

Northern Gas Networks Holdings Limited
(formerly Gas Network Limited)

Annual report and accounts
for the year ended 31 December 2005

Registered number: 5213525

Directors' report

For the year ended 31 December 2005

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 2005.

Principal activity

Since 1 June 2005, the principal activity of the group has been the distribution of gas for 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. The comparisons to the consolidated profit and loss account, balance sheet and related notes represent the company only for the period from incorporation on 24 August 2004 to 31 December 2004.

Business review

On 1 June 2005, the company acquired Northern Gas Networks Limited ("NGN") (formerly Blackwater F Limited) from National Grid Gas plc (formerly Transco plc). NGN was incorporated to facilitate the hive down of the business and assets of the North of England gas distribution network.

On acquisition the directors chose to separate the asset management and ownership responsibilities of the network from the delivery of operational activity under a model referred to as strategic asset management. This split of assets and operations means NGN retains all the obligations and responsibilities required by its Licence to Operate, issued by the industry regulator Ofgem (Office of Gas & Electricity Markets) and the safety case agreed with the Health & Safety Executive. 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.

The overall loss for the year is as a result of the seasonality within the business. The key revenue months of January to March were pre acquisition, whilst the expenditure required to maintain the network and meet obligations must still be carried out throughout the calendar year.

The directors expect the general level of activity to remain stable with the group benefiting from the effect of a full year of trade in 2006.

The company changed its name from Gas Network Limited to Northern Gas Networks Holdings Limited on 1 June 2005.

Results and dividends

The group loss for the year after taxation was £12,701,000 (2004 - £nil).

The directors do not recommend payment of a final dividend. An interim dividend of 4.4p per share was paid on 29 December 2005.

Directors' report (continued)

Directors

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

| | |
|-----------------------|-----------------------------|
| W Shurniak (Chairman) | (appointed 1 February 2005) |
| E Tak Chuen Ip | (resigned 1 February 2005) |
| F R Frame | |
| A Hunter | |
| E Bing Sing Kwan | |
| H Lam Kam | |
| D V Latham | |
| B Scarsella | |
| K Sum Tso | |
| G A I Waters | |

Directors' interests

The directors who held office at 31 December 2005 had no interests in the shares of the company at any time in the period. 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 2005 were equivalent to 22 (2004 – nil) days' purchases, based on the average daily amount invoiced by suppliers during the period since acquisition.

Charitable and political contributions

During the year the group made charitable donations of £500 (2004 - £nil), principally to local charities serving the communities in which the group operates.

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. All employees receive an annual bonus related to the overall profitability of the group.

Auditors

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,



Director

12 April 2006

B Scarsella

Directors' responsibilities

UK company law requires the directors to prepare accounts for each financial year which 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 profit or loss of the group for that period. In preparing those 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 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 company and group will continue in business.

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

Independent auditors' report

To the Members of Northern Gas Networks Holdings Limited

We have audited the group and individual company accounts ("the accounts") of Northern Gas Networks Holdings Limited for the year ended 31 December 2005 which comprise the consolidated profit and loss account, the consolidated and individual 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 numbered 1 to 28. 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 the 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 United Kingdom 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 in accordance with the relevant financial reporting framework and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the accounts, if 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 Directors' report for the above year and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

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 made by the directors in the preparation of the accounts and of whether the accounting policies are appropriate to the circumstances of the company and the group, consistently applied and adequately disclosed.

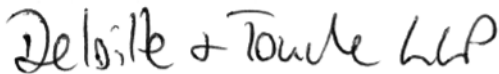
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error.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

Independent auditors' report (continued)

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 individual company's affairs as at 31 December 2005 and of the group's loss for the year then ended and the accounts have been properly prepared in accordance with the Companies Act 1985.



Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Leeds

12 April 2006

Consolidated profit and loss account

For the year ended 31 December 2005

| | Notes | 2005 £'000 | 2004 £'000 |
|---|-------|---------------|---------------|
| Turnover - Acquisitions | 1 | 137,717 | - |
| Cost of sales | | (11,209) | - |
| Gross profit | | 126,508 | - |
| Other operating expenses | 2 | (111,485) | - |
| Operating profit - Acquisitions | | 15,023 | - |
| Finance charges (net) | 3 | (26,478) | - |
| Loss on ordinary activities before taxation | 4 | (11,455) | - |
| Tax on loss on ordinary activities | 7 | (1,246) | - |
| Loss for the financial year | | (12,701) | - |
| Dividends paid on equity shares | 9 | (25,000) | - |
| Retained loss for the year transferred to reserves | 20 | (37,701) | - |

The above results derive 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 2005

| | Notes | 2005 £'000 | 2004 £'000 |
|---|-------|-----------------|---------------|
| Loss for the financial year | | (37,701) | - |
| Actuarial loss relating to the pension scheme | 26 | (5,500) | - |
| Deferred tax attributable to actuarial loss | | 1,650 | - |
| Total recognised gains and losses relating to the year | | (41,551) | - |

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

Consolidated balance sheet

31 December 2005

| | Notes | 2005 £'000 | 2004 £'000 |
|---|-------|------------------|---------------|
| Fixed assets | | | |
| Intangible assets - Goodwill | 10 | 222,734 | - |
| Tangible assets | 11 | 1,370,768 | - |
| Investments | 12 | 104 | - |
| | | <u>1,593,606</u> | <u>-</u> |
| Current assets | | | |
| Debtors – due within one year | 14 | 41,695 | 1 |
| Cash at bank and in hand | | 209 | - |
| | | <u>41,904</u> | <u>1</u> |
| Creditors: Amounts falling due within one year | 15 | <u>(91,757)</u> | <u>-</u> |
| Net current (liabilities) assets | | <u>(49,853)</u> | <u>1</u> |
| Total assets less current liabilities | | 1,543,753 | 1 |
| Creditors: Amounts falling due after more than one year | 16 | (876,963) | - |
| Provisions for liabilities and charges excluding pension liability | 18 | <u>(115,880)</u> | <u>-</u> |
| Net assets excluding pension liability | | <u>550,910</u> | <u>1</u> |
| Pension liability | 26 | <u>(20,790)</u> | <u>-</u> |
| Net assets including pension liability | | <u>530,120</u> | <u>1</u> |
| Capital and reserves | | | |
| Called-up share capital | 19 | 571,671 | 1 |
| Profit and loss account | 20 | <u>(41,551)</u> | <u>-</u> |
| Equity shareholders' funds | 21 | <u>530,120</u> | <u>1</u> |

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

Company balance sheet

31 December 2005

| | Notes | 2005 £'000 | 2004 £'000 |
|---|-------|---------------|---------------|
| Fixed assets | | | |
| Investments | 12 | 550,174 | - |
| Current assets | | | |
| Debtors | | | |
| - due within one year | 14 | 1 | 1 |
| - due after one year | 14 | 24,328 | - |
| Cash at bank and in hand | | 9 | - |
| | | 24,338 | 1 |
| Creditors: Amounts falling due within one year | 15 | (2,736) | - |
| Net current assets | | 21,602 | 1 |
| Total assets less current liabilities | | 571,776 | 1 |
| Net assets | | 571,776 | 1 |
| Capital and reserves | | | |
| Called-up share capital | 19 | 571,671 | 1 |
| Profit and loss account | 20 | 105 | - |
| Equity shareholders' funds | | 571,776 | 1 |

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

The accounts were approved by the board of directors on 3 April 2006 and signed on its behalf by:



B Scarsella

Director

12 April 2006

Consolidated cash flow statement

For the year ended 31 December 2005

| | Notes | 2005 £'000 | 2004 £'000 |
|--|-------|---------------|---------------|
| Net cash inflow from operating activities | 22 | 55,564 | - |
| Returns on investments and servicing of finance | 23 | (19,699) | - |
| Capital expenditure and financial investment | 23 | (22,449) | - |
| Acquisitions and disposals | 23 | (1,453,504) | - |
| Equity dividends paid | | (25,000) | - |
| Cash outflow before financing | | (1,465,088) | - |
| Financing | 23 | 1,465,297 | - |
| Increase in cash in the year | 24 | <u>209</u> | <u>-</u> |

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

Statement of accounting policies

31 December 2005

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding period.

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. 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 |

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.

Statement of accounting policies (continued)

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.

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 Asset Services Agreement. 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 company from UUOL, under the terms of the Asset Services Agreement. 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.

