shares held under trust
Shares in the company purchased for the Long Term Incentive Plan are held under trust and are recorded within investments in the balance sheet at cost. The cost of awards made by the trust under the Long Term Incentive Plan, being the difference between the fair value of the shares and the option price at the date of grant, is taken to the profit and loss account on a straight line basis over the period in which performance is measured. The amount recorded in the balance sheet for shares in the company purchased for employee sharesave schemes represents the amounts receivable from option holders on exercise of the options.

Group Profit and Loss Account

for the year ended 31 March 1998

	Notes	1998 £m	1997 £m
Turnover: group and share of joint ventures and associates		**3,134.1**	2,947.4
Less: share of joint ventures turnover		**(3.8)**	(4.6)
Less: share of associates turnover		**(2.1)**	(2.1)
Group turnover from continuing operations	1	**3,128.2**	2,940.7
Cost of sales		**(1,850.7)**	(1,743.5)
Gross profit from continuing operations		**1,277.5**	1,197.2
Transmission and distribution costs		**(219.1)**	(222.8)
Administrative expenses		**(303.0)**	(331.1)
Other operating income		**29.7**	20.6
Operating profit from continuing operations	1,2	**785.1**	663.9
Income from interests in joint ventures		**1.6**	1.8
Income from interests in associated undertakings		**0.3**	0.9
Profit on ordinary activities before interest		**787.0**	666.6
Net interest charge			
– Group		**(147.1)**	(107.5)
– Joint ventures		**(0.2)**	(0.5)
– Associates		**(0.1)**	(0.2)
	4	**(147.4)**	(108.2)
Profit on ordinary activities before taxation		**639.6**	558.4
Ordinary taxation			
– Group		**(151.5)**	(135.7)
– Joint ventures		**(0.4)**	(0.7)
– Associates		**0.3**	(0.4)
	5	**(151.6)**	(136.8)
Profit after ordinary taxation		**488.0**	421.6
Exceptional taxation – windfall tax	6	**(317.0)**	–
Profit after taxation		**171.0**	421.6
Minority interests	26	**(0.9)**	(0.5)
Profit for the financial year		**170.1**	421.1
Dividends	8	**(243.3)**	(218.1)
(Loss)/profit retained	25	**(73.2)**	203.0
Earnings per ordinary share	7	**14.41p**	38.11p
Adjusting item – windfall tax		**26.87p**	–
Earnings per ordinary share before windfall tax	7	**41.28p**	38.11p
Dividend per ordinary share	8	**20.40p**	18.50p

The Accounting Policies and Definitions on pages 38 to 41, together with the Notes on pages 44 to 45, 47 and 49 to 62 form part of these Accounts.

Statement of Total Recognised Gains and Losses
for the year ended 31 March 1998

	Note	1998 £m	1997 £m
Profit for the financial year		**170.1**	421.1
Surplus on revaluation of assets	15	**229.0**	–
Total recognised gains and losses		**399.1**	421.1

Note of Historical Cost Profits and Losses
for the year ended 31 March 1998

	Note	1998 £m	1997 £m
Profit on ordinary activities before taxation		**639.6**	558.4
Difference between historical cost depreciation charge and actual depreciation charge for the period calculated on the revalued amount of fixed assets	15	**1.7**	–
Historical cost profit on ordinary activities before taxation		**641.3**	558.4
Historical cost (loss)/profit retained for the period after taxation, minority interests and dividends		**(71.5)**	203.0

Reconciliation of Movements in Shareholders' Funds
for the year ended 31 March 1998

	1998 £m	1997 £m
Profit for the financial year	**170.1**	421.1
Dividends	**(243.3)**	(218.1)
(Loss)/profit retained	**(73.2)**	203.0
Share capital issued (net of costs)	**45.5**	633.2
Shares to be issued	**–**	13.4
Revaluation of fixed assets	**229.0**	–
Goodwill written off	**(16.2)**	(534.6)
Net movement in shareholders' funds	**185.1**	315.0
Opening shareholders' funds	**1,522.7**	1,207.7
Closing shareholders' funds	**1,707.8**	1,522.7

The Accounting Policies and Definitions on pages 38 to 41, together with the Notes on pages 44 to 45, 47 and 49 to 62 form part of these Accounts.

Notes to the Group Profit and Loss Account
for the year ended 31 March 1998

1 Segmental business information

(a) Turnover by business segment

	Note	Total turnover 1998 £m	Total turnover 1997 £m	Inter-segment turnover 1998 £m	Inter-segment turnover 1997 £m	External turnover 1998 £m	External turnover 1997 £m
Generation Wholesale		**1,014.3**	974.4	**764.8**	744.4	**249.5**	230.0
Power Systems		**443.0**	429.2	**391.1**	386.8	**51.9**	42.4
Energy Supply		**1,336.2**	1,270.4	**11.5**	0.9	**1,324.7**	1,269.5
Manweb		**667.8**	759.3	**13.9**	4.2	**653.9**	755.1
Southern Water	(i)	**453.0**	316.7	**0.4**	0.5	**452.6**	316.2
Developing businesses and ancillary services		**524.0**	412.9	**128.4**	85.4	**395.6**	327.5
Total						**3,128.2**	2,940.7

(b) Operating profit by business segment

	Note	1998 £m	1997 £m
Generation Wholesale		**130.8**	146.1
Power Systems		**249.5**	228.0
Energy Supply		**15.1**	32.4
Manweb		**131.3**	135.0
Southern Water	(i)	**240.7**	135.6
Developing businesses and ancillary services		**17.7**	8.0
Sub total		**785.1**	685.1
Southern Water reorganisation costs		**–**	(21.2)
Total		**785.1**	663.9

(i) The 1997 figures for Southern Water cover the post-acquisition period from 6 August 1996 to 31 March 1997.

2 Operating profit

Operating profit is stated after charging/(crediting):

	Note	1998 £m	1997 £m
Depreciation		**165.6**	145.5
Release of customer contributions/grants		**(20.6)**	(22.5)
Research and development		**5.4**	5.6
Hire of plant and equipment – operating leases		**2.6**	2.6
Hire of other assets – operating leases		**25.0**	20.6
Auditors' remuneration for audit of			
– group		**0.6**	0.6
– company		**0.3**	0.3
Auditors' remuneration for non-audit services to the company and its UK subsidiary undertakings	(i)	**1.2**	1.4

(i) Non-audit services consist mainly of regulatory advice, consulting resources and sundry returns for regulatory purposes.

3 Employee information

(a) Employee costs

	1998 £m	1997 £m
Wages and salaries	**304.6**	277.1
Social security costs	**24.0**	22.7
Pension costs	**18.1**	24.7
Total employee costs	**346.7**	324.5
Less: charged as capital expenditure	**(67.8)**	(48.0)
Charged to the profit and loss account	**278.9**	276.5

(b) Employee numbers

The year end and average numbers of employees (full time and part time) employed by the group, including executive directors, were:

	At 31 March 1998	At 31 March 1997	Annual average 1998	Annual average 1997
Generation Wholesale	**1,020**	1,054	**1,068**	1,094
Power Systems	**2,736**	2,684	**2,757**	2,831
Energy Supply	**1,139**	797	**982**	810
Manweb	**2,248**	2,830	**2,330**	2,975
Southern Water	**2,406**	3,618	**2,856**	4,006
Developing businesses and ancillary services	**5,550**	4,035	**5,086**	3,587
	15,099	15,018	**15,079**	15,303
The number of full time equivalent staff was:	**14,306**	14,401	**14,356**	14,657

4 Net interest charge

(a) Analysis of net interest charge

	1998 £m	1997 £m
Interest on overdrafts, bonds and other borrowings:		
Repayable wholly within five years	**41.6**	65.4
Not wholly repayable within five years	**33.8**	12.6
Repaid during the year	**84.7**	33.0
	160.1	111.0
On finance leases	**0.4**	0.5
Total interest payable	**160.5**	111.5
Interest receivable	**(3.1)**	(3.3)
Capitalised interest	**(10.0)**	–
Net interest charge	**147.4**	108.2
Interest cover (times)	**5.3**	6.2

Interest cover is calculated by dividing profit on ordinary activities before interest by the net interest charge.

(b) Analysis of total interest payable

	1998 £m	1997 £m
Bank loans and overdrafts	**45.0**	65.5
Government borrowings	**16.3**	16.3
Loan notes	**1.6**	2.7
Commercial paper	**73.3**	24.3
Medium term notes/private placements	**4.5**	–
Euro-bonds	**19.4**	2.2
Finance leases	**0.4**	0.5
	160.5	111.5

5 Ordinary taxation

Reconciliation of tax charge to standard rate of UK Corporation Tax

	1998 £m	1997 £m
Tax on profit before tax at standard rate of 31% (1997 33%)	**198.2**	184.2
Timing differences between taxable and accounting profit:		
– accelerated capital allowances	**(35.8)**	(49.7)
– other timing differences	**1.1**	4.5
Permanent differences	**27.0**	9.5
Advance corporation tax written back	**(38.9)**	(11.7)
Ordinary taxation charged to profit and loss account	**151.6**	136.8
Effective tax rate	**23.7%**	24.5%

The effective tax rate is calculated by dividing ordinary taxation by profit on ordinary activities before taxation.

6 Exceptional taxation – windfall tax

Exceptional taxation relates to the group's estimated share of the windfall tax according to the formula contained within the Finance (No. 2) Act 1997. The first of two equal instalments was paid on 1 December 1997 with the second instalment due on 1 December 1998.

7 Earnings per ordinary share

(a) Earnings per ordinary share have been calculated by dividing the profit for the period by the weighted average number of ordinary shares in issue and ranking for dividend during the period, based on the following information.

	1998	1997
Profit for the financial year (£ million)	**170.1**	421.1
Weighted average share capital (number of shares, million)	**1,180.1**	1,104.9

(b) Fully diluted earnings per ordinary share based on options outstanding have not been provided as the effect of dilution would not be material.

