

Northern Gas Networks Holdings Limited

Annual Report and accounts
for the year ended 31 December 2006

Registered number: 5213525

Directors' report

For the year ended 31 December 2006

The directors present their Annual Report on the affairs of the group, together with the accounts and auditors' report, for the year ended 31 December 2006.

Principal activity

The principal activity of the group throughout the year was the distribution of gas through the North of England network.

The subsidiary undertakings principally affecting the profits or net assets of the group in the year are listed in note 12 to the accounts.

Business review

The business has made a strong start in achieving both its operational and financial targets during the key early stages of new ownership in the UK. On acquisition of the business, the directors implemented a unique operating model, referred to as strategic asset management, by separating the asset management and ownership responsibilities of the network from the delivery of operational activity. The split of assets and operations means Northern Gas Networks Limited ("NGN") retains all of the obligations and responsibilities required by its Gas Distribution Licence and the safety case agreed with the Health and Safety Executive ("HSE"). NGN owns the assets and is responsible and accountable for the continued safe and efficient running of the gas distribution network, ensuring the highest possible performance standards from planning through to asset maintenance and replacement. The operation and maintenance of the network, together with the implementation of the asset maintenance and replacement programmes has been contracted out to United Utilities Operations Limited ("UUOL"), a company owned by United Utilities plc, under the terms of an Asset Services Agreement ("ASA"). Following the first full year of operation, this model is delivering the expected operational results.

The group's financial results for the year are in line with expectations but are not comparable with the previous year as it only included seven months of trading and was distorted as the high revenue months of January to March were pre acquisition and not included in the previous year results. The financial performance of the business for the year is heavily weighted towards the winter months as approximately 60% of revenue is earned in the period November to March, due to the seasonality of gas consumption. Total revenue for the year was £273.3m (2005 - £137.7m) which was impacted by reduced throughput volumes as a result of the warmer than seasonal normal weather experienced, with 2006 being the warmest year on record across the UK. Operating profit for the year was £46.4m (2005 - £15.0m).

The group has gross debt (before financing costs) of £935.4m (2005 - £896.4m) at the year end. This includes a drawn term loan of £366.4m (2005 - £366.4m) repayable on 31 March 2010 and short term facilities of £64.0m (2005 - £25.0m), both of which carry interest at 6 month LIBOR plus a margin of 0.26% and bonds of £505.0m, with £250.0m repayable in 2027 and £255.0m repayable in 2035. Interest on the bonds is payable at a rate of 4.875%. This debt structure has given rise to interest payable and similar charges of £45.5m (2005 - £27.8m).

The tax charge for the year was £5.7m (2005 - £1.2m) which represents an effective tax rate of 213% (2005 - 11%). The high effective tax rate is as a result of the fair value assessment and the resulting revaluation of the asset base at acquisition.

Directors' report (continued)

Capital expenditure for the period was £44.3m (2005 - £22.8m) principally due to investment in network assets and the completion of the development of the new IT systems used to support many of the group's operational business activities.

The group generated a net cash inflow from operating activities for the year of £111.6m (2005 - £55.6m). At the end of the year, the group's undrawn borrowing facilities available for use amounted to £89.6m (2005 - £128.6m).

Key performance indicators

The key financial and non-financial performance indicators used by the Board of Directors in their monitoring of the group focus on the areas of safety, efficiency and customer service. Key financial and non-financial performance indicators include:

	2006	2005
Post maintenance interest coverage ratio	1.6	1.3
EBITDA interest coverage ratio	2.0	1.5
Senior debt/Regulatory Asset Value	66.8%	69.2%
Number of lost time injuries	9	17*

* includes pre and post acquisition to give a full year comparative

Environment

The group recognises the importance of its environmental responsibilities and undertakes its operations in an environmentally sensitive manner, complying with all relevant legislative requirements and higher standards where possible. The group is committed to the protection of the environment in the region it serves. The group's environmental management systems are certified under ISO14001. This helps the directors deal proactively with future environmental issues and legislation and assist in the development of projects, for example, the land recycling project at Sheepscar in Leeds.

Principal risks and uncertainties

The group's principal risks and uncertainties are set out below:

Regulatory environment, revenue and costs

The gas industry is subject to extensive legal and regulatory obligations and controls which NGN, as the licensed entity must comply with. The application and possible changes of these laws, regulations and regulatory standards could have an adverse affect on the operations and financial position of the group.

Health and safety

There is a risk that an incident within the network leads to injury to an employee, contractor or member of the public. Any such incident could have an adverse affect on the reputation of the group, or lead to potential prosecution and reduced productivity.

Directors' report (continued)

Price control

NGN could be unsuccessful in negotiating an acceptable five year price control outcome resulting in lower than expected revenue. The final outcome for the 2008-2013 price control is expected to be published in late 2007.

Contract and contractor management

As described above, the operation and maintenance of the network, as well as the responsibility for implementing the Capex and Repex programmes, has been contracted out to UUOL under the terms of the ASA which expires on 31 March 2013. Under the terms of the ASA, UUOL's costs of providing such services are passed through to the group, subject to bonus and penalty payments where the costs are respectively below or above agreed target levels. There is a risk that any delivery delays, excessive costs or inadequate quality by UUOL would damage the group's business reputation or increase costs and liabilities.

Network performance

If the network assets were to fail it could result in a loss in supply of gas to customers and associated adverse publicity.

Employees

The success of the group depends to a significant extent on the contribution of its employees. Fair and effective recruitment, training and employee development are critical to the successful functioning and progression of the business. The ability to adapt in a climate of change is dependent on the appointment of a high calibre, competent, flexible, quality conscious and customer focused workforce all of whom are committed to business success. Appropriate succession planning strategies mean that development of existing staff is crucial. Effective resourcing and selection processes also play a positive role in improving the image of the group in the community it serves.