For an interest rate swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the periods of the contracts.

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss recognised at that time.

Notes to the accounts

31 December 2005

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

| | 2005 £'000 | 2004 £'000 |
|-------------------------|----------------|---------------|
| Distribution costs | 107,366 | - |
| Administrative expenses | 4,119 | - |
| | <u>111,485</u> | <u>-</u> |

3 Finance charges (net)

| | 2005 £'000 | 2004 £'000 |
|--|---------------|---------------|
| Interest payable and similar charges | 27,830 | - |
| Interest receivable and similar income | (252) | - |
| Other finance income | (1,100) | - |
| Other interest receivable and similar income | (1,352) | - |
| | <u>26,478</u> | <u>-</u> |

Interest payable and similar charges

| | 2005 £'000 | 2004 £'000 |
|--|---------------|---------------|
| Bank loans and overdrafts | 24,969 | - |
| Guaranteed Bonds | 3,103 | - |
| Finance leases and hire purchase contracts | 119 | - |
| | <u>28,191</u> | <u>-</u> |
| Finance costs capitalised | (361) | - |
| | <u>27,830</u> | <u>-</u> |

Finance costs have been capitalised based on a capitalisation rate of 6.25% which is the weighted average cost of capital of the group during the year.

Other finance income

| | 2005 £'000 | 2004 £'000 |
|--|----------------|---------------|
| Net return on pension scheme (see note 26) | (1,100) | - |
| | <u>(1,100)</u> | <u>-</u> |

Notes to the accounts (continued)

4 Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging:

| | 2005 £'000 | 2004 £'000 |
|--|---------------|---------------|
| Depreciation and amounts written off tangible fixed assets | | |
| - owned | 19,446 | - |
| - held under finance leases and hire purchase contracts | 983 | - |
| Amortisation of goodwill | 3,296 | - |
| Auditors' remuneration for audit services | | |
| - group | 84 | - |
| - company | 5 | 2 |
| | <u>5</u> | <u>2</u> |

Amounts payable to Deloitte & Touche LLP and their associates by the company and its UK subsidiary undertakings in respect of non-audit services were £164,000 (2004 - £nil).

5 Staff costs

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

| | 2005 Number | 2004 Number |
|----------------|----------------|----------------|
| Administration | 18 | - |
| | <u>18</u> | <u>-</u> |

| | 2005 £'000 | 2004 £'000 |
|---|---------------|---------------|
| Their aggregate remuneration comprised: | | |
| Wages and salaries | 940 | - |
| Social security costs | 89 | - |
| Other pension costs | 58 | - |
| | <u>1,087</u> | <u>-</u> |

Notes to the accounts (continued)

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

| | 2005 £'000 | 2004 £'000 |
|---|---------------|---------------|
| Emoluments | 275 | - |
| Company contributions to money purchase pension schemes | 17 | - |
| | <u>292</u> | <u>-</u> |

Pensions

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

| | 2005 Number | 2004 Number |
|------------------------|----------------|----------------|
| Money purchase schemes | 1 | - |
| | <u>1</u> | <u>-</u> |

Highest-paid director

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

| | 2005 £'000 | 2004 £'000 |
|---|---------------|---------------|
| Emoluments and long-term incentive schemes | 275 | - |
| Company contributions to money purchase schemes | 17 | - |
| | <u>292</u> | <u>-</u> |

Transactions

There have been no transactions with directors in the year (2004 - £nil) other than as set out above in respect of remuneration.

Notes to the accounts (continued)

7 Tax on loss on ordinary activities

The tax charge comprises:

| | 2005 £'000 | 2004 £'000 |
|---|---------------|---------------|
| Current tax | | |
| UK corporation tax | - | - |
| Total current tax | - | - |
| Deferred tax | | |
| Origination and reversal of timing differences | 1,246 | - |
| Total deferred tax (see note 18) | 1,246 | - |
| Total tax on loss on ordinary activities | 1,246 | - |