(c) The calculation of earnings per ordinary share, on a basis which excludes the windfall tax, is as follows:

	1998 £m	1997 £m
Profit for the financial year	**170.1**	421.1
Adjusting item – windfall tax	**317.0**	–
Profit for the financial year before windfall tax	**487.1**	421.1
Earnings per ordinary share before windfall tax	**41.28p**	38.11p

8 Dividend per ordinary share

	1998 pence per ordinary share	1997 pence per ordinary share	1998 £m	1997 £m
Interim dividend paid	**6.80**	6.17	**80.4**	72.6
Proposed final dividend	**13.60**	12.33	**162.9**	145.5
Total dividend	**20.40**	18.50	**243.3**	218.1

Group Cash Flow Statement

for the year ended 31 March 1998

	Notes	1998 £m	1997 £m
Cash inflow from continuing operating activities	10	**987.3**	791.2
Dividends received from associates and joint ventures		**0.9**	–
Returns on investments and servicing of finance	9	**(146.7)**	(101.1)
Ordinary taxation		**(134.5)**	(117.4)
Free cash flow before windfall tax		**707.0**	572.7
Exceptional taxation – windfall tax	6	**(157.8)**	–
Free cash flow		**549.2**	572.7
Capital expenditure and financial investment	9	**(565.9)**	(381.4)
Cash flow before acquisitions and disposals		**(16.7)**	191.3
Acquisitions and disposals	9	**67.9**	(1,234.6)
Equity dividends paid		**(226.0)**	(170.0)
Cash outflow before use of liquid resources and financing		**(174.8)**	(1,213.3)
Management of liquid resources	9,13	**(17.5)**	(21.0)
Financing			
Issue of ordinary share capital (net of expenses)	9	**8.9**	238.0
Increase in debt	9,13	**252.6**	1,048.6
		261.5	1,286.6
Increase in cash in year	13	**69.2**	52.3

Free cash flow represents cash flow from operations after adjusting for returns on investments and servicing of finance and taxation.

Reconciliation of Net Cash Flow to Movement in Net Debt

	1998 £m	1997 £m
Increase in cash in year	**69.2**	52.3
Cash inflow from increase in debt	**(252.6)**	(1,048.6)
Cash outflow from movement in liquid resources	**17.5**	21.0
Change in net debt resulting from cash flows	**(165.9)**	(975.3)
Net debt acquired	**(0.1)**	(168.6)
Net debt disposed	**6.7**	–
Loan notes issued	**(3.0)**	(14.3)
Movement in net debt in year	**(162.3)**	(1,158.2)
Net debt at end of previous year	**(1,790.3)**	(632.1)
Net debt at end of year	**(1,952.6)**	(1,790.3)

The Accounting Policies and Definitions on pages 38 to 41, together with the Notes on pages 44 to 45, 47 and 49 to 62 form part of these Accounts.

Notes to the Group Cash Flow Statement

for the year ended 31 March 1998

9 Analysis of cash flows

	1998 £m	1997 £m
(a) Returns on investments and servicing of finance		
Interest received	**2.7**	3.3
Interest paid	**(149.0)**	(103.9)
Interest element of finance lease rental payments	**(0.4)**	(0.5)
Net cash outflow for returns on investments and servicing of finance	**(146.7)**	(101.1)
(b) Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(635.3)**	(435.4)
Deferred income received	**55.4**	44.7
Sale of tangible fixed assets	**26.4**	13.9
Purchase of fixed asset investments	**(12.4)**	(4.6)
Net cash outflow for capital expenditure and financial investment	**(565.9)**	(381.4)
(c) Acquisitions and disposals		
Purchase of subsidiary undertakings	**(0.4)**	(1,234.6)
Sale of subsidiary businesses	**68.3**	–
Net cash inflow/(outflow) from acquisitions and disposals	**67.9**	(1,234.6)
(d) Management of liquid resources		
Cash outflow in relation to short term deposits and other short term investments	**(17.5)**	(21.0)
Net cash outflow for management of liquid resources	**(17.5)**	(21.0)
(e) Financing		
Issue of ordinary share capital	**8.9**	263.0
Expenses paid in connection with share issue	**–**	(25.0)
	8.9	238.0
Debt due within one year:		
– net (repayment)/drawdown of uncommitted facilities	**(81.8)**	252.9
– net commercial paper (redeemed)/issued	**(31.0)**	700.5
– net medium term notes issued/private placements	**62.5**	–
– redemption of loan notes	**(39.4)**	(0.4)
– European Investment Bank loan	**1.3**	8.7
Debt due after one year:		
– net drawdown of uncommitted facilities	**–**	3.8
– net repayment of committed facilities	**(200.6)**	(100.0)
– net medium term notes issued/private placements	**240.9**	–
– European Investment Bank loan	**20.0**	(11.6)
– 5.875% euro-US dollar bond issue	**182.9**	–
– Variable coupon bond issue	**99.6**	–
– 8.375% euro-sterling bond issue	**0.2**	196.6
Capital element of finance lease rental payments	**(2.0)**	(1.9)
Increase in Debt	**252.6**	1,048.6
Net cash inflow from financing	**261.5**	1,286.6

10 Reconciliation of operating profit to cash inflow from continuing operating activities

	1998 £m	1997 £m
Operating profit	**785.1**	663.9
Acquisition reorganisation accruals and provisions	**–**	15.2
Depreciation charge	**165.6**	145.5
Profit on sale of tangible fixed assets and disposal of businesses	**(21.7)**	(2.4)
Release of deferred income	**(20.6)**	(22.5)
Movement in provisions for liabilities and charges	**(7.5)**	(17.1)
Increase in stocks	**(32.0)**	(31.1)
Decrease in debtors	**76.5**	38.7
Increase in creditors	**41.9**	1.0
Cash inflow from continuing operating activities	**987.3**	791.2

The acquisition reorganisation accruals and provisions for 1997 relate to the cost of implementing the post-acquisition plans for Southern Water.

11 Effect of acquisitions and disposals on cash flows

	1998 £m	1997 £m
Cash flow from operating activities	**10.0**	140.3
Returns on investment and servicing of finance	**(0.7)**	(5.6)
Taxation	**–**	(18.0)
Capital expenditure and financial investment	**(5.3)**	(93.2)
Management of liquid resources	**–**	49.0
Financing	**2.1**	(2.8)
Increase in cash	**6.1**	69.7

12 Analysis of cash flows in respect of acquisitions and disposals

	1998 £m	1997 £m
Cash consideration including (disposal)/acquisition expenses	**(70.2)**	1,290.8
Cash at bank and in hand disposed/(acquired)	**1.9**	(58.6)
Bank overdrafts acquired	**–**	2.4
	(68.3)	1,234.6

The analysis of cash flows from disposals in 1998 relates to the cash flows during the period for the Southern Water non-core businesses that were sold during the year. The cash flows from the acquisitions in 1998 were not material to the group.

13 Analysis of net debt

	At 1 April 1997 £m	Cash flow £m	Acquisitions (excl. cash & overdrafts) £m	Disposals (excl. cash & overdrafts) £m	Other non-cash changes £m	**At 31 March 1998 £m**
Cash at bank	2.5	56.3	–	–	–	**58.8**
Overdrafts	(22.2)	12.9	–	–	–	**(9.3)**
		69.2				
Debt due after 1 year	(689.4)	(343.0)	–	–	–	**(1,032.4)**
Debt due within 1 year	(1,111.7)	88.4	(0.1)	–	(3.0)	**(1,026.4)**
Finance leases	(8.7)	2.0	–	6.7	–	**–**
		(252.6)				
Other deposits	39.2	17.5	–	–	–	**56.7**
Total	(1,790.3)	(165.9)	(0.1)	6.7	(3.0)	**(1,952.6)**

‘Other non-cash changes’ to net debt represents loan notes issued as part of the consideration for Pinnacle Cellular Limited.

Balance Sheets

as at 31 March 1998

	Notes	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Fixed assets					
Tangible assets	15	**4,718.5**	4,052.1	**1,755.1**	1,577.8
Investments					
– Investments in joint ventures:					
Share of gross assets		**23.8**	13.4		
Share of gross liabilities		**(8.0)**	(7.4)		
		15.8	6.0	**13.6**	4.4
– Investments in associates		**7.4**	7.9	**–**	–
– Other investments		**44.1**	3.8	**1,731.2**	1,506.6
	16	**67.3**	17.7	**1,744.8**	1,511.0
		4,785.8	4,069.8	**3,499.9**	3,088.8
Current assets					
Stocks	17	**144.2**	113.7	**128.9**	101.0
Debtors	18	**531.3**	622.8	**1,811.1**	1,500.7
Short term bank and other deposits		**115.5**	41.7	**48.6**	1.1
		791.0	778.2	**1,988.6**	1,602.8
Creditors: amounts falling due within one year					
Loans and other borrowings	19	**(1,035.7)**	(1,137.1)	**(1,031.1)**	(1,118.6)
Other creditors	20	**(1,396.3)**	(1,112.0)	**(1,455.5)**	(983.5)
		(2,432.0)	(2,249.1)	**(2,486.6)**	(2,102.1)
Net current liabilities		**(1,641.0)**	(1,470.9)	**(498.0)**	(499.3)
Total assets less current liabilities		**3,144.8**	2,598.9	**3,001.9**	2,589.5
Creditors: amounts falling due after more than one year					
Loans and other borrowings	19	**(1,032.4)**	(694.9)	**(932.8)**	(542.4)
Provisions for liabilities and charges	22	**(38.1)**	(45.6)	**(10.4)**	(17.6)
Deferred income	23	**(364.6)**	(335.3)	**(179.9)**	(172.0)
Net assets	14	**1,709.7**	1,523.1	**1,878.8**	1,857.5
Called up share capital	24,25	**598.4**	588.7	**598.4**	588.7
Share premium	25	**388.7**	305.7	**388.7**	305.7
Merger reserve	25	**–**	–	**8.2**	13.4
Revaluation reserve	25	**227.3**	–	**–**	–
Profit and loss account	25	**493.4**	628.3	**883.5**	949.7
Equity shareholders' funds	25	**1,707.8**	1,522.7	**1,878.8**	1,857.5
Minority interest	26	**1.9**	0.4	**–**	–
Capital employed		**1,709.7**	1,523.1	**1,878.8**	1,857.5

Approved by the Board on 6 May 1998 and signed on its behalf by

Murray Stuart
Chairman

Ian Russell
Finance Director

The Accounting Policies and Definitions on pages 38 to 41, together with the Notes on pages 44 to 45, 47 and 49 to 62 form part of these Accounts.