The group, as an equal opportunities employer, ensures that no job applicant receives less favourable treatment because of his or her age, colour, disability, ethnic or national origin, gender, marital status or sexuality or is disadvantaged by conditions or requirements which are irrelevant to performance and the group's needs.

Future outlook

The directors expect the general level of activity to remain stable however the future outlook has some dependence on the outcome of the current five year price control review.

Financial risk management objectives and policies

The group's financial instruments, other than derivatives, comprise borrowings, cash and various items, such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to finance the group's operations.

The group also enters into derivative transactions, principally interest rate swaps. The purpose of such transactions is to manage the interest rate risks arising from the group's sources of finance.

Directors' report (continued)

The main risks arising from the group's financial instruments are interest rate risk, currency risk and liquidity risk. The Board of Directors reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

The approach adopted in eliminating interest rate exposures on debt is to synchronise the maturities of fixed rate interest hedges with the timing of the regulator's five yearly price control periods. This ensures that interest rate hedges are reset in the economic environment prevailing at the time the regulator is resetting the industry's weighted average cost of capital.

Currency risk

No exposures are currently identified. Regular monitoring procedures will identify material risks as they arise. Currency risk management is only used to hedge underlying commercial exposures. Therefore trading in currency is prohibited and if an underlying exposure ceases to exist then the corresponding hedge is closed out immediately.

All non-sterling borrowings and associated service costs are hedged into sterling at the time the commitment to draw down is made.

Liquidity risk

The maturities of required committed debt facilities will be managed such that at any one time all have a time to maturity of more than one year and that at least 50% by value have a time to maturity of more than two years except for the working capital facility and finance leases which are less than one year.

Facilities are staggered to mature to avoid excessive concentrations in any twelve month period (though the value of facilities required may be insufficient to allow split maturities) as well as removing refinancing risk if such timeframes coincide with a regulatory reset date. Non-facility debt maturities are also staggered where practicable.

Dividends

The directors do not recommend payment of a final dividend. Interim dividends of 2.6p per share were paid on 27 June 2006 and of 7.9p per share were paid on 27 December 2006 making a total of 10.5p per share for the year (2005 – 4.4p).

Directors' report (continued)

Directors

The directors, who served throughout the year except as noted, were as follows:

W Shurniak (Chairman)

B Scarsella

F R Frame

D V Latham

H Lam Kam

K Sum Tso

N McGee (appointed 4 July 2006)

A Hunter (resigned 4 July 2006, re-appointed 1 December 2006)

E Bing Sing Kwan (resigned 1 December 2006)

G A I Waters (deceased 23 December 2006)

C J Brook (appointed 2 January 2007, resigned 12 April 2007)

C Cornish (appointed 12 April 2007)

Directors' interests

The directors who held office at 31 December 2006 had no interests in the shares of the company at any time during the year. The directors do not have any other interests required to be disclosed under Schedule 7 of the Companies Act 1985.

Supplier payment policy

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the group at 31 December 2006 were equivalent to 14 (2005 – 22) days' purchases, based on the average daily amount invoiced by suppliers during the year.

Charitable and political contributions

During the year the group made charitable donations of £4,520 (2005 - £500), principally to local charities serving the communities in which the group operates. No political donations were made (2005 - £nil).

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the group continues and that appropriate training is arranged. It is the policy of the group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Directors' report (continued)

Employee consultation

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through both formal and informal meetings. Employees are consulted regularly on a wide range of matters affecting their current and future interests. Employees are eligible to receive an annual bonus related to the overall financial and operational performance of the group.

Auditors

Each of the directors at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- the director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

The directors will place a resolution before the annual general meeting to reappoint Deloitte & Touche LLP as auditors for the ensuing year.

1100 Century Way
Thorpe Park Business Park
Colton
Leeds
LS15 8TU

By order of the Board,



23 May 2007

B Scarsella

Director

Directors' responsibilities

The directors are responsible for preparing the Annual Report and accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare accounts for each financial year. Under that law the directors have elected to prepare the accounts in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The accounts are required by law to give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that period. In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the group and company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the group's website. Legislation in the United Kingdom governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

Independent auditors' report

To the Members of Northern Gas Networks Holdings Limited

We have audited the group and parent company accounts (the "accounts") of Northern Gas Networks Holdings Limited for the year ended 31 December 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, the Consolidated Statement of Total Recognised Gains and Losses, the Statement of Accounting Policies and the related notes 1 to 27. These accounts have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and accounts in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the accounts.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements

Independent auditors' report (continued)

made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the group's and company'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 accounts 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 accounts.

Opinion

In our opinion:

- the accounts give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 December 2006 and of the group's loss for the year then ended;
- the accounts have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the accounts.



Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Leeds

23 May 2007

Consolidated profit and loss account

For the year ended 31 December 2006

	Notes	2006 £'000	2005 £'000
Turnover	1	273,326	137,717
Cost of sales		(20,866)	(11,209)
Gross profit		252,460	126,508
Other operating expenses	2	(206,062)	(111,485)
Operating profit		46,398	15,023
Profit on disposal of fixed assets	4	941	-
Finance charges (net)	3	(44,663)	(26,478)
Profit (loss) on ordinary activities before taxation	4	2,676	(11,455)
Tax on profit (loss) on ordinary activities	7	(5,706)	(1,246)
Loss for the financial year	19	(3,030)	(12,701)

The above results arise from continuing operations.

The accompanying notes are an integral part of this consolidated profit and loss account.

Consolidated statement of total recognised gains and losses

For the year ended 31 December 2006

	Notes	2006 £'000	2005 £'000
Loss for the financial year		(3,030)	(12,701)
Actuarial gain (loss) relating to the pension scheme	25	400	(5,500)
Deferred tax attributable to actuarial gain (loss)		(120)	1,650
Total recognised losses relating to the year		(2,750)	(16,551)

The accompanying notes are an integral part of this consolidated statement of total recognised gains and losses.