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

| | 2005 £'000 | 2004 £'000 |
|--|---------------|---------------|
| Group loss on ordinary activities before tax | (11,455) | - |
| Tax on group loss on ordinary activities at standard UK corporation tax rate of 30% (2004 - 30%) | (3,437) | - |
| Effects of: | | |
| Expenses not deductible for tax purposes | 4,683 | - |
| Creation of tax losses | 417 | - |
| Capital allowances in excess of depreciation | (1,552) | - |
| Other timing differences | (111) | - |
| Group current tax charge for period | - | - |

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

8 Profit attributable to the company

The profit for the financial year dealt with in the accounts of the parent company was £25,105,000 (2004 - £nil). 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

| | 2005 £'000 | 2004 £'000 |
|--|---------------|---------------|
| Dividends paid on equity shares | | |
| Equity shares | | |
| - interim dividend paid of 4.4p per ordinary share | 25,000 | - |
| | <u>25,000</u> | <u>-</u> |

10 Intangible fixed assets - goodwill

| | £'000 |
|-----------------------|----------------|
| Cost | |
| At 1 January 2005 | - |
| On acquisition | 226,030 |
| At 31 December 2005 | <u>226,030</u> |
| Amortisation | |
| At 1 January 2005 | - |
| Charge for the year | 3,296 |
| At 31 December 2005 | <u>3,296</u> |
| Net book value | |
| At 31 December 2005 | <u>222,734</u> |
| At 31 December 2004 | <u>-</u> |

The goodwill arose on the acquisition of Northern Gas Networks Limited on 1 June 2005. See note 13 for further detail.

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 2005 | - | - | - | - | - | - |
| Acquisition of subsidiary undertaking | 2,589 | 1,352,589 | 3,723 | 9,486 | - | 1,368,387 |
| Additions | - | 16,720 | 262 | 233 | 5,595 | 22,810 |
| At 31 December 2005 | <u>2,589</u> | <u>1,369,309</u> | <u>3,985</u> | <u>9,719</u> | <u>5,595</u> | <u>1,391,197</u> |
| Depreciation | | | | | | |
| At 1 January 2005 | - | - | - | - | - | - |
| Charge for the year | 160 | 17,912 | 987 | 1,370 | - | 20,429 |
| At 31 December 2005 | <u>160</u> | <u>17,912</u> | <u>987</u> | <u>1,370</u> | <u>-</u> | <u>20,429</u> |
| Net book value | | | | | | |
| 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> |
| At 31 December 2004 | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Leased assets included above: | | | | | | |
| Net book value | | | | | | |
| At 31 December 2005 | <u>41</u> | <u>-</u> | <u>2,739</u> | <u>-</u> | <u>-</u> | <u>2,780</u> |
| At 31 December 2004 | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |

Short leasehold included within Land & Buildings above has a cost on acquisition of the business of £42,000 and depreciation charge in the period of £1,000 giving a net book value at 31 December 2005 of £41,000.

Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £361,000 (2004 - £nil).

The company does not hold any tangible fixed assets (2004 - £nil).

Notes to the accounts (continued)

12 Investments

| | Group | | Company | |
|-------------------------|---------------|---------------|----------------|---------------|
| | 2005 £'000 | 2004 £'000 | 2005 £'000 | 2004 £'000 |
| Subsidiary undertakings | - | - | 550,174 | - |
| Other investments | 104 | - | - | - |
| | <u>104</u> | <u>-</u> | <u>550,174</u> | <u>-</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. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

| | Country of incorporation | Principal activity | Holding | % |
|--|-----------------------------|-----------------------|---------------------------------|-----|
| Subsidiary undertakings | | | | |
| 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.

Subsidiary undertakings

£'000

Cost and net book value

| | |
|-------------------------|----------------|
| At 1 January 2005 | - |
| Additions (see note 13) | 550,174 |
| At 31 December 2005 | <u>550,174</u> |

Other Investments

£'000

Cost and net book value

| | |
|---------------------------------------|------------|
| At 1 January 2005 | - |
| Acquisition of subsidiary undertaking | 104 |
| At 31 December 2005 | <u>104</u> |

Notes to the accounts (continued)

13 Acquisition of subsidiary undertaking

On 1 June 2005 the company acquired 100% of the issued share capital of Northern Gas Networks Limited (formerly Blackwater F Limited) for cash consideration. The fair value of the total consideration was £1,453.5m, which included the repayment of the intercompany creditor of £903.3m.