Notes to the Balance Sheets

as at 31 March 1998

14 Segmental business information

Net assets/(liabilities) by business segment

	Notes	1998 £m	1997 £m
Generation Wholesale		**361.2**	323.2
Power Systems		**1,136.4**	1,030.2
Energy Supply		**45.2**	41.7
Manweb		**607.3**	520.4
Southern Water		**1,222.4**	1,224.2
Developing businesses and ancillary services	(a)	**220.4**	246.6
Sub total		**3,592.9**	3,386.3
Unallocated net liabilities	(b)	**(1,883.2)**	(1,863.2)
Total		**1,709.7**	1,523.1

(a) The net assets of the Retail business, included within developing businesses and ancillary services, excluding short term bank and other deposits of £19.7 million (1997 £9.7 million), are £35.6 million (1997 £120.9 million).

(b) Unallocated net liabilities include net debt, dividends payable and tax liabilities.

15 Fixed assets

(a) Tangible assets – group

	Note	Land and buildings £m	Water infra-structure assets £m	Plant and machinery £m	Vehicles and equipment £m	Total £m
Cost or valuation:						
At 1 April 1997		785.3	689.8	3,236.6	420.5	5,132.2
Additions		73.5	99.0	335.4	176.8	684.7
Acquisitions		0.4	–	1.2	0.2	1.8
Revaluation	(i)	9.4	34.4	108.2	–	152.0
Grants and contributions		–	(5.5)	–	–	(5.5)
Disposals		(21.1)	–	(36.7)	(86.8)	(144.6)
At 31 March 1998		**847.5**	**817.7**	**3,644.7**	**510.7**	**5,820.6**
Depreciation:						
At 1 April 1997		139.7	–	867.6	72.8	1,080.1
Charge for the year		14.9	–	88.6	62.1	165.6
Revaluation	(i)	–	–	(77.0)	–	(77.0)
Disposals		(2.0)	–	(21.9)	(42.7)	(66.6)
At 31 March 1998		**152.6**	**–**	**857.3**	**92.2**	**1,102.1**
Net book value:						
At 31 March 1998		**694.9**	**817.7**	**2,787.4**	**418.5**	**4,718.5**
At 31 March 1997		645.6	689.8	2,369.0	347.7	4,052.1

Historic cost analysis

	1998 £m	1997 £m
Cost	**5,668.6**	5,132.2
Depreciation based on cost	**(1,177.4)**	(1,080.1)
Net book value based on cost	**4,491.2**	4,052.1

(b) Tangible assets – company

	Land and buildings £m	Water infra-structure assets £m	Plant and machinery £m	Vehicles and equipment £m	Total £m
Cost:					
At 1 April 1997	279.9	–	2,114.1	198.3	2,592.3
Additions	9.1	–	138.8	111.2	259.1
Disposals	(0.7)	–	(3.9)	(1.7)	(6.3)
At 31 March 1998	**288.3**	**–**	**2,249.0**	**307.8**	**2,845.1**
Depreciation:					
At 1 April 1997	130.5	–	816.5	67.5	1,014.5
Charge for the year	1.4	–	44.0	34.4	79.8
Disposals	(0.2)	–	(2.8)	(1.3)	(4.3)
At 31 March 1998	**131.7**	**–**	**857.7**	**100.6**	**1,090.0**
Net book value:					
At 31 March 1998	**156.6**	**–**	**1,391.3**	**207.2**	**1,755.1**
At 31 March 1997	149.4	–	1,297.6	130.8	1,577.8

15 Fixed assets continued

Included in the cost or valuation of fixed assets above are:

	Note	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Major assets in the course of construction		**277.3**	185.1	**12.9**	–
Grants and contributions in respect of water infrastructure assets		**(8.0)**	(2.5)	**–**	–
Capitalised interest		**18.0**	8.0	**8.0**	8.0
Assets not subject to depreciation	(ii)	**889.5**	710.3	**29.2**	7.3

The net book value of tangible fixed assets held under finance leases at 31 March 1998 was £nil (1997 £15.0 million). The charge for depreciation against these assets during the previous year was £2.4 million.

(i) At their respective dates of acquisition, the Manweb distribution assets and the Southern Water operational assets were recorded in the consolidated balance sheet of Scottish Power plc at their estimated recoverable amounts. These amounts were assessed by discounting estimated future cash flows using an appropriate discount rate and allowing for uncertainties in relation to regulatory, market and other risk factors. The directors are of the opinion that these uncertainties are diminished significantly following the imposition of the windfall tax (see Note 6). In view of the relative significance and isolated nature of this change, the directors believe that a revaluation of the Manweb distribution and Southern Water operational assets is appropriate as at 30 September 1997 to better reflect their value as part of the group's asset base. This revaluation was carried out at 30 September 1997 by the directors and was determined by assessing discounted estimated future cash flows. This has resulted in an uplift in asset value of £229.0 million, and the creation of a revaluation reserve of an equivalent amount (see Note 25).

(ii) Assets not subject to depreciation are land, water infrastructure and certain hydro civil assets. Land and buildings held by the group and company are predominantly freehold. The exceptions are a number of retail premises and other operational sites which are held under lease.

16 Fixed asset investments

	Subsidiary undertakings Shares £m	Subsidiary undertakings Loans £m	Joint ventures Shares £m	Joint ventures Loans £m	Associated undertakings Shares £m	Associated undertakings Loans £m	Own shares held under trust £m	Other investments £m	Total £m
Group							(a)		
Cost or valuation:									
At 1 April 1997	–	–	1.6	4.4	6.0	1.9	2.2	1.6	17.7
Additions	–	–	–	9.9	0.7	–	39.4	0.9	50.9
Acquisitions	–	–	–	–	–	–	–	–	–
Share of retained profit	–	–	1.0	–	0.5	–	–	–	1.5
Disposals and other	–	–	(0.4)	(0.7)	(0.5)	(1.2)	–	–	(2.8)
At 31 March 1998	**–**	**–**	**2.2**	**13.6**	**6.7**	**0.7**	**41.6**	**2.5**	**67.3**
Company									
Cost or nominal value:									
At 1 April 1997	1,504.4	–	–	4.4	–	–	2.2	–	1,511.0
Additions	–	176.2	–	9.9	–	–	39.4	0.5	226.0
Acquisitions	8.5	–	–	–	–	–	–	–	8.5
Disposals	–	–	–	(0.7)	–	–	–	–	(0.7)
At 31 March 1998	**1,512.9**	**176.2**	**–**	**13.6**	**–**	**–**	**41.6**	**0.5**	**1,744.8**

The principal subsidiary undertakings, joint ventures and associated undertakings are listed on page 62.

On 1 May 1998 the group acquired 100% share capital of Demon Internet Limited for £66 million.

(a) Shares in the company held under trust during the year are as follows:

	Notes	Dividends waived	Shares held at 1 April 1997 (000s)	Shares acquired during year (000s)	Shares transferred during year (000s)	**Shares held at 31 March 1998 (000s)**	**Market value at 31 March 1998 £m**
Long Term Incentive Plan	(i)	no	678	716	–	**1,394**	**7.8**
ScottishPower Sharesave Scheme	(ii)	yes	–	16,457	(2,539)	**13,918**	**78.3**
			678	17,173	(2,539)	**15,312**	**86.1**

(i) Shares of the company are held under trust as part of the Long Term Incentive Plan for executive directors and other senior managers (see Report of the Emoluments and Nominations Committee on pages 35 to 37 for details of the plan).

(ii) Shares of the company are held in a Qualifying Employee Share Ownership Trust as part of the ScottishPower Sharesave Scheme. Holders of options granted under the scheme between 30 June 1993 and 20 June 1996 will be awarded shares by the trust following the completion of savings contracts and upon exercise of the options. Details of options granted under the scheme are disclosed in Note 31.

17 Stocks

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Raw materials and consumables	**50.1**	41.1	**41.5**	33.6
Gas stocks	**48.3**	36.2	**48.3**	36.2
Work in progress	**7.3**	5.6	**3.1**	1.5
Finished goods and goods for resale	**38.5**	30.8	**36.0**	29.7
	144.2	113.7	**128.9**	101.0

Gas stocks represent gas delivered to third parties under sale and repurchase agreements to match gas usage requirements arising mainly from generation, with existing gas purchase obligations. Under the provisions of Financial Reporting Standard No. 5, the cost of gas delivered to third parties is shown as gas stocks and amounts payable to third parties totalling £29.4 million (1997 £25.7 million) are included in accrued expenses in Note 20.

18 Debtors

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
(a) Amounts falling due within one year:				
Trade debtors	**255.5**	428.9	**127.3**	265.7
Amounts owed by subsidiary undertakings	**–**	–	**428.6**	218.3
Prepayments and accrued income	**159.3**	104.9	**102.3**	67.8
Other debtors	**68.9**	48.6	**33.0**	26.3
	483.7	582.4	**691.2**	578.1
(b) Amounts falling due after more than one year:				
Amounts owed by subsidiary undertakings	**–**	–	**1,079.2**	886.2
Amounts receivable under finance leases	**3.0**	3.6	**–**	–
Advance corporation tax recoverable on proposed dividend	**40.7**	36.4	**40.7**	36.4
Other debtors	**3.9**	0.4	**–**	–
	531.3	622.8	**1,811.1**	1,500.7

Amounts receivable under finance leases relate to ScottishPower Leasing Limited, one of the company's subsidiaries (see page 62). The total cost of assets acquired by ScottishPower Leasing Limited for letting under leases is £3.7 million (1997 £4.0 million). Total amounts receivable during the year under finance leases were £0.4 million (1997 £0.4 million).

19 Loans and other borrowings

(a) Analysis by instrument

	Notes	Weighted average interest rate 1998	Weighted average interest rate 1997	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Bank overdraft		**–**	–	**9.3**	22.2	**8.4**	15.7
Uncommitted bank loan		**7.0%**	6.2%	**211.7**	293.4	**211.1**	293.3
Committed bank loan	(i)	**7.1%**	6.5%	**–**	200.6	**–**	200.0
Commercial paper	(ii)	**6.9%**	6.3%	**728.3**	759.3	**728.3**	759.3
Medium term notes/private placements	(iii)	**7.6%**	–	**303.4**	–	**303.4**	–
Loan notes	(iv)	**6.2%**	5.9%	**17.7**	54.1	**14.6**	54.1
European Investment Bank loan	(v)	**10.0%**	10.0%	**176.4**	155.1	**176.4**	–
Lease finance		**–**	–	**–**	8.7	**–**	–
11.457% sterling bond 2001 (held by HM Treasury)		**11.5%**	11.5%	**142.0**	142.0	**142.0**	142.0
5.875% euro-US dollar bond 2003		**6.9%**	–	**182.9**	–	**182.9**	–
Variable coupon bond 2008		**6.8%**	–	**99.6**	–	**–**	–
8.375% euro-sterling bond 2017		**8.4%**	8.4%	**196.8**	196.6	**196.8**	196.6
				2,068.1	1,832.0	**1,963.9**	1,661.0

With the exception of finance leases, all borrowings are unsecured.