Consolidated balance sheet

31 December 2006

	Notes	2006 £'000	2005 £'000
Fixed assets			
Intangible assets - goodwill	10	217,083	222,734
Tangible assets	11	1,379,782	1,370,768
Investments	12	104	104
		<u>1,596,969</u>	<u>1,593,606</u>
Current assets			
Debtors – due within one year	13	45,097	41,695
Cash at bank and in hand		4,814	209
		<u>49,911</u>	<u>41,904</u>
Creditors: Amounts falling due within one year	14	<u>(153,869)</u>	<u>(91,757)</u>
Net current liabilities		<u>(103,958)</u>	<u>(49,853)</u>
Total assets less current liabilities		1,493,011	1,543,753
Creditors: Amounts falling due after more than one year	15	(884,487)	(876,963)
Provisions for liabilities and charges excluding pension liability	17	<u>(121,570)</u>	<u>(115,880)</u>
Net assets excluding pension liability		<u>486,954</u>	<u>550,910</u>
Pension liability	25	<u>(19,584)</u>	<u>(20,790)</u>
Net assets including pension liability		<u>467,370</u>	<u>530,120</u>
Capital and reserves			
Called-up share capital	18	571,671	571,671
Profit and loss account	19	<u>(104,301)</u>	<u>(41,551)</u>
Shareholders' funds	20	<u>467,370</u>	<u>530,120</u>

The accompanying notes are an integral part of this consolidated balance sheet.

Company balance sheet

31 December 2006

	Notes	2006 £'000	2005 £'000
Fixed assets			
Investments	12	<u>550,174</u>	<u>550,174</u>
Current assets			
Debtors			
- due within one year	13	1	1
- due after one year	13	24,328	24,328
Cash at bank and in hand		<u>5</u>	<u>9</u>
		24,334	24,338
Creditors: Amounts falling due within one year	14	<u>(2,732)</u>	<u>(2,736)</u>
Net current assets		<u>21,602</u>	<u>21,602</u>
Total assets less current liabilities		<u>571,776</u>	<u>571,776</u>
Net assets		<u>571,776</u>	<u>571,776</u>
Capital and reserves			
Called-up share capital	18	571,671	571,671
Profit and loss account	19	<u>105</u>	<u>105</u>
Shareholders' funds		<u>571,776</u>	<u>571,776</u>

The accompanying notes are an integral part of this balance sheet.

The accounts were approved by the Board of Directors and authorised for issue on 21 May 2007 and signed on its behalf by:



B Scarsella

Director

23 May 2007

Consolidated cash flow statement

For the year ended 31 December 2006

	Notes	2006 £'000	2005 £'000
Net cash inflow from operating activities	21	111,612	55,564
Returns on investments and servicing of finance	22	(41,753)	(19,699)
Taxation – UK corporation tax paid		(1,695)	-
Capital expenditure and financial investment	22	(41,252)	(22,449)
Acquisitions and disposals	22	-	(1,453,504)
Equity dividends paid		(60,000)	(25,000)
Cash outflow before financing		(33,088)	(1,465,088)
Financing	22	37,693	1,465,297
Increase in cash in the year	23	<u>4,605</u>	<u>209</u>

The accompanying notes are an integral part of this consolidated cash flow statement.

Statement of accounting policies

31 December 2006

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year other than for the adoption of Financial Reporting Standard (FRS) 20 "Share based payments". This new standard is not considered by management to have had a material effect on the accounts in the current or prior year.

Basis of accounting

The accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

Basis of consolidation

The group accounts consolidate the accounts of the company and its subsidiary undertakings drawn up to 31 December. The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

Intangible assets – goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 40 years in line with the acquired asset base. Provision is made for any impairment.

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Cost includes internal labour costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the estimated economic lives of the assets. Depreciation is provided on all tangible fixed assets, other than freehold land and assets in the course of construction, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Mains & Services	55 to 65 years
Storage	40 years
Plant & machinery	10 to 50 years
Freehold buildings	50 years
Leasehold land and buildings	Lesser of lease period and 50 years
Motor vehicles and office equipment	3 to 10 years

Statement of accounting policies (continued)

Investments

Fixed asset investments are shown at cost less provision for impairment. Current asset investments are stated at the lower of cost and net realisable value.

Replacement expenditure

Replacement expenditure represents the cost of planned maintenance of the gas mains and services assets by replacing or lining sections of pipe. This expenditure is principally undertaken to repair and to maintain the safety of the network and is expensed as incurred. Expenditure that enhances the performance of the mains and services assets is treated as an addition to tangible fixed assets.

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the accounts. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Decommissioning and environmental costs

Decommissioning and environmental costs, based on discounted future estimated expenditures, are provided for in full and where appropriate a corresponding tangible fixed asset is also recognised. The unwinding of the discount is included within the profit and loss account as a financing charge.

Turnover

Turnover represents amounts receivable for the distribution of gas and provision of other services in the normal course of business, net of trade discounts, VAT and other sales related taxes. Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end.

Statement of accounting policies (continued)

Pension costs

The group has obligations for a defined benefit scheme which is operated on its behalf by UUOL under the terms of the ASA. The responsibility for making payments of current service costs lies with UUOL, however the responsibility for any scheme deficit or surplus remains with the group. The amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments. They are included within operating costs, as part of the charge to the group from UUOL, under the terms of the ASA. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

Defined benefit schemes are funded with the assets of the scheme held separately from those of the group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet.

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Leases

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the leases to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful lives.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Finance costs

Finance costs of debt are recognised in the profit and loss account over the term of the instrument at a constant rate on the carrying amount.

Statement of accounting policies (continued)

Finance costs (continued)

Finance costs which are directly attributable to the construction of tangible fixed assets are capitalised as part of the cost of those assets. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress.

Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete.

Debt

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting period and reduced by payments made in the period.

Derivative financial instruments

The group uses derivative financial instruments to reduce exposure to interest rate movements. The group does not hold or issue derivative financial instruments for speculative purposes. The group does not hedge account.

Notes to the accounts

31 December 2006

1 Segment information

The directors consider that the group has only one class of business and one geographical segment by both destination and origin.

2 Other operating expenses

	2006 £'000	2005 £'000
Distribution costs	197,704	107,366
Administrative expenses	8,358	4,119
	<u>206,062</u>	<u>111,485</u>

3 Finance charges (net)

	2006 £'000	2005 £'000
Interest payable and similar charges	45,522	27,830
Less: investment income	(981)	(252)
Other finance charges (income)	122	(1,100)
	<u>44,663</u>	<u>26,478</u>

Interest payable and similar charges

	2006 £'000	2005 £'000
Bank loans and overdrafts	21,477	24,969
Guaranteed bonds	24,618	3,103
Finance leases and hire purchase contracts	204	119
	<u>46,299</u>	<u>28,191</u>
Finance costs capitalised	(777)	(361)
	<u>45,522</u>	<u>27,830</u>

Finance costs have been capitalised based on a capitalisation rate of 6.25% (2005 - 6.25%).

Investment income

	2006 £'000	2005 £'000
Income from fixed asset investments	147	-
Interest receivable and similar income	834	252
	<u>981</u>	<u>252</u>

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Other finance charges (income)

	2006 £'000	2005 £'000
Unwinding of discount on provisions (see note 17)	22	-
Net return on pension scheme (see note 25)	100	(1,100)
	<u>122</u>	<u>(1,100)</u>

4 Profit (loss) on ordinary activities before taxation

Profit (loss) on ordinary activities before taxation is stated after charging:

	2006 £'000	2005 £'000
Depreciation and amounts written off tangible fixed assets		
- owned	33,732	19,446
- held under finance leases and hire purchase contracts	1,533	983
Amortisation of goodwill	5,651	3,296
Operating lease rentals - other	175	-
	<u>175</u>	<u>-</u>

The analysis of auditors' remuneration is as follows:

	2006 £'000	2005 £'000
Fees payable to the company's auditors for the audit of the company's annual accounts and consolidation	11	5
<i>Fees payable to the company's auditors and their associates for other services to the group</i>		
- The audit of the company's subsidiaries pursuant to legislation	<u>61</u>	<u>57</u>
Total audit fees	<u>72</u>	<u>62</u>

Fees payable to the company's auditors and their associates for other services to the group

- Other services pursuant to legislation	42	75
- Tax services	64	31
- Corporate finance services	-	41
- Other services	<u>33</u>	<u>39</u>
Total non-audit fees	<u>139</u>	<u>186</u>

Notes to the accounts (continued)

4 Profit (loss) on ordinary activities before taxation (continued)

Fees payable to Deloitte & Touche LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated accounts are required to disclose such fees on a consolidated basis.

The profit on disposal of fixed assets relates to the sale of land in the year. The effect of the profit on disposal of fixed assets on the tax on profit on ordinary activities is an increase of £282,000 (2005 - £nil).

5 Staff costs

The average monthly number of employees (including executive directors) was:

	2006 Number	2005 Number
Administration	28	18
	<u>28</u>	<u>18</u>

	2006 £'000	2005 £'000
Their aggregate remuneration comprised:		
Wages and salaries	2,044	940
Social security costs	250	89
Other pension costs	158	58
	<u>2,452</u>	<u>1,087</u>

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	2006 £'000	2005 £'000
Emoluments	435	275
Amounts receivable (other than shares and share options) under long-term incentive schemes	31	-
Company contributions to money purchase pension schemes	34	17
	<u>500</u>	<u>292</u>

Notes to the accounts (continued)

6 Directors' remuneration and transactions (continued)

Pensions

The number of directors who were members of pension schemes was as follows:

	2006 Number	2005 Number
Money purchase schemes	<u>1</u>	<u>1</u>

Highest-paid director

The above amounts for remuneration include the following in respect of the highest paid director:

	2006 £'000	2005 £'000
Emoluments	435	275
Amounts receivable (other than shares and share options) under long-term incentive schemes	31	-
Company contributions to money purchase schemes	<u>34</u>	<u>17</u>
	<u>500</u>	<u>292</u>

Transactions

There have been no transactions with directors in the year (2005 - £nil) other than as set out above in respect of remuneration.

Notes to the accounts (continued)

7 Tax on profit (loss) on ordinary activities

The tax charge comprises:

	2006 £'000	2005 £'000
Current tax		
UK corporation tax	11	-
Total current tax	<u>11</u>	<u>-</u>
Deferred tax		
Current year - origination and reversal of timing differences	7,592	1,246
Adjustments in respect of prior years	(1,897)	-
Total deferred tax	<u>5,695</u>	<u>1,246</u>
Total tax on profit (loss) on ordinary activities	<u>5,706</u>	<u>1,246</u>

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK Corporation tax to the profit (loss) before tax is as follows:

	2006 £'000	2005 £'000
Group profit (loss) on ordinary activities before tax	<u>2,676</u>	<u>(11,455)</u>
Tax on group profit (loss) on ordinary activities at standard UK corporation tax rate of 30% (2005 - 30%)	803	(3,437)
Effects of:		
Expenses not deductible for tax purposes	6,800	4,683
Utilisation of tax losses	(2,749)	-
Creation of tax losses	-	417
Capital allowances in excess of depreciation	(4,551)	(1,552)
Other timing differences	(292)	(111)
Group current tax charge for the year	<u>11</u>	<u>-</u>

The group earns its profits in the UK. Therefore the tax rate used for tax on profit (loss) on ordinary activities is the standard rate for UK corporation tax, currently 30% (2005 – 30%).