The following table sets out the book values of the identifiable assets and liabilities acquired and their provisional fair value to the group:

| | Book value £'000 | Revaluation £'000 | Fair value to group £'000 |
|----------------------------|---------------------|----------------------|---------------------------------|
| Fixed assets | | | |
| Intangible – goodwill | 164,349 | (164,349) | - |
| Investment | 104 | - | 104 |
| Tangible | 1,368,387 | - | 1,368,387 |
| Current assets | | | |
| Debtors | 20,460 | - | 20,460 |
| Total assets | <u>1,553,300</u> | <u>(164,349)</u> | <u>1,388,951</u> |
| Creditors | | | |
| Intercompany creditor | (903,330) | - | (903,330) |
| Other creditors & accruals | (29,023) | (503) | (29,526) |
| Provisions | | | |
| Pensions | (18,200) | 770 | (17,430) |
| Environmental | (7,260) | - | (7,260) |
| Taxation | (99,109) | 395 | (98,714) |
| Other | (8,547) | - | (8,547) |
| Total liabilities | <u>(1,065,469)</u> | <u>662</u> | <u>(1,064,807)</u> |
| Net assets | <u>487,831</u> | <u>(163,687)</u> | 324,144 |
| Goodwill | | | 226,030 |
| | | | <u>550,174</u> |
| Satisfied by | | | |
| Cash | | | 550,174 |
| | | | <u>550,174</u> |

The fair value adjustments arise from the recognition of liabilities incurred relating to the period prior to acquisition, the revaluation of the pension deficit by the actuary and the recalculation of the deferred tax liability as at 1 June 2005.

Notes to the accounts (continued)

13 Acquisition of subsidiary undertaking (continued)

Net cash outflows in respect of the acquisition comprised:

| | £'000 |
|---------------------------------|------------------|
| Cash consideration | 550,174 |
| Intercompany creditor repayment | 903,330 |
| | <u>1,453,504</u> |

Northern Gas Networks Limited (formerly Blackwater F Limited) earned a loss after taxation of £13.3m in the nine month period ended 31 December 2005 (period ended 30 March 2005 – profit of £8.3m), of which a loss of £1.4m arose in the period from 31 March 2005 to 1 June 2005. The summarised profit and loss account and statement of total recognised gains and losses for the period from 31 March 2005 to 1 June 2005, shown on the basis of the accounting policies of Northern Gas Networks Limited (formerly Blackwater F Limited) prior to the acquisition, are as follows:

| Profit and loss account | £'000 |
|--|----------------|
| Turnover | 18,095 |
| Cost of sales | (359) |
| | <u>17,736</u> |
| Gross profit | 17,736 |
| Other operating expenses (net) | (17,018) |
| | <u>718</u> |
| Operating profit | 718 |
| Finance charges (net) | (2,405) |
| | <u>(1,687)</u> |
| Loss on ordinary activities before taxation | (1,687) |
| Tax on loss on ordinary activities | 243 |
| | <u>(1,444)</u> |
| Loss for the financial period | <u>(1,444)</u> |

| Statement of total recognised gains and losses | £'000 |
|--|----------------|
| Loss for the financial period | (1,444) |
| Actuarial loss relating to the pension scheme | (1,100) |
| UK deferred tax attributable to actuarial loss | 330 |
| | <u>(2,214)</u> |
| Total recognised gains and losses relating to the period | <u>(2,214)</u> |

Notes to the accounts (continued)

14 Debtors

| | Group | | Company | |
|--------------------------------------|---------------|---------------|---------------|---------------|
| | 2005 £'000 | 2004 £'000 | 2005 £'000 | 2004 £'000 |
| Amounts falling due within one year: | | | | |
| Trade debtors | 5,831 | - | - | - |
| Amounts owed by parent undertakings | 1 | 1 | 1 | 1 |
| Prepayments and accrued income | 35,863 | - | - | - |
| | <u>41,695</u> | <u>1</u> | <u>1</u> | <u>1</u> |

| | Group | | Company | |
|---|---------------|---------------|---------------|---------------|
| | 2005 £'000 | 2004 £'000 | 2005 £'000 | 2004 £'000 |
| Amounts falling due after more than one year: | | | | |
| Amounts owed by group undertakings | - | - | 24,328 | - |
| | - | - | <u>24,328</u> | - |
| | <u>41,695</u> | <u>1</u> | <u>24,329</u> | <u>1</u> |