(i) Committed bank loan
As at 31 March 1998 there were no amounts drawn (1997 £200 million) under a £2.6 billion (1997 £2.6 billion) revolving credit facility in place until 2001.

(ii) Commercial paper
The company has an established US$2.0 billion (1997 US$1.5 billion) euro-commercial paper programme. Paper is issued in a range of currencies and swapped back into sterling. Amounts borrowed under commercial paper are repayable in less than one year.

(iii) Medium term notes/private placements
The company has an established US$2.0 billion euro-medium term note programme. Paper is issued in a range of currencies and swapped back into sterling. As at 31 March 1998, maturities range from one to ten years. During the year, the group entered into two private placements with Japanese lenders. The loans are denominated in Japanese Yen and have been swapped back into sterling. The loans are for periods of up to ten years.

(iv) Loan notes
All loan notes are redeemable at the holders discretion. Ultimate maturity dates range from 1999 to 2006.

(v) European Investment Bank loan
This loan incorporates agreements with various interest rates and maturity dates. The maturity dates of these arrangements range from 2006 to 2011. During the year this loan was restructured to include Scottish Power plc as a co-borrower.

(b) Maturity analysis

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Repayments fall due as follows:				
Within one year, or on demand	**1,035.7**	1,137.1	**1,031.1**	1,118.6
After more than one year	**1,032.4**	694.9	**932.8**	542.4
	2,068.1	1,832.0	**1,963.9**	1,661.0
Repayments due after more than one year are split as follows:				
Between one and two years	**89.5**	13.3	**89.5**	–
Between two and three years	**165.8**	13.7	**165.8**	–
Between three and four years	**31.4**	153.9	**31.4**	142.0
Between four and five years	**243.0**	214.3	**242.9**	200.0
More than five years	**502.7**	299.7	**403.2**	200.4
	1,032.4	694.9	**932.8**	542.4

19 Loans and other borrowings continued

(c) Interest rate analysis

	Borrowings at 31 March 1998 £m	1997 £m	Weighted average interest rate at which borrowings are fixed/ capped at 31 March 1998 %	1997 %	Weighted average period for which interest rate is fixed/capped 1998 Years	1997 Years
Fixed rate borrowings	**1,668.6**	1,384.6	**8.2**	8.6	**7**	8
Capped rate borrowings	**200.0**	200.0	**7.0**	7.0	**4**	5
Floating rate borrowings	**199.5**	247.4				
	2,068.1	1,832.0				

All amounts in the analysis above are payable in sterling and take into account the effect of interest rate swaps and caps and currency swaps.

Based on the floating rate net debt of £199.5 million at 31 March 1998 (1997 £247.4 million), a 1% change in interest rates would result in a £2.0 million change in profit before tax for the year (1997 £2.4 million change).

(d) Financial instruments and risk management

(i) Overview

The main financial risks faced by the group are exchange rate risk, interest rate risk and Pool price risk. The Board has reviewed and agreed policies for managing each of these risks as summarised below. The use of all classes of financial instruments to manage these risks has been approved by the Board. Corporate treasury, which is authorised to conduct the day-to-day treasury activities of the group, reports at least annually to the Board and is subject to examination by internal audit. The energy trading group, which is authorised to carry out activities to manage the group's Pool price risk, reports monthly to a risk committee which is comprised of two executive directors and an external consultant. The energy trading group also reports at least annually to the Board and is subject to examination by internal audit.

(ii) Treasury strategy

The group uses a variety of financial instruments, including derivatives, to raise finance for its operations and to manage the risks arising from those operations. The group borrows in the major global markets in a range of currencies at both fixed and floating rates of interest, using derivatives where appropriate to generate the desired effective currency profile and interest basis.

This can be done at lowest cost by raising floating rate debt and converting the interest rate obligations to fixed rates, via an interest rate swap and/or cap. The conversion is generally made to fixed rate sterling. This is done where the debt is raised in other than sterling by combining the interest rate swap with a foreign exchange forward contract. Under an interest rate swap, the group agrees with another party to exchange at specific intervals the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. The notional principal of these instruments reflects the extent of the group's involvement in the instruments, but does not represent its exposure to credit risk. Gains and losses on both the medium term debt and the associated swaps are deferred and included in the interest cost of the debt for the relevant period.

All transactions are undertaken to manage the risks arising from underlying activities and no speculative trading is undertaken. The counterparties to these instruments generally consist of financial institutions and other bodies with good credit ratings. Although the group is potentially exposed to credit risk in the event of non-performance by counterparties, such credit risk is controlled through credit rating reviews of the counterparties and by limiting the total amount of the exposure to any one party. The group does not believe that it is exposed to any material concentrations of credit risk.

(iii) Energy trading strategy

Almost all electricity generated in England and Wales must be sold to the Pool, and electricity suppliers must likewise buy electricity from the Pool for resale to their customers. The Pool was established at the time of privatisation in England and Wales for bulk electricity trading between generators and suppliers. ScottishPower participates in the Pool by exporting/importing electricity to/from England and Wales via the Interconnector. The Pool is operated under a Pooling and Settlement Agreement to which all licensed generators and suppliers of electricity in Great Britain are party.

The group has procedures in place to minimise exposure to Pool price variations, that is, the possibility that a change in Pool prices will reduce the proceeds of electricity sold to the Pool or increase the cost of electricity purchased from the Pool. These procedures involve ScottishPower and its subsidiary Manweb entering into contracts for differences (CfDs). In general, the terms of CfDs are such that contracts are settled monthly (or more frequently) in arrears by reference to actual half hourly Pool prices.

These CfDs involve a degree of credit risk. This is the risk that the counterparty to the CfD defaults on settlement. The group controls credit risk arising from holding the CfDs through credit approvals, limits and monitoring procedures.

(iv) Principal financial instruments used by the group

Interest rate swaps

Interest rate swaps are used solely to convert floating rate borrowings to fixed rates to reduce the financial risk to the group from potential future increases in interest rates.

Interest rate caps

Interest rate caps are used solely to limit the group exposure to possible future increases in interest rates.

Forward contracts

The group generally hedges foreign exchange transaction exposures up to one year forward. Hedges are put in place using forward contracts at the time that the forecast exposure becomes reasonably certain. Gains and losses resulting from changes in exchange rates on contracts designated as hedges of forecast foreign exchange transactions are deferred and included in the measurement of the related foreign currency transaction in the period they occur.

Commercial paper is issued in several different foreign currencies. Forward contracts are taken out solely to convert the debt to sterling to eliminate the financial risk to the group of currency movements. As at the year end, the group had outstanding forward foreign exchange contracts, the majority of which were for periods of three months or less, denominated in US Dollars, Canadian Dollars, French Francs, Dutch Guilders, Ecus and Italian Lira.

Contracts for differences (CfDs)

A CfD is a contract between two parties (e.g. a generator and a public electricity supplier) that requires each party to either make or receive monthly payments over a specific term based on the difference between an agreed price (i.e. the bilaterally determined strike price) and a price that varies with a specified commodity index (i.e. the Pool), applied to an agreed quantity (i.e. number of kWs). The average duration for these contracts is approximately one year. The group's use of such derivative instruments relates directly to the underlying purchase and sale of electricity to and from the Pool.

The group has developed a methodology to estimate the internal value (i.e. the group's best estimate of fair value) of the CfDs outstanding at the balance sheet date based upon assumptions of a number of complex factors, in particular the anticipated long term level of Pool prices, total Pool demand, plant availability, plant operating costs, bidding behaviour of generators and appropriate market discount rates. The group has determined that the fair value amount of CfDs, being the difference between the strike price of the contract and the estimated Pool price for the relevant half hourly periods, outstanding at the year end is not material to the group's financial statements.

The gross value of outstanding CfDs as at 31 March 1998 was £781.2 million (1997 £343.7 million).

19 Loans and other borrowings continued

(e) Current value of financial instruments

	At 31 March 1998			At 31 March 1997		
	Book amount £m	**Gross contract amount £m**	**Current value £m**	Book amount £m	Gross contract amount £m	Current value £m
Short term debt and current portion of long term debt	**1,035.7**	**1,035.7**	**1,035.7**	1,137.1	1,137.1	1,137.1
Long term debt	**1,032.4**	**1,036.8**	**1,114.5**	694.9	698.3	731.2
Total debt	**2,068.1**	**2,072.5**	**2,150.2**	1,832.0	1,835.4	1,868.3
Interest rate swaps	**–**	**925.0**	**51.7**	–	875.0	5.3
Interest rate caps	**(4.7)**	**200.0**	**(3.0)**	(8.7)	200.0	(10.8)
Forward rate agreements	**–**	**706.6**	**–**	–	297.4	–
Total financial instruments	**2,063.4**	**3,904.1**	**2,198.9**	1,823.3	3,207.8	1,862.8

The assumptions used to estimate current fair values of financial instruments are summarised below:

(i) For cash and short term deposits and short term borrowings (uncommitted borrowing, commercial paper, loan notes and short term drawings under the £2.6 billion revolving credit facility), the book value amounts approximate to fair value because of their short maturities.

(ii) The fair value of long term sterling bond 2001 and the European Investment Bank loans have been calculated by estimating the premium payable on redemption of these borrowings using market rates adjusted to reflect the redemption adjustments allowed under each agreement.

(iii) The fair value of the euro-sterling bond 2017 has been estimated on the basis of quoted market prices.

(iv) The fair values of the sterling interest rate swaps and sterling interest rate caps have been estimated by calculating the present value of estimated future cash flows, using market discount rates in effect at the balance sheet date.

(v) The above analysis of total debt incorporates the sterling equivalent of all loans sourced in foreign currencies. The value of forward rate agreements used to hedge the underlying currency loans approximates to £706.6 million as at 31 March 1998 (1997 £297.4 million).