The group's planned level of capital investment is expected to remain at similar levels of current investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years, at a similar level to the current year.

Notes to the accounts (continued)

7 Tax on profit (loss) on ordinary activities (continued)

The announcement of the 2007 Budget introduced several potential corporation tax changes which if enacted may impact the deferred tax liability in respect of accelerated capital allowances in future periods. The changes are not believed to significantly impact the group.

8 Profit attributable to the company

The profit for the financial year dealt with in the accounts of the parent company was £60,000,000 (2005 - £25,105,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

9 Dividends paid on equity shares

	2006 £'000	2005 £'000
Dividends paid on equity shares		
Equity shares		
- interim dividend paid of 2.6p per ordinary share	15,000	-
- interim dividend paid of 7.9p (2005 – 4.4p) per ordinary share	45,000	25,000
	<u>60,000</u>	<u>25,000</u>

10 Intangible fixed assets - goodwill

£'000

Cost

At 1 January 2006 and 31 December 2006 226,030

Amortisation

At 1 January 2006 3,296

Charge for the year 5,651

At 31 December 2006 8,947

Net book value

At 31 December 2006 217,083

At 31 December 2005 222,734

Notes to the accounts (continued)

11 Tangible fixed assets

Group	Land and buildings £'000	Gas distribution assets £'000	Motor vehicles £'000	Other equipment £'000	Assets in the course of construction £'000	Total £'000
Cost						
At 1 January 2006	2,589	1,369,309	3,985	9,719	5,595	1,391,197
Additions	400	26,228	283	1,326	16,044	44,281
Disposals	(2)	-	-	-	-	(2)
Transfers	-	-	-	21,562	(21,562)	-
At 31 December 2006	<u>2,987</u>	<u>1,395,537</u>	<u>4,268</u>	<u>32,607</u>	<u>77</u>	<u>1,435,476</u>
Depreciation						
At 1 January 2006	160	17,912	987	1,370	-	20,429
Charge for the year	306	31,055	1,594	2,310	-	35,265
At 31 December 2006	<u>466</u>	<u>48,967</u>	<u>2,581</u>	<u>3,680</u>	<u>-</u>	<u>55,694</u>
Net book value						
At 31 December 2006	<u>2,521</u>	<u>1,346,570</u>	<u>1,687</u>	<u>28,927</u>	<u>77</u>	<u>1,379,782</u>
At 31 December 2005	<u>2,429</u>	<u>1,351,397</u>	<u>2,998</u>	<u>8,349</u>	<u>5,595</u>	<u>1,370,768</u>
Leased assets included above:						
Net book value						
At 31 December 2006	<u>406</u>	<u>-</u>	<u>1,207</u>	<u>-</u>	<u>-</u>	<u>1,613</u>
At 31 December 2005	<u>41</u>	<u>-</u>	<u>2,739</u>	<u>-</u>	<u>-</u>	<u>2,780</u>

Short leasehold included within land and buildings above has a cost of £442,000 (2005 - £42,000), depreciation charge in the year of £35,000 (2005 - £1,000), accumulated depreciation of £36,000 (2005 - £1,000) and a net book value of £406,000 (2005 - £41,000).

Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £1,138,000 (2005 - £361,000).

The company does not hold any tangible fixed assets (2005 - £nil).

Notes to the accounts (continued)

12 Investments

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Subsidiary undertakings	-	-	550,174	550,174
Other investments	104	104	-	-
	<u>104</u>	<u>104</u>	<u>550,174</u>	<u>550,174</u>

Principal group investments

The parent company and the group have investments in the following subsidiary undertakings which principally affected the profits or net assets of the group.

Subsidiary undertakings	Country of incorporation	Principal activity	Holding	%
Northern Gas Networks Limited ⁺	England & Wales	Gas transportation	100 ordinary shares of £1	100
Northern Gas Networks Finance Plc	England & Wales	Financing	50,000 ordinary shares of £1	100

⁺ Held directly by Northern Gas Networks Holdings Limited.

The other investment represents a 10.38% holding in xoserve Limited, which provides information, data processing, invoicing and supply point administration services to the group. xoserve Limited is registered in England & Wales.

Subsidiary undertakings

£'000

Cost and net book value

At 1 January 2006 and 31 December 2006

550,174

Other Investments

£'000

Cost and net book value

At 1 January 2006 and 31 December 2006

104

Notes to the accounts (continued)

13 Debtors

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Amounts falling due within one year:				
Trade debtors	7,268	5,831	-	-
Amounts owed by parent undertakings	1	1	1	1
Prepayments and accrued income	36,133	35,863	-	-
UK Corporation tax	1,695	-	-	-
	<u>45,097</u>	<u>41,695</u>	<u>1</u>	<u>1</u>
Amounts falling due after more than one year:				
Amounts owed by group undertakings	-	-	24,328	24,328
	-	-	<u>24,328</u>	<u>24,328</u>
	<u>45,097</u>	<u>41,695</u>	<u>24,329</u>	<u>24,329</u>

14 Creditors: Amounts falling due within one year

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Bank loans	64,000	25,000	-	-
Obligations under finance leases and hire purchase contracts	425	705	-	-
Payments received on account	8,396	12,517	-	-
Trade creditors	9,291	3,074	-	-
Amounts owed to group undertakings	-	-	2,668	687
Other taxation and social security	1,805	880	-	-
Accruals and deferred income	69,932	49,559	64	2,049
Defined contribution pension scheme accrual	20	22	-	-
	<u>153,869</u>	<u>91,757</u>	<u>2,732</u>	<u>2,736</u>

Bank loans are a working capital facility of £25.0m repayable on 31 January 2007 and a revolving credit facility of £39.0m repayable on 28 February 2007. Both carry interest at 6 month LIBOR plus a margin of 0.26%.