15 Creditors: Amounts falling due within one year

| | Group | | Company | |
|--|---------------|---------------|---------------|---------------|
| | 2005 £'000 | 2004 £'000 | 2005 £'000 | 2004 £'000 |
| Bank loans and overdrafts | 25,000 | - | - | - |
| Obligations under finance leases and hire purchase contracts | 705 | - | - | - |
| Payments received on account | 12,517 | - | - | - |
| Trade creditors | 3,074 | - | - | - |
| Amounts owed to group undertakings | - | - | 687 | - |
| Other taxation and social security | 880 | - | - | - |
| Accruals and deferred income | 49,559 | - | 2,049 | - |
| Defined contribution pension scheme accrual | 22 | - | - | - |
| | <u>91,757</u> | <u>-</u> | <u>2,736</u> | <u>-</u> |

The bank loan and overdraft is a working capital facility which is repayable on 22 March 2006 and carries interest at 6 month LIBOR plus 0.46%.

Notes to the accounts (continued)

16 Creditors: Amounts falling due after more than one year

| | Group | |
|--|---------------|---------------|
| | 2005 £'000 | 2004 £'000 |
| Term loan | 364,811 | - |
| Obligations under finance leases and hire purchase contracts | 1,039 | - |
| Guaranteed bond due 2027 | 249,564 | - |
| Guaranteed bond due 2035 | 254,554 | - |
| Deferred income | 6,995 | - |
| | <hr/> | <hr/> |
| | 876,963 | - |
| | <hr/> | <hr/> |

The term loan is repayable on 31 March 2010 and carries interest at 6 month LIBOR plus a margin of 0.46%.

The guaranteed bond due 2027 of £250m 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 £255m matures on 15 November 2035 and will be redeemed at par. Interest is paid annually on 15 November at a rate of 4.875%.

17 Derivatives and other financial instruments

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 raise finance for 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.

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

Notes to the accounts (continued)

17 Derivatives and other financial instruments (continued)

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 Gas Distribution Price Determination. This ensures that interest rate hedges are reset in the same economic environment prevailing at the time the regulator is re-calculating 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 will be used to hedge underlying commercial exposures i.e. trading in currency is prohibited. Therefore if an underlying exposure ceases to exist then the corresponding hedge is to be 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 will be staggered to mature over a timeframe of up to ten years avoiding 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 will also be staggered where practicable.

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.

Interest rate profile

The group has no financial assets other than sterling cash deposits of £209,000 (2004 - £nil) which are part of the financing arrangements of the group. The sterling cash deposits comprise monies held in bank deposit accounts.

Notes to the accounts (continued)

17 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 2005 was as follows. There were no financial liabilities as at 31 December 2004.

| | Floating rate 31 December 2005 £'000 | Fixed rate 31 December 2005 £'000 | Total 31 December 2005 £'000 |
|------------------------|---|--|---------------------------------------|
| Borrowings – Term Loan | 364,811 | 25,000 | 389,811 |
| Borrowings – 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 2005 is as follows.

| | Floating rate | Fixed rate | |
|------------------------|---|---|--|
| | Weighted average interest rate % | Weighted average interest rate % | Weighted average period for which rate is fixed Years |
| Borrowings – Term Loan | 4.5 | 4.6 | 0.25 |
| Borrowings – Bonds | - | 4.875 | 26 |
| Finance leases | - | 15 | 5 |

Further details of interest rates on long term borrowings are given in note 16.

Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December 2005 was as follows:

| | 2005 £'000 | 2004 £'000 |
|---|----------------|---------------|
| In one year or less | 25,705 | - |
| In more than one year but not more than two years | 807 | - |
| In more than two years but not more than five years | 365,043 | - |
| In more than five years | 504,118 | - |
| | <u>895,673</u> | <u>-</u> |

Notes to the accounts (continued)

17 Derivatives and other financial instruments (continued)

Borrowing facilities

The group had undrawn committed borrowing facilities at 31 December 2005, in respect of which all conditions precedent had been met, as follows:

| | 2005 £'000 | 2004 £'000 |
|---------------------------------|----------------|---------------|
| Expiring in more than two years | 128,564 | - |
| | <u>128,564</u> | <u>-</u> |