20 Other creditors

	Group		Company	
	1998 £m	1997 £m	**1998 £m**	1997 £m
Amounts falling due within one year:				
Trade creditors	**204.6**	165.7	**122.7**	89.9
Amounts owed to subsidiary undertakings	**–**	–	**689.7**	354.0
Corporation tax	**164.1**	148.7	**74.2**	72.1
Windfall tax	**159.2**	–	**47.4**	–
Advance corporation tax	**60.8**	54.6	**60.8**	54.5
Other taxes and social security	**7.3**	19.9	**12.4**	22.9
Payments received on account	**32.7**	47.9	**3.2**	17.8
Capital creditors and accruals	**183.8**	144.4	**62.6**	34.7
Other creditors	**65.7**	74.3	**27.9**	23.7
Accrued expenses	**355.2**	311.0	**191.7**	168.4
Proposed dividend	**162.9**	145.5	**162.9**	145.5
	1,396.3	1,112.0	**1,455.5**	983.5

21 Deferred taxation

No provision for deferred taxation is considered necessary at 31 March 1998, since future taxation depreciation is expected to exceed accounting depreciation and therefore no deferred taxation liabilities are expected to crystallise in the foreseeable future. Total potential deferred liabilities computed at the future rate of corporation tax of 30% (1997 33%) are as follows:

	Group		Company	
	1998 £m	1997 £m	**1998 £m**	1997 £m
Accelerated capital allowances	**609.4**	632.3	**303.5**	316.2
Other timing differences	**(35.8)**	(47.8)	**(7.3)**	(16.0)
Advance corporation tax	**(12.9)**	(51.9)	**–**	–
	560.7	532.6	**296.2**	300.2

22 Provisions for liabilities and charges

	Balance at 1 April 1997 £m	Charged to the profit and loss account £m	Utilised during year £m	**Balance at 31 March 1998 £m**
Group				
Power station repairs and maintenance	9.2	–	(2.6)	**6.6**
Employment claims	5.4	(3.0)	(2.4)	**–**
Reorganisation and restructuring	4.2	(0.6)	(2.5)	**1.1**
Pensions	13.5	2.1	–	**15.6**
Environmental	3.4	–	–	**3.4**
Other	9.9	2.4	(0.9)	**11.4**
	45.6	0.9	(8.4)	**38.1**
Company				
Power station repairs and maintenance	9.2	–	(2.6)	**6.6**
Employment claims	5.4	(3.0)	(2.4)	**–**
Other	3.0	0.8	–	**3.8**
	17.6	(2.2)	(5.0)	**10.4**

23 Deferred income

	Balance at 1 April 1997 £m	Receivable during year £m	Released to profit and loss account £m	**Balance at 31 March 1998 £m**
Grants and customer contributions:				
– Group	335.3	49.9	(20.6)	**364.6**
– Company	172.0	20.0	(12.1)	**179.9**

Deferred income excludes grants and contributions received in respect of water infrastructure assets.

24 Share capital

	Note	**1998 £m**	1997 £m
Authorised:			
1,700,000,000 (1997 1,700,000,000) ordinary shares of 50p each		**850.0**	850.0
One Special Share of £1	(a)	**–**	–
		850.0	850.0
Allotted, called up and fully paid:			
1,196,752,324 (1997 1,177,365,936) ordinary shares of 50p each		**598.4**	588.7
One Special Share of £1	(a)	–	–
		598.4	588.7

(a) Special Share

The ‘Special Share’, which can be held only by one of the Secretaries of State or any other person acting on behalf of HM Government, does not carry rights to vote at the general or separate meetings but entitles the holder to attend and speak at such meetings. Written consent of the Special Shareholder is required before certain provisions of the company’s Articles of Association or certain rights attaching to the Special Share are varied. This share shall confer no rights to participate in the capital or profits of the company, except that in a winding up the Special Shareholder shall be entitled to repayment in priority to the other shareholders. The Special Share is redeemable at par at any time by the Special Shareholder after consultation with the company.

25 Analysis of movements in shareholders' funds

	Notes	Number of Shares 000s	Share capital £m	Share premium £m	Merger reserve £m	Revaluation reserve £m	Profit and loss account £m	Total £m
Group								
Balance at 31 March 1997 (as published)		**1,177,366**	**588.7**	**305.7**	**(419.4)**	**–**	**1,047.7**	**1,522.7**
Prior period reclassification	(a)	–	–	–	419.4	–	(419.4)	–
Balance at 31 March 1997 (as restated)		**1,177,366**	**588.7**	**305.7**	**–**	**–**	**628.3**	**1,522.7**
Retained loss for the year		–	–	–	–	–	(73.2)	(73.2)
Share capital issued								
– Employee sharesave scheme	(b)	18,687	9.3	81.1	(5.2)	–	(42.0)	43.2
– Executive share option scheme		699	0.4	1.9	–	–	–	2.3
Revaluation of fixed assets (see Note 15)		–	–	–	–	229.0	–	229.0
Revaluation surplus realised		–	–	–	–	(1.7)	1.7	–
Goodwill written off	(a)	–	–	–	5.2	–	(21.4)	(16.2)
Balance at 31 March 1998		**1,196,752**	**598.4**	**388.7**	**–**	**227.3**	**493.4**	**1,707.8**
Company								
Balance at 1 April 1997		**1,177,366**	**588.7**	**305.7**	**13.4**	**–**	**949.7**	**1,857.5**
Retained loss for the year	(c)	–	–	–	–	–	(24.2)	(24.2)
Share capital issued								
– Employee sharesave scheme	(b)	18,687	9.3	81.1	(5.2)	–	(42.0)	43.2
– Executive share option scheme		699	0.4	1.9	–	–	–	2.3
Balance at 31 March 1998		**1,196,752**	**598.4**	**388.7**	**8.2**	**–**	**883.5**	**1,878.8**

(a) Goodwill written off

On 1 September 1997, the company entered into an agreement with Martin Dawes Telecommunications Limited (MDT) whereby each company acquired 50% of the share capital of Scottish Telecommunications (Services) Limited (STS). On the same day, STS acquired both the share capital of Woodend Group Limited and the Scottish mobile telephone business of MDT. The business of Woodend, being the mobile telephone operations of ScottishPower, was then transferred up to STS. Goodwill written off during the period relates to these transactions and the acquisitions of Telephone International Media Limited on 1 August 1997, Pinnacle Cellular Limited on 25 February 1998 and Lancastrian Holdings Limited on 31 March 1998. In each case, the entire share capital was acquired. The cumulative amount of goodwill written off to reserves at 31 March 1998, and the reserves to which they have been written off, are shown in the table below. In accordance with the requirement of FRS 10 not to show eliminated goodwill as a debit balance on a separate goodwill write-off reserve, the comparatives for 1997 have been restated such that goodwill is eliminated against merger reserve to reduce the merger reserve to zero and thereafter has been offset against the profit and loss reserve.

Cumulative goodwill written off	1998 £m	As restated 1997 £m	As published 1997 £m
Merger reserve	**574.2**	579.4	998.8
Profit and loss account	**462.5**	441.1	21.7
Total	**1,036.7**	1,020.5	1,020.5

(b) Share capital issued

The movement on the merger reserve reflects the reduction in shares to be issued following the acquisition of Southern Water plc in August 1996. It represented the cost to ScottishPower of transferring existing options over Southern Water plc shares to the Scottish Power plc Share Option Scheme. As these options are exercised, the merger reserve is reduced for the attributable cost of the option.

The movement on the profit and loss account represents the difference between the exercise price of options granted under the employee sharesave scheme and the market value of the company's shares immediately prior to the company issuing shares to a Qualifying Employee Share Ownership Trust in respect of these options.

(c) Profit and loss account of the company

As permitted by Section 230 of the Companies Act 1985, the company has not presented its own profit and loss account. The company's profit and loss account was approved by the Board on 6 May 1998. The profit for the financial year per the accounts of the company was £219.1 million (1997 £300.5 million).

26 Minority interests

	1998 £m	1997 £m
Equity minority interests:		
Balance at 1 April	**0.4**	(0.8)
Additions	**0.6**	0.7
Profit and loss account	**0.9**	0.5
Balance at 31 March	**1.9**	0.4

27 Pensions

Pension fund	Scheme type	Funded or unfunded	Pension charge for the year 1998 £m	Pension charge for the year 1997 £m	Prepayment as at 31 March 1998 £m	Prepayment as at 31 March 1997 £m
ScottishPower	Defined benefit	funded	**6.5**	13.6	**11.9**	18.4
Manweb	Defined benefit	funded	**5.8**	6.0	**–**	–
Southern Water	Defined benefit	funded	**5.8**	5.1	**–**	–

Pension fund	Latest full actuarial valuation	Valuation carried out by	Value of assets based on valuation £m	Valuation method adopted	Principal actuarial assumptions: Average investment rate of return	Average salary increases	Average pension increases	Value of fund assets/ accrued benefits
ScottishPower	31 December 1994	William M Mercer	1,025.7	projected unit	9.0%	7.0%	5.0%	111%
Manweb	31 March 1995	Bacon & Woodrow	412.3	projected unit	9.0%	7.0%	5.0%	100%
Southern Water	31 March 1995	Watson Wyatt	148.3	projected unit	8.5%	6.5%	5.0%	102%

(a) Effect of the Finance (No. 2) Act 1997
The Chancellor has abolished the payment of tax credits for pension schemes on dividends paid on or after 2 July 1997. The impact of this change will be incorporated within the remaining actuarial valuations which are currently being undertaken and will be spread over the expected remaining service lives of the members of the schemes. The directors have sought advice from the actuaries regarding the likely impact of the removal of the ACT credit and are of the opinion that the impact will not be material.

(b) ScottishPower
The company operates a funded pension scheme providing defined benefits based on final pensionable salary for eligible employees of the company. The assets of the Scheme are held separately from those of the company in a separate trustee administered fund. The pension charge for the year is based on the advice of the Scheme's independent qualified actuary. The prepayment included in the balance sheet represents the accumulated excess of the actual contributions paid to the Scheme over the pension accounting charge. During the year a valuation review of the Scheme was carried out by William M Mercer as part of the preparation for the full actuarial valuation as at 31 December 1997. The outcome of the review resulted in the accounting rate used for the calculation of the 1997-98 pension charge (shown in the table above) reducing from 10.6% of pensionable salaries to 4.8% of pensionable salaries. The Trustees of the Scheme are due to finalise approval of the full valuation at their meeting in June 1998, the results of which are consistent with the valuation review. The full valuation takes account of a full review of the long term actuarial assumptions following the abolition of ACT credits in July 1997. The revised assumptions assume a reduced long term rate of price inflation of 4.5% per annum, resulting in revised assumptions of an average investment rate of return of 8.5% per annum, average salary increases of 6.5% per annum and average pension increases of 4.5% per annum.