Notes to the accounts (continued)

15 Creditors: Amounts falling due after more than one year

	Group	
	2006 £'000	2005 £'000
Term loan	365,024	364,811
Obligations under finance leases and hire purchase contracts	12	1,039
Guaranteed bond due 2027	249,536	249,564
Guaranteed bond due 2035	254,520	254,554
Deferred income	15,395	6,995
	<u>884,487</u>	<u>876,963</u>

The term loan is repayable on 31 March 2010 and carries interest at 6 month LIBOR plus a margin of 0.26%.

The guaranteed bond due 2027 of £250.0m matures on 30 June 2027 and will be redeemed at par. Interest is paid annually on 30 June at a rate of 4.875%.

The guaranteed bond due 2035 of £255.0m matures on 15 November 2035 and will be redeemed at par. Interest is paid annually on 15 November at a rate of 4.875%.

16 Derivatives and other financial instruments

Pages 3 and 4 of the Directors' report provide an explanation of the role that financial instruments have had during the year in creating or changing the risks the group faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS 13"). Certain financial assets such as investments in subsidiary companies are excluded from the scope of these disclosures.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures. The directors believe that the fair values are not materially different from the balance sheet values.

Interest rate profile

The group has no financial assets other than sterling cash deposits of £4,814,000 (2005 - £209,000) which are part of the financing arrangements of the group. The sterling cash deposits comprise monies held in bank accounts.

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

After taking into account interest rate swap contracts entered into by the group, the interest rate profile of the group's financial liabilities at 31 December 2006 was as follows.

	Floating rate 2006 £'000	Fixed rate 2006 £'000	Total 2006 £'000
Borrowings – Bank Loans	365,024	64,000	429,024
Borrowings – Guaranteed Bonds	-	504,056	504,056
Finance leases	-	437	437
Total	<u>365,024</u>	<u>568,493</u>	<u>933,517</u>

The profile at 31 December 2005 for comparison purposes was as follows.

	Floating rate 2005 £'000	Fixed rate 2005 £'000	Total 2005 £'000
Borrowings – Bank Loans	364,811	25,000	389,811
Borrowings – Guaranteed Bonds	-	504,118	504,118
Finance leases	-	1,744	1,744
Total	<u>364,811</u>	<u>530,862</u>	<u>895,673</u>

Further analysis of the interest rate profile at 31 December 2006 and 31 December 2005 is as follows.

	2006		
	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings – Bank Loans	4.5	5.1	0.13
Borrowings – Guaranteed Bonds	-	4.875	25
Finance leases	-	15	4

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

	2005		
	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings – Bank Loans	4.5	4.6	0.25
Borrowings – Guaranteed Bonds	-	4.875	26
Finance leases	-	15	5

Further details of interest rates on long term borrowings are given in note 15.

Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December was as follows:

	2006 £'000	2005 £'000
In one year or less	64,425	25,705
In more than one year but not more than two years	12	807
In more than two years but not more than five years	365,024	365,043
In more than five years	504,056	504,118
	<u>933, 517</u>	<u>895,673</u>

Borrowing facilities

The group had undrawn committed borrowing facilities at 31 December, in respect of which all conditions precedent had been met, as follows:

	2006 £'000	2005 £'000
Expiring in more than two years	<u>89,564</u>	<u>128,564</u>

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

Fair values

Set out below is a comparison by category of book values and fair values of the group's financial assets and liabilities at 31 December.

Liabilities (assets)	2006		2005	
	Book value £'000	Fair value £'000	Book value £'000	Fair value £'000
Primary financial instruments held or issued to finance the group's operations				
Working capital and revolving credit facilities	64,000	64,000	25,000	24,363
Long term borrowings	365,024	358,362	364,811	371,166
Guaranteed bonds	504,056	507,442	504,118	524,988
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	-	1,477	-	(15,198)

The fair values of the interest rate swaps have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

Gains and losses on hedges

The group enters into interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the accounts until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

	2006			2005		
	Gains £'000	Losses £'000	Net £'000	Gains £'000	Losses £'000	Net £'000
Unrecognised gains and losses on hedges at 1 January	17,436	(2,238)	15,198	-	-	-
Gains and losses arising in previous years that were recognised in the year	-	-	-	-	-	-
Gains and losses arising before 1 January that were not recognised in the year	17,436	(2,238)	15,198	-	-	-
Gains and losses arising in the year that were not recognised in the year	6,763	(23,438)	(16,675)	17,436	(2,238)	15,198
Unrecognised gains and losses on hedges at 31 December	<u>24,199</u>	<u>(25,676)</u>	<u>(1,477)</u>	<u>17,436</u>	<u>(2,238)</u>	<u>15,198</u>
Of which:						
Gains and losses expected to be recognised in 2007	-	-	-	-	-	-
Gains and losses expected to be recognised in 2008 or later	<u>24,199</u>	<u>(25,676)</u>	<u>(1,477)</u>	<u>17,436</u>	<u>(2,238)</u>	<u>15,198</u>

Notes to the accounts (continued)

17 Provisions for liabilities and charges excluding pension liability

	Deferred taxation £'000	Environmental restoration £'000	Other £'000	Total £'000
Group				
At 1 January 2006	99,750	7,260	8,870	115,880
Charged to profit and loss account	5,567	-	352	5,919
Utilised in year	-	-	(251)	(251)
Adjustment arising from discounting	-	19	3	22
At 31 December 2006	<u>105,317</u>	<u>7,279</u>	<u>8,974</u>	<u>121,570</u>

Deferred tax

Deferred tax is provided as follows:

	2006 £'000	2005 £'000
Group		
Accelerated capital allowances	105,259	99,218
Other timing differences	58	949
Tax losses available	-	(417)
Provision for deferred tax	<u>105,317</u>	<u>99,750</u>

Deferred tax in respect of the group's defined benefit pension scheme is disclosed in note 25.