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 2005.

| | 2005 | | 2004 | |
|---|------------------------|------------------------|------------------------|------------------------|
| | Book value £'000 | Fair value £'000 | Book value £'000 | Fair value £'000 |
| Liabilities (assets) | | | | |
| Primary financial instruments held or issued to finance the company's operations | | | | |
| Working capital facility | 25,000 | 24,363 | - | - |
| Long term borrowings | 364,811 | 371,166 | - | - |
| Guaranteed bonds | 504,118 | 524,988 | - | - |
| Derivative financial instruments held to manage the interest rate and currency profile | | | | |
| Interest rate swaps | - | (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)

17 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:

| | Gains £ | Losses £ | Net £ |
|---|---------------|--------------|---------------|
| Unrecognised gains and losses on hedges at 1 January 2005 | - | - | - |
| Gains and losses arising in previous periods that were recognised in the year to 31 December 2005 | - | - | - |
| Gains and losses arising before 1 January 2005 that were not recognised in the year to 31 December 2005 | - | - | - |
| Gains and losses arising in the year to 31 December 2005 that were not recognised in the year to 31 December 2005 | 17,436 | 2,238 | 15,198 |
| Unrecognised gains and losses on hedges at 31 December 2005 | 17,436 | 2,238 | 15,198 |
| Of which: | | | |
| Gains and losses expected to be recognised in 2006 | - | - | - |
| Gains and losses expected to be recognised in 2007 or later | 17,436 | 2,238 | 15,198 |

18 Provisions for liabilities and charges excluding pension liability

| | Deferred taxation £'000 | Environmental restoration £'000 | Other £'000 | Total £'000 |
|---------------------------------------|-------------------------------|---------------------------------------|----------------|----------------|
| Group | | | | |
| At 1 January 2005 | - | - | - | - |
| Charged to profit and loss account | 1,036 | - | 330 | 1,366 |
| Acquisition of subsidiary undertaking | 98,714 | 7,260 | 8,547 | 114,521 |
| Utilised in year | - | - | (7) | (7) |
| At 31 December 2005 | 99,750 | 7,260 | 8,870 | 115,880 |

Notes to the accounts (continued)

18 Provisions for liabilities and charges (continued)

Deferred tax

Deferred tax is provided as follows:

| | 2005 £'000 | 2004 £'000 |
|-----------------------------------|---------------|---------------|
| Group | | |
| Accelerated capital allowances | 99,218 | - |
| Other timing differences | 949 | - |
| Tax losses available | (417) | - |
| Provision for deferred tax | 99,750 | - |

Deferred tax in respect of the group's defined benefit pension scheme is disclosed in note 26.

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.

19 Called-up share capital

| | 2005 £'000 | 2004 £'000 |
|---|----------------|----------------|
| <i>Authorised</i> | | |
| 600,000,000 (2004 – 550,000,000) ordinary shares of £1 each | 600,000 | 550,000 |
| 1 special share of £1 | - | - |
| | 600,000 | 550,000 |
| <i>Allotted, called-up and fully-paid</i> | | |
| 571,669,980 ordinary shares of £1 each | 571,670 | - |
| <i>Allotted and called-up</i> | | |
| 999 ordinary shares of £1 each | 1 | 1 |
| 1 special share of £1 | - | - |
| | 571,671 | 1 |

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

Notes to the accounts (continued)

19 Called-up share capital (continued)

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.

During the year, on the dates set out below, the company allotted a total of 571,669,980 ordinary shares of £1 each at par for cash consideration to fund the acquisition and operation of the business.

| | Number |
|-------------------|-------------|
| 28 February 2005 | 2,175,000 |
| 11 April 2005 | 1,863,600 |
| 16 May 2005 | 530,968,370 |
| 23 June 2005 | 20,000,000 |
| 22 September 2005 | 16,663,010 |

20 Reserves

| | Profit and loss account £'000 |
|--|-------------------------------------|
| Group | |
| At 1 January 2005 | - |
| Retained loss for the year | (37,701) |
| Actuarial loss relating to the pension scheme | (5,500) |
| UK deferred tax attributable to the actuarial loss | 1,650 |
| At 31 December 2005 | <u>(41,551)</u> |
| | Profit and loss account £'000 |
| Company | |
| At 1 January 2005 | - |
| Retained profit for the year | 105 |
| At 31 December 2005 | <u>105</u> |