(c) Manweb
Most of the Manweb employees are entitled to join the Electricity Supply Pension Scheme which provides pension and other related benefits based on final pensionable pay to employees throughout the Electricity Supply Industry in England and Wales. The assets are held in a separate trustee administered fund. The pension charge for the year is based on the advice of the Scheme's independent qualified actuary.

(d) Southern Water
The Southern Water group operates a number of pension schemes. The scheme details above relate to the principal defined benefit scheme which covers the majority of the Southern Water employees. The assets are held in a separate trustee administered fund. Southern Water's other schemes are not material to the group. The pension charge for the year is based on the advice of the scheme's independent qualified actuary. The 1997 comparative relates only to the post-acquisition period. The full year charge was £7.6 million.

28 Contingent liabilities

(a) The group has contingent liabilities under performance bonds and actual and potential claims, none of which, in the opinion of the directors, is material to the group.

(b) The company has guaranteed the overdraft of one subsidiary undertaking up to an amount of £0.5 million (1997 one subsidiary undertaking for £0.5 million).

(c) The company has guaranteed Manweb's liabilities to the Pool in England and Wales. At 31 March 1998 these liabilities were £37.4 million (1997 £30.3 million).

29 Financial commitments

(a) Group analysis of annual commitments under operating leases

Leases of land and buildings	1998 £m	1997 £m
Expiring within one year	**0.5**	0.1
Expiring between two and five years inclusive	**1.3**	0.8
Expiring in over five years	**16.2**	13.5
	18.0	14.4
Other operating leases		
Expiring within one year	**4.5**	6.2
Expiring between two and five years inclusive	**7.8**	3.9
Expiring in over five years	**0.6**	0.3
	12.9	10.4

(b) Group analysis of annual commitments under finance leases

	1998 £m	1997 £m
Expiring within one year	**–**	3.2
Expiring between two and five years inclusive	**–**	5.4
Expiring in over five years	**–**	0.1
	–	8.7

As at 31 March 1998, no finance lease commitments existed for the group and company (1997 no finance lease commitments for the company).

29 Financial commitments continued

(c) Capital commitments

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Contracted but not provided	**262.0**	394.4	**70.3**	49.5

(d) Other contractual commitments

Under contractual commitments the group has rights and obligations in relation to the undernoted contracts. The annual value of the purchases and income arising from these contracts is provided below.

	Notes	Commitment entered into	Commitment expires	Purchases/sales in year under group commitments 1998 £m	1997 £m
The purchase of electricity from Scottish Nuclear Limited		1990	2005	**365.8**	373.2
The purchase of electricity from Scottish Hydro-Electric plc	(i)	1990	see below	**100.5**	120.5
The supply of electricity to Scottish Hydro-Electric plc		1990	2004	**16.8**	15.7
Revenue from the operation of the company's transmission system and access by Scottish Hydro-Electric plc to the Anglo-Scottish Interconnector		1990	no fixed date of expiry	**26.1**	24.7
Purchase of coal from the Scottish Coal Company Limited	(ii)	1998	see below	**76.9**	75.5
Purchase of gas from various fields in the North Sea		1994	2010	**81.8**	50.4

(i) There are two agreements relating to the purchase of electricity from Scottish Hydro-Electric plc. These expire in 2012 and 2039.

(ii) A contract will be signed with Scottish Coal Company Limited on 10 May 1998 to secure supplies of coal from deep mines for 1.67 million tonnes per annum for 6 years from 1 April 1998 and from opencast mines for 0.75 million tonnes per annum for 5 years from 1 April 1998.

30 Related party transactions

In accordance with FRS 8, the following disclosure relates to related party transactions during the year.

Related party transactions and balances with joint ventures and associated undertakings

(a) Trading transactions and balances arising in the normal course of business

Related party	Related party relationship to group	Sales/(purchases) to/(from) other group companies during the year 1998 £m	1997 £m	Amounts due from/(to) other group companies as at 31 March 1998 £m	1997 £m
Sales by related parties					
Scotland On-Line Limited	50% owned subsidiary	**0.2**	0.1	**–**	0.1
ScottishPower Telecommunications (Services) Limited	50% owned subsidiary	**0.9**	–	**0.2**	–
Purchases by related parties					
Scotland On-Line Limited	50% owned subsidiary	**(0.3)**	(0.1)	**(0.3)**	(0.1)
Scottish Electricity Settlements Limited	50% owned joint venture	**(1.3)**	(1.2)	**(0.3)**	(0.7)
ScottishPower Telecommunications (Services) Limited	50% owned subsidiary	**(0.2)**	–	**(0.1)**	–

Southern Water non-core businesses

The group made purchases of £18 million on normal trading terms from the Southern Water non-core businesses subsequent to their disposal.

(b) Funding transactions and balances arising in the normal course of business

Related party	Related party relationship to group	Interest receivable/(payable) from/(to) other group companies during the year 1998 £m	1997 £m	Amounts due from/(to) other group companies as at 31 March 1998 £m	1997 £m
Scottish Electricity Settlements Limited	50% owned joint venture	**(0.6)**	(0.1)	**(11.8)**	(1.7)
Scotland On-Line Limited	50% owned subsidiary	**–**	–	**(0.2)**	–
ScottishPower Telecommunications (Services) Limited	50% owned subsidiary	**–**	–	**(0.3)**	–
CeltPower Limited	50% owned subsidiary	**–**	–	**(2.0)**	(2.7)
Wind Resources Limited	45% owned associated undertaking	**–**	–	**(0.7)**	(1.1)

(c) Other related party transactions

ScottishPower Telecommunications (Services) Limited 50% owned subsidiary

The group's 50% interest in ScottishPower Telecommunications (Services) Limited (STS) arose through the transactions detailed in Note 25(a).

31 Employee Share Schemes

The group has three types of share scheme for employees. Options have been granted and awards made to eligible employees to subscribe for ordinary shares in Scottish Power plc in accordance with the rules of each scheme. The ScottishPower and Southern Water Schemes are savings related and under normal circumstances share options are exercisable on completion of a three, five or seven year save-as-you-earn contract as appropriate. The Executive Share Option Scheme applied to executive directors and certain senior managers. However, this Scheme has been replaced with the Long Term Incentive Plan and, although it will not affect options already granted, this plan supersedes executive share options. Awards granted under the Long Term Incentive Plan will vest only if the Emoluments and Nominations Committee is satisfied that certain performance measures related to the sustained underlying financial performance of the group and improvements in customer service standards are achieved over a period of three financial years commencing with the financial year preceding the date an award is made.

(a) Summary of movements in share options in ScottishPower shares

	ScottishPower Sharesave Scheme (number of shares 000s)	Southern Water Sharesave Scheme (number of shares 000s)	Executive Share Option Scheme (number of shares 000s)	Total (number of shares 000s)
Outstanding at 1 April 1997	17,514	6,692	1,553	25,759
Granted	5,268	–	–	5,268
Exercised	(2,813)	(1,956)	(699)	(5,468)
Lapsed	(974)	(487)	–	(1,461)
Outstanding at 31 March 1998	**18,995**	**4,249**	**854**	**24,098**

(b) Analysis of share options outstanding at 31 March 1998

	Date of grant	Number of participants	Number of shares (000s)	Option price (pence)	Normal exercisable date
ScottishPower Sharesave Scheme	06.10.92	13	40	197.6	6 months to June 1998
	30.06.93	694	958	248.4	6 months to March 1999
	22.06.94	1,078	1,365	273.8	6 months to March 2000
	20.06.95	1,002	1,215	262.1	6 months to March 2001
	20.06.96	5,388	10,348	263.1	6 months to March 2000 or 2002
	20.06.97	4,971	5,069	307.0	6 months to March 2001 or 2003
Southern Water Sharesave Scheme	16.01.91	83	434	70.4	6 months to September 1998
	03.02.92	69	286	74.0	6 months to September 1999
	26.01.93	340	965	111.0	6 months to September 1998 or 2000
	25.01.94	332	545	154.9	6 months to September 1999 or 2001
	25.01.95	454	1,137	136.1	6 months to September 2000 or 2002
	25.01.96	503	882	160.2	6 months to September 2001 or 2003
Executive Share Option Scheme	18.12.91	8	128	227.4	1994-2001
	25.06.92	14	23	237.7	1995-2002
	01.07.93	4	60	310.0	1996-2003
	17.12.93	48	70	454.8	1996-2003
	27.05.94	15	56	354.0	1997-2004
	18.11.94	5	34	352.1	1997-2004
	12.05.95	24	395	335.0	1998-2005
	10.11.95	3	88	357.5	1998-2005

All options are exercisable over Scottish Power plc shares. Where reference is made to Southern Water, this is to identify the Sharesave Scheme under which the options over Scottish Power plc shares have been granted. The exercise prices of options granted prior to the rights issue on 30 August 1996 were adjusted to reflect the bonus element inherent in the rights issue.

For the Southern Water Sharesave Scheme, the date of grant refers to the date the original Southern Water share options were granted. These options were exchanged for options over ScottishPower shares following acquisition in 1996.

32 Directors' emoluments and interests

(a) Policy

The Emoluments and Nominations Committee is responsible for determining the remuneration policy for the ScottishPower group. The aim of ScottishPower's remuneration policy is to ensure that the rewards for executives and directors attract and retain executives of high quality who are incentivised to achieve performance which exceeds that of competitors. Furthermore, the objective is to ensure that incentive schemes are in line with best practice and promote the interests of the shareholders.

(b) Total emoluments

The following table provides a breakdown of the total emoluments of the Chairman and all directors in office during the year ended 31 March 1998. Full details of the remuneration policy of the ScottishPower group are contained in the Report of the Emoluments and Nominations Committee on pages 35 to 37.