Environmental restoration

Estimated environmental restoration costs are provided where the group has a legal obligation to restore sites at the balance sheet date. The provision represents the estimated net present value for statutory decontamination of old gas manufacturing sites. It also reflects the obligations associated with other environmental damage.

Other

Other provisions relate to the estimated net present value of future claims in relation to past public and employer's liability events.

The timing of the utilisation of the environmental and other provisions is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date.

Notes to the accounts (continued)

18 Called-up share capital

	2006 £'000	2005 £'000
<i>Authorised</i>		
600,000,000 ordinary shares of £1 each	600,000	600,000
1 special share of £1	-	-
	<u>600,000</u>	<u>600,000</u>
<i>Allotted, called-up and fully-paid</i>		
571,669,980 ordinary shares of £1 each	571,670	571,670
<i>Allotted and called-up</i>		
999 ordinary shares of £1 each	1	1
1 special share of £1	-	-
	<u>571,671</u>	<u>571,671</u>

The unpaid shares remain outstanding within debtors at the year end.

The ordinary shares and the special share are separate classes of shares and carry the same rights and privileges and rank pari passu in all respects.

19 Reserves

	Profit and loss account £'000
Group	
At 1 January 2006	(41,551)
Loss for the financial year	(3,030)
Actuarial gain relating to the pension scheme	400
UK deferred tax attributable to the actuarial gain	(120)
Dividends paid on equity shares	<u>(60,000)</u>
At 31 December 2006	<u>(104,301)</u>
	Profit and loss account £'000
Company	
At 1 January 2006	105
Profit for the financial year	60,000
Dividends paid on equity shares	<u>(60,000)</u>
At 31 December 2006	<u>105</u>

Notes to the accounts (continued)

20 Reconciliation of movements in group shareholders' funds

	2006 £'000	2005 £'000
Loss for the financial year	(3,030)	(12,701)
Other recognised gains and losses relating to the year (net)	280	(3,850)
	<u>(2,750)</u>	<u>(16,551)</u>
Dividends paid on equity shares	(60,000)	(25,000)
New shares issued	-	571,670
Net movement in shareholders' funds	<u>(62,750)</u>	<u>530,119</u>
Opening shareholders' funds	530,120	1
Closing shareholders' funds	<u>467,370</u>	<u>530,120</u>

21 Reconciliation of operating profit to operating cash flows

	2006 £'000	2005 £'000
Operating profit	46,398	15,023
Depreciation and amortisation	40,916	23,725
Increase in debtors	(1,707)	(21,234)
Increase in creditors	26,466	37,330
Increase in provisions	101	320
Adjustment for pension funding	(562)	400
Net cash inflow from operating activities – continuing operations	<u>111,612</u>	<u>55,564</u>

22 Analysis of cash flows

	2006 £'000	2005 £'000
<i>Returns on investments and servicing of finance</i>		
Interest received	981	252
Interest paid	(42,480)	(19,951)
Interest element of finance lease rentals	(254)	-
Net cash outflow	<u>(41,753)</u>	<u>(19,699)</u>
<i>Capital expenditure and financial investment</i>		
Purchase of tangible fixed assets	(42,195)	(22,449)
Sale of tangible fixed assets	943	-
Net cash outflow	<u>(41,252)</u>	<u>(22,449)</u>

Notes to the accounts (continued)

22 Analysis of cash flows (continued)

	2006 £'000	2005 £'000
<i>Acquisitions and disposals</i>		
Purchase of subsidiary undertaking	-	(1,453,504)
Net cash outflow	-	(1,453,504)

In the prior year, the company acquired the entire issued share capital of Northern Gas Networks Limited. The total cash consideration was £1,453.5m, which included the repayment of the intercompany creditor of £903.3m.

Financing

Issue of ordinary share capital	-	571,670
Issue of guaranteed bonds	-	504,118
Increase in short term borrowings	39,000	25,000
New unsecured term loan	-	364,811
Capital element of finance lease rental payments	(1,307)	(302)
Net cash inflow	37,693	1,465,297

23 Analysis and reconciliation of net debt

	1 January 2006 £'000	Cash flow £'000	Other non-cash changes £'000	31 December 2006 £'000
Cash at bank and in hand	209	4,605	-	4,814
		4,605		
Debt due after 1 year	(868,929)	286	(437)	(869,080)
Debt due within 1 year	(25,000)	(39,000)	-	(64,000)
Finance leases	(1,744)	1,307	-	(437)
		(37,407)		
Net debt	(895,464)	(32,802)	(437)	(928,703)

Notes to the accounts (continued)

23 Analysis and reconciliation of net debt (continued)

	2006 £'000	2005 £'000
Increase in cash in the year	4,605	209
Cash inflow from increase in debt and lease financing	(37,407)	(893,627)
Change in net debt resulting from cash flows	(32,802)	(893,418)
Other non-cash movements	(437)	-
Finance leases acquired with subsidiary	-	(2,046)
Movement in net debt in year	(33,239)	(895,464)
Net debt at 1 January	(895,464)	-
Net debt at 31 December	<u>(928,703)</u>	<u>(895,464)</u>

24 Financial commitments

Capital commitments are as follows:

	Group	
	2006 £'000	2005 £'000
Contracted for but not provided for	-	1,415
	<u>-</u>	<u>1,415</u>

Annual commitments under non-cancellable operating leases are as follows:

	Land and buildings	
	2006 £'000	2005 £'000
Group		
Expiry date:		
- within one year	47	-
- between two and five years	-	234
- after five years	683	683
	<u>730</u>	<u>917</u>

Notes to the accounts (continued)

24 Financial commitments (continued)

The group has a total commitment of £12.6m (2005 - £13.1m) over the term of the bonds in relation to a financial guarantee from FGIC UK Limited ("FGIC") to cover the guaranteed bonds included within long term borrowings in note 15.

The group has also entered in to a Guarantee and Reimbursement Agreement with FGIC in relation to the bonds issued by Northern Gas Networks Finance Plc ("the Issuer") in November 2005 of £505.0m. The group guarantees the punctual payment of any and all sums and fees due to FGIC and undertakes to pay any amount due from the Issuer but not paid by it. The group also indemnifies FGIC against any loss or liability suffered, if any obligation guaranteed by FGIC is, or becomes, unenforceable, invalid or illegal. The amount of the loss or liability under the indemnity is equal to the amount FGIC would otherwise have been entitled to recover.

Under the terms of the ASA which expires on 31 March 2013, the operation and maintenance of the network, together with the implementation of the asset and replacement programmes has been contracted out to UUOL. The total value of the contract, to its expiry date, is estimated to be £0.9bn (2005 - £1.1bn).

Notes to the accounts (continued)

25 Pension arrangements

The group has obligations for a defined benefit pension scheme which is operated on its behalf by UUOL who are responsible for making payments of current service costs, which are then charged to the company under the terms of the ASA. The scheme was set up following the acquisition of the business and the first full actuarial valuation will be carried out in 2008. The value on acquisition, at 31 December 2005 and at 31 December 2006 was calculated by a qualified actuary. The major assumptions used for the actuarial valuation were:

	31 December 2006	31 December 2005	31 May 2005
Rate of increase in salaries	3.50%	3.30%	3.20%
Rate of increase in pensions in payment	3.00%	2.80%	2.70%
Discount rate	4.90%	4.70%	5.10%
Inflation assumption	3.00%	2.80%	2.70%

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return at each balance sheet date and at acquisition were:

	31 December 2006 %	31 December 2006 £'000	31 December 2005 %	31 December 2005 £'000	31 May 2005 %	31 May 2005 £'000
Equities	7.30	86,100	7.00	82,500	7.30	143,200
Gilts & Bonds	4.40	90,300	4.20	81,800	-	-
Cash	4.75	9,800	4.50	3,300	-	-
Total fair value of assets		186,200		167,600		143,200
Present value of scheme liabilities		(214,177)		(197,300)		(168,100)
Deficit in the scheme		(27,977)		(29,700)		(24,900)
Related deferred tax asset		8,393		8,910		7,470
Net pension liability		<u>(19,584)</u>		<u>(20,790)</u>		<u>(17,430)</u>

The contribution rate for 2006 was 31.1% of pensionable earnings and the agreed contribution rates for the foreseeable future is 31.1% of pensionable earnings.

Notes to the accounts (continued)

25 Pension arrangements (continued)

The scheme is a closed scheme and therefore under the projected unit method the current service cost would be expected to increase as the members of the scheme approach retirement.

Analysis of the amount charged to operating profit

	2006 £'000	2005 £'000
Current service cost	<u>7,400</u>	<u>3,700</u>

Analysis of the amount (charged) credited to net finance charges

	2006 £'000	2005 £'000
Expected return on pension scheme assets	9,500	6,200
Interest on pension scheme liabilities	<u>(9,600)</u>	<u>(5,100)</u>
	<u>(100)</u>	<u>1,100</u>

Analysis of the actuarial gain (loss) in the statement of total recognised gains and losses

	2006 £'000	2005 £'000
Actual return less expected return on pension scheme assets	1,000	17,000
Experience gains and losses arising on the scheme liabilities	-	400
Changes in assumptions underlying the present value of the scheme liabilities	<u>(600)</u>	<u>(22,900)</u>
	<u>400</u>	<u>(5,500)</u>

Notes to the accounts (continued)

25 Pension arrangements (continued)

Movement in scheme deficit during the year before deferred tax

	2006 £'000	2005 £'000
At 1 January	(29,700)	(24,900)
Current service cost	(7,400)	(3,700)
Contributions	8,823	3,300
Net finance (charge) income	(100)	1,100
Actuarial gain (loss)	400	(5,500)
At 31 December	<u>(27,977)</u>	<u>(29,700)</u>

History of experience gains and losses

	31 December 2006	31 December 2005	31 May 2005
Difference between the expected and actual return on scheme assets:			
Amount (£'000)	1,000	17,000	-
Percentage of scheme assets	1%	10%	-
Experience gains and losses on scheme liabilities:			
Amount (£'000)	-	400	-
Percentage of the present value of scheme liabilities	-	0%	-
Total actuarial gain (loss) in the statement of total recognised gains and losses:			
Amount (£'000)	400	(5,500)	-
Percentage of the present value of scheme liabilities	0%	(3%)	-

The group also operates defined contribution schemes for which the pension cost charge for the year amounted to £158,000 (2005 - £58,000).

Notes to the accounts (continued)

26 Related party transactions

Transactions with the directors of the company are disclosed in note 6.

During the year the group purchased services in the ordinary course of business from related parties as follows:

	2006 £'000	2005 £'000
Able Venture Profits Limited	-	517
CHED Services Limited	322	1,188
	<u>322</u>	<u>1,705</u>

CHED Services Limited is controlled within the Cheung Kong Infrastructure Holdings Limited group of companies.

There were no amounts owed by and to related parties at 31 December 2006 (2005 - £nil).

27 Ultimate controlling party

The company is wholly owned by a consortium consisting of:

<u>Shareholder</u>	<u>Ultimate parent undertaking</u>
Able Venture Profits Limited (40%)	Hutchison Whampoa Limited
Alpha Central Profits Limited (19.9%)	Hongkong Electric Holdings Limited
Challenger Northern Gas Limited (5.8%)	Not applicable
Goldia Resources Limited (15.2%)	Li Ka Shing (Overseas) Foundation
SAS Trustee Corporation (4.1%)	Not applicable
United Utilities Contract Solutions Limited (15%)	United Utilities plc