	Basic Salary £	Bonuses £	Benefits in kind £	**Total 1998 £**	Total 1997 £
Chairman and executive directors					
C M Stuart	180,000	–	14,294	**194,294**	154,665
I Robinson	350,000	119,875	17,470	**487,345**	397,256
M J Kinski (resigned 7 April 1998)	237,500	90,000	7,970	**335,470**	267,716
I M Russell	245,833	83,100	27,145	**356,078**	333,706
K L Vowles	180,000	61,650	11,851	**253,501**	210,576
D Whyte	215,000	73,638	17,338	**305,976**	279,169
Non-executive directors (fees and expenses)					
Sir Ronald Garrick	30,000	–	1,889	**31,889**	25,449
Sir Peter Gregson	22,500	–	2,460	**24,960**	7,999
Baroness Jay of Paddington (resigned 13 May 1997)	2,661	–	836	**3,497**	13,038
N C D Kuenssberg (retired 23 July 1997)	10,000	–	–	**10,000**	25,540
E C S Macpherson	28,333	–	1,689	**30,022**	13,421
J Parnaby	22,500	–	4,145	**26,645**	23,825
J A Scott (retired 24 July 1996)	–	–	–	–	7,028
	1,524,327	428,263	107,087	**2,059,677**	1,759,388
Other emoluments – executive directors					
Relocation expenses	–	–	–	**14,358**	6,368
Pension contributions	–	–	–	**128,892**	130,752
Total	1,524,327	428,263	107,087	**2,202,927**	1,896,508

The emoluments of the highest paid director (Mr Robinson) excluding pension contributions were £487,345 (1997 £397,256). Pension contributions made by the company under approved pension arrangements for Mr Robinson amounted to £nil (1997 £10,138). Mr Robinson also has an entitlement under the unapproved pension benefits described further in note c(iii) below. The total of the liabilities for the 14 executives and senior employees arising in relation to unapproved benefits for service for the year to 31 March 1998 is £432,676 (31 March 1997 £305,952)

(c) Directors' pension benefits

An overview of pension benefits provided to all executive directors is set out in the Report of the Emoluments and Nominations Committee on pages 35 to 37. Details of pension benefits earned by the executive directors are shown below:

Defined benefits pension scheme

	Transferred in benefits £	Additional pension earned in the year £	Accrued entitlement £	Transfer value of increases after indexation (net of Directors' contribution) £
Chairman and executive directors				
C M Stuart	–	–	–	–
I Robinson	97,650	7,831	141,348	114,606
M J Kinski	29,011	3,564	50,639	35,671
I M Russell	6,748	2,076	23,553	19,994
K L Vowles	79,685	3,278	99,289	39,457
D Whyte	60,416	2,433	95,456	44,030

(i) The accrued entitlement of the highest paid director (Mr Robinson) was £141,348 (1997 £101,762).

(ii) The pension entitlement shown is that which would be paid annually on retirement based on service to the end of the year. Members of the scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.

(iii) Executives who joined the company on or after 1 June 1989 are subject to the earnings cap introduced in the Finance Act 1989. Pension entitlements which cannot be provided through the company's approved schemes due to the earnings cap are provided through unapproved pension arrangements. Full details are included in the Report of the Emoluments and Nominations Committee. The pension benefits disclosed above include approved and unapproved pension arrangements.

(iv) The increase in additional pension earned in the year excludes any increase for inflation.

(v) The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11, less directors' contributions.

(vi) Transferred in benefits represent pension rights accrued in respect of previous employments.

32 Directors' emoluments and interests continued

(d) Directors' interests in share options

Executive director	At 1 April 1997	Granted	Exercised	At 31 March 1998	Option exercise price (pence)	Date exercised	Market price at date of exercise (pence)	Date from which exercisable	Expiry date
Maximum contingent awards under Long Term Incentive Plan									
I Robinson	51,533	–	–	51,533	nil			09.08.2000	08.08.2003
	–	53,846	–	53,846	nil			16.05.2001	15.05.2004
	51,533	53,846	–	105,379					
M J Kinski (resigned 7 April 1998) (see footnote)	36,809	–	–	36,809	nil				
	–	33,846	–	33,846	nil				
	36,809	33,846	–	70,655					
I M Russell	38,650	–	–	38,650	nil			09.08.2000	08.08.2003
	–	36,923	–	36,923	nil			16.05.2001	15.05.2004
	38,650	36,923	–	75,573					
K L Vowles	27,607	–	–	27,607	nil			09.08.2000	08.08.2003
	–	27,692	–	27,692	nil			16.05.2001	15.05.2004
	27,607	27,692	–	55,299					
D Whyte	35,889	–	–	35,889	nil			09.08.2000	08.08.2003
	–	32,307	–	32,307	nil			16.05.2001	15.05.2004
	35,889	32,307	–	68,196					
Executive Share Option Scheme									
I Robinson (see footnote)	286,457	–	–	286,457	335.0			12.05.1998	11.05.2005
M J Kinski (resigned 7 April 1998)	14,822	–	(14,822)	–	354.0	24.11.1997	483.0		
	17,033	–	(17,033)	–	352.1	24.11.1997	483.0		
	31,855	–	(31,855)	–					
I M Russell	139,748	–	(139,748)	–	354.0	12.01.1998	515.5		
	17,033	–	(17,033)	–	352.1	12.01.1998	515.5		
	156,781	–	(156,781)	–					
K L Vowles	2,505	–	(2,505)	–	454.8	09.12.1997	508.0		
	3,274	–	(3,274)	–	354.0	09.12.1997	508.0		
	44,570	–	(44,570)	–	352.1	09.12.1997	508.0		
	50,349	–	(50,349)	–					
D Whyte	6,593	–	(6,593)	–	454.8	10.12.1997	506.0		
	9,316	–	(9,316)	–	354.0	24.11.1997	483.0		
	28,956	–	(28,956)	–	352.1	24.11.1997	483.0		
	44,865	–	(44,865)	–					
Sharesave Scheme									
I Robinson	6,581	–	–	6,581	262.1			01.09.2000	28.02.2001
M J Kinski (resigned 7 April 1998) (see footnote)	4,861	–	–	4,861	248.4			01.09.1998	28.02.1999
	1,111	–	–	1,111	263.1*			01.09.1999	29.02.2000
	5,972	–	–	5,972					
I M Russell	6,300	–	–	6,300	273.8			01.09.1999	29.02.2000
K L Vowles	3,795	–	(3,795)	–	197.6	01.12.1997	478.7		
	3,933	–	–	3,933	263.1			01.09.2001	28.02.2002
	7,728	–	(3,795)	3,933					
D Whyte	3,795	–	(3,795)	–	197.6	01.12.1997	478.7		
	2,223	–	–	2,223	263.1*			01.09.1999	29.02.2000
	6,018	–	(3,795)	2,223					

* Denotes options granted under a three year scheme.

Footnote
The option for 286,457 shares held by Mr Robinson was exercised on 15 May 1998, the relevant market price at the date of exercise being 542p per share.
Following the resignation of Mr Kinski from the Board, the awards and options granted to him under the Long Term Incentive Plan and the Sharesave Scheme have lapsed.
Awards made to directors under the Long Term Incentive Plan on 7 May 1998 were as follows: I Robinson 41,916; I M Russell 31,706; K L Vowles 22,570; and D Whyte 25,257.

32 Directors' emoluments and interests continued

Notes

(i) The market price of the shares at 31 March 1998 was 562.5p and the range during 1997–98 was 352.0p to 582.0p

(ii) The Long Term Incentive Plan supersedes the Executive Share Option Scheme, and annual awards to acquire shares in ScottishPower at nil or nominal cost are made to the plan participants up to a maximum value equal to 60% of base salary. The award will vest only if the Emoluments and Nominations Committee is satisfied that certain performance measures related to the sustained underlying financial performance of the company and improvements in certain OFFER published Customer Service Standards and OFWAT published levels of service (in the case of awards granted in 1997) are achieved over a period of three financial years commencing with the financial year preceding the date an award is made. Assuming that such targets have been achieved, the number of shares that can be acquired will be dependent upon how the company ranks in terms of its total shareholder return performance over a three year period, in comparison to the constituent companies of the FTSE 100 Index and the electricity and water sectors. A percentage of each half of the award will vest depending upon the company's ranking within each of the relevant comparator groups. The plan participant may acquire the shares in respect of the percentage of the award which has vested at any time after the fourth year up to the seventh year after the grant of the award. No dividends accrue to participants prior to vesting.

(iii) The option price of executive share options is based on the middle-market share price on the day immediately preceding the date of grant. For Sharesave options, the option price is calculated in the same way at the date of invitation and discounted by 20% in accordance with the Inland Revenue rules for such schemes.

(iv) The options initially granted to each executive director under the Executive Share Option Scheme were based on a multiple of four times salary in respect of the Chief Executive, Mr Robinson, and three times in respect of the other executive directors, which is in accordance with the limits set out in current guidelines. Subsequent grants of options were made to reflect increases in directors' basic salary levels, following periodic review by the Emoluments and Nominations Committee of the performance of the company and the executive directors individually. Executive options are normally exercisable in a manner which does not attract an income tax liability provided that exercise occurs between three and ten years after the date of grant and at least three years have elapsed from the date of the last 'tax relieved' exercise. Total gains made on exercise of directors' share options during the year were £424,097(1997 £16,979).

(v) The number of options granted to a director under the Sharesave Scheme is calculated by reference to the total amount which the director agrees to save for a period of three or five years under an Inland Revenue approved savings contract, subject to a current maximum of £250 per month. Options under the Sharesave Scheme are, subject to a few exceptions, exercisable within a period of six months from the date of completion of the savings contract.

33 Summary of differences between UK and US Generally Accepted Accounting Principles ("GAAP")

The consolidated financial statements of the group are prepared in accordance with UK GAAP which differs in certain significant respects from US GAAP. The effect of the US GAAP adjustments to profit for the financial year and equity shareholders' funds are set out in the tables below.

(a) Reconciliation of profit for the financial year to US GAAP:

	1998 £m	1997 £m
Profit for the financial year under UK GAAP	**170.1**	421.1
US GAAP adjustments:		
Amortisation of goodwill	**(29.8)**	(23.7)
Deferred tax	**(28.1)**	(55.2)
Pensions	**22.7**	16.0
Depreciation on revaluation uplift	**1.7**	–
	136.6	358.2
Deferred tax effect of US GAAP adjustments:		
Pensions	**(6.8)**	(5.3)
Profit for the financial year under US GAAP	**129.8**	352.9
Earnings per share under US GAAP	**11.00p**	31.66p
Earnings per share before windfall tax under US GAAP	**37.86p**	31.66p

(b) Effect on equity shareholders' funds of differences between UK GAAP and US GAAP:

	1998 £m	1997 £m
Equity shareholders' funds under UK GAAP	**1,707.8**	1,522.7
US GAAP adjustments for:		
Goodwill	**1,036.7**	1,020.5
Business combinations	**163.1**	152.3
Amortisation of goodwill	**(62.1)**	(32.3)
ESOP shares held in trust	**(36.6)**	–
Pensions	**99.2**	76.5
Dividends	**162.9**	145.5
Revaluation of fixed assets	**(229.0)**	–
Depreciation on revaluation uplift	**1.7**	–
Deferred tax:		
Effect of US GAAP adjustments	**(30.4)**	(12.8)
Effect of differences in methodology	**(560.7)**	(532.6)
Equity shareholders' funds under US GAAP	**2,252.6**	2,339.8

Principal Subsidiary Undertakings and Other Investments

Subsidiary undertakings	Class of share capital	Proportion of shares held	Activity
Caledonian Gas Limited	Ordinary shares £1	100%	Gas retailing
CRE Energy Limited*	Ordinary shares £1	100%	Wind-powered electricity generation
Domestic Appliance Insurance Limited* (Isle of Man)	Ordinary shares £1	100%	Insurance
Genscot Limited*	Ordinary shares £1	100%	Holding of investments
Lancastrian Holdings Limited* (1)	Ordinary shares £1	100%	Premium rate service company
Manweb Energy Consultants Limited*	Ordinary shares £1	100%	Electrical contracting
Manweb Gas Limited*	Ordinary shares £1	100%	Gas retailing
Manweb Generation Holdings Limited*	Ordinary shares £1	100%	Holding company
Manweb Generation (Winnington) Limited*	Ordinary shares £1	100%	Holding company
Manweb plc*	Ordinary shares 50p	100%	Regional electricity company
Pinnacle Cellular Limited*	Ordinary shares £1	100%	Specialist communication retailer
Scotland On-Line Limited*	Ordinary shares £1	50%	Internet service provider
ScottishPower Insurance Limited* (Isle of Man)	Ordinary shares £1	100%	Insurance
ScottishPower Investments Limited (2)	Ordinary shares £1	100%	Holding of investments
ScottishPower Leasing Limited*	Ordinary shares £1	100%	Leasing company
ScottishPower Telecommunications Limited*	Ordinary shares £1	100%	Telecommunications
ScottishPower Telecommunications (Services) Limited	Ordinary shares £1	50%	Mobile telecommunications
Southern Water plc	Ordinary shares £1	100%	Holding company
Southern Water Services Finance plc	Ordinary shares £1	100%	Finance company
Southern Water Services Limited*	Ordinary shares £1	100%	Water supply and waste water services
Teledata (Holdings) Limited	Ordinary shares £1	100%	Telecommunications
Telephone International Media Limited	Ordinary shares £1	100%	Telecommunications
Telephone Information Services Limited	Ordinary shares £1	100%	Telecommunications
Fixed asset investments			
Joint ventures			
CeltPower Limited	Ordinary shares £1	50%	Wind-powered electricity generation
Scottish Electricity Settlements Limited	Ordinary shares £1	50%	Scottish electricity settlements
South Coast Power Limited	Ordinary shares £1	50%	Electricity generation
Associated undertakings			
Coastal Wastewater Consultants Limited*	Ordinary shares £1	50%	Marine treatment, engineering design and consultancy
Wind Resources Limited*	Ordinary shares £1	45%	Wind-powered electricity generation
Other investments			
Folkestone & Dover Water Services Limited*	Ordinary shares £1	25%	Water supply
	Preference shares £1	22%	
	Deferred shares £1	12%	

Notes

* The investments in these companies are indirect holdings.
(1) The year end of Lancastrian Holdings Limited is 31 December.
(2) The year end of ScottishPower Investments Limited is 28 February

All companies are incorporated in the United Kingdom, unless otherwise stated.

Report of the Auditors

to the members of Scottish Power plc

We have audited the financial statements on pages 38 to 62.

Respective responsibilities of directors and auditors

As described on page 34, the company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the Accounting Policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit 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 statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the company and the group at 31 March 1998 and of the profit, total recognised gains and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers & Lybrand

Coopers & Lybrand
Chartered Accountants and Registered Auditors
Glasgow

6 May 1998

Report of the Auditors

to Scottish Power plc on Corporate Governance matters

In addition to our audit of the financial statements, we have reviewed the directors' statements on pages 33 and 34 concerning the company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

Basis of opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the group's system of internal financial control or its corporate governance procedures nor on the ability of the group and company to continue in operational existence.

Opinion

With respect to the directors' statements on internal financial control on pages 33 and 34 and going concern on page 34, in our opinion the directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statements on pages 33 and 34 appropriately reflect the company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

Coopers & Lybrand

Coopers & Lybrand
Chartered Accountants
Glasgow

6 May 1998

Five Year Financial Summary

	Years ended 31 March				
	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Results					
Turnover	3,128	2,941	2,271	1,716	1,569
Earnings before interest, tax & depreciation	932	790	515	430	413
Profit before taxation	640	558	404	375	351
Profit after ordinary taxation	488	422	295	274	258
Windfall tax	(317)	–	–	–	–
Profit for financial year	170	421	296	274	258
Dividends	(243)	(218)	(146)	(112)	(101)
Free cash flow*	707	573	242	180	335
Capital expenditure (net)	630	460	227	166	142
Net debt	1,953	1,790	632	86	4
Net Assets	1,710	1,523	1,207	1,106	942
Ratios and statistics					
Gearing	114%	118%	52%	8%	0%
Earnings per ordinary share*	41.28p	38.11p	33.12p	32.88p	30.95p
Dividend per ordinary share	20.40p	18.50p	15.50p	13.65p	12.40p
Return on equity*	27.2%	27.7%	24.5%	24.8%	27.4%
Interest cover	5.3x	6.2x	14.4x	61.5x	41.8x
Employees					
Number of employees (full time equivalent) at 31 March					
– Scottish Energy businesses	4,748	4,916	5,215	5,595	5,922
– Manweb	2,151	2,757	2,979	–	–
– Southern Water	2,364	3,526	–	–	–
– Developing businesses	5,043	3,202	2,579	2,445	2,058
	14,306	14,401	10,773	8,040	7,980
US GAAP information					
Profit for the financial year under US GAAP	£130m	£353m	£271m	–	–
Earnings per ordinary share per US GAAP*	37.86p	31.66p	30.14p	–	–
Equity Shareholders' funds per US GAAP	£2,253m	£2,340m	£1,510m	–	–

* 1998 figures are quoted excluding the effects of the windfall tax liability of £317 million and the windfall tax payment of £158 million.

Company Information

Non-executive directors

Murray Stuart *Chairman*
Mair Barnes
Sir Ronald Garrick
Sir Peter Gregson
Ewen Macpherson
John Parnaby

Executive directors

Ian Robinson *Chief Executive*
Ian Russell *Finance Director*
Ken Vowles *Executive Director Generation and Energy Trading*
Duncan Whyte *Executive Director Multi-Utility*

Secretary and Registered Office

Andrew Mitchell
1 Atlantic Quay
Glasgow G2 8SP

Members of the Audit Committee

Sir Ronald Garrick *Chairman*
Sir Peter Gregson *(with effect from 20 March 1998)*
Ewen Macpherson
Murray Stuart

Members of the Emoluments and Nominations Committee

Ewen Macpherson *Chairman*
Mair Barnes *(with effect from 24 April 1998)*
Sir Ronald Garrick
Sir Peter Gregson
John Parnaby

Shareholder Information

The year ahead

1 June 1998	Shares 'ex-dividend'
5 June 1998	Last date for registering transfers to receive the final dividend
22 July 1998	Annual General Meeting
1 October 1998	Final dividend payable
November 1998	Announcement of interim results for 1998–99
December 1998	Shares 'ex-dividend'
December 1998	Last date for registering transfers to receive the interim dividend
March 1999	Interim dividend payable
May 1999	Preliminary announcement of final results for 1998–99

Annual General Meeting

The Annual General Meeting will be held at the Edinburgh Festival Theatre, 13/29 Nicolson Street, Edinburgh, on Wednesday 22 July 1998 at 11.00 a.m. Details of the resolutions to be proposed at the Annual General Meeting are contained in the Notice of Meeting.

Interim Report

The company, as permitted by the London Stock Exchange, publishes its Interim Report in one national newspaper. In 1998, it is expected that the Interim Report will be published in The Daily Telegraph. Press releases and up-to-date information on the company can also be found on the ScottishPower web page (www.scottishpower.plc.uk).

Copies of the Interim Report may be obtained, free of charge, on request from the Company Secretary at the company's registered office.

Share registration enquiries

The Registrar
Bank of Scotland
Apex House
9 Haddington Place
Edinburgh EH7 4AL
Tel: 0870 6015366
Fax: 0131 243 5047

Shareholder services

ScottishPower, by arrangement with Bank of Scotland and Barclays Stockbrokers Limited, offers the following services for the private investor:

Share consolidation and PEPs
Share consolidation is a facility which allows a number of holdings, and especially family holdings, to be consolidated into one holding. This service is provided free of charge.

Personal equity plans (PEPs) are suitable for those private investors who may wish to shelter their ScottishPower shares from Income and Capital Gains Taxes. A Corporate PEP service is offered, comprising the ScottishPower General PEP and ScottishPower Single Company PEP.

Further details of these services, and copies of the ScottishPower PEP brochure, may be obtained from Bank of Scotland on Freephone 0500 143543.

Share dealing
ScottishPower shares may be bought or sold at competitive rates by post or telephone. For further details, please contact Barclays Stockbrokers on 0345 777400.

Analysis of shareholders

Range of holdings	No. of shareholders	No. of shares
1–100	17,485	758,936
101–200	248,618	41,499,746
201–600	195,256	59,200,580
601–1,000	39,547	30,305,551
1,001–5,000	46,686	83,062,760
5,001–100,000	3,791	59,266,944
100,001 and above	711	922,657,807

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