Notes to the accounts (continued)

21 Reconciliation of movements in group equity shareholders' funds

| | 2005 £'000 | 2004 £'000 |
|--|-----------------|---------------|
| Loss for the financial year | (12,701) | - |
| Other recognised gains and losses relating to the year (net) | (3,850) | - |
| | <u>(16,551)</u> | <u>-</u> |
| Dividends paid and proposed on equity shares | (25,000) | - |
| New shares issued | 571,670 | 1 |
| Net addition to equity shareholders' funds | <u>530,119</u> | <u>-</u> |
| Opening equity shareholders' funds | 1 | - |
| Closing equity shareholders' funds | <u>530,120</u> | <u>1</u> |

22 Reconciliation of operating profit to operating cash flows

| | 2005 £'000 | 2004 £'000 |
|--|---------------|---------------|
| Operating profit | 15,023 | - |
| Depreciation and amortisation | 23,725 | - |
| Increase in debtors | (21,234) | - |
| Increase in creditors | 37,330 | - |
| Increase in provisions | 320 | - |
| Adjustment for pension funding | 400 | - |
| Net cash inflow from operating activities – continuing operations | <u>55,564</u> | <u>-</u> |

23 Analysis of cash flows

| | 2005 £'000 | 2004 £'000 |
|--|-----------------|---------------|
| <i>Returns on investments and servicing of finance</i> | | |
| Interest received | 252 | - |
| Interest paid | (19,951) | - |
| Net cash outflow | <u>(19,699)</u> | <u>-</u> |

Notes to the accounts (continued)

23 Analysis of cash flows (continued)

| | 2005 £'000 | 2004 £'000 |
|---|--------------------|---------------|
| <i>Capital expenditure and financial investment</i> | | |
| Purchase of tangible fixed assets | (22,449) | - |
| Net cash outflow | (22,449) | - |
| <i>Acquisitions and disposals</i> | | |
| Purchase of subsidiary undertaking | (1,453,504) | - |
| Net cash outflow | (1,453,504) | - |
| <i>Financing</i> | | |
| Issue of ordinary share capital | 571,670 | - |
| Issue of guaranteed bonds | 504,118 | - |
| Increase in short term borrowings | 25,000 | - |
| New unsecured term loan | 364,811 | - |
| Capital element of finance lease rental payments | (302) | - |
| Net cash inflow | 1,465,297 | - |

Companies acquired in the year contributed £55.6m to the group's net operating cash flows, paid £19.7m in respect of net returns on investment and servicing of finance, paid £nil in respect of taxation and utilised £22.4m for capital expenditure.

Notes to the accounts (continued)

24 Analysis and reconciliation of net debt

| | 1 January 2005 £'000 | Cash flow £'000 | Acquisitions and disposals £'000 | 31 December 2005 £'000 |
|--------------------------|----------------------------|--------------------|---|---------------------------------|
| Cash at bank and in hand | - | 209 | - | 209 |
| | | <u>209</u> | | |
| Debt due after 1 year | - | (868,929) | - | (868,929) |
| Debt due within 1 year | - | (25,000) | - | (25,000) |
| Finance leases | - | 302 | (2,046) | (1,744) |
| | | <u>(893,627)</u> | | |
| Net debt | - | (893,418) | (2,046) | (895,464) |

| | 2005 £'000 | 2004 £'000 |
|---|------------------|---------------|
| Increase in cash in the year | 209 | - |
| Cash inflow from increase in debt and lease financing | (893,627) | - |
| Change in net debt resulting from cash flows | (893,418) | - |
| Finance leases acquired with subsidiary | (2,046) | - |
| Movement in net debt in year | (895,464) | - |
| Net debt at 1 January | - | - |
| Net debt at 31 December | <u>(895,464)</u> | <u>-</u> |

Notes to the accounts (continued)

25 Financial commitments

Capital commitments are as follows:

| | Group | |
|-------------------------------------|---------------|---------------|
| | 2005 £'000 | 2004 £'000 |
| Contracted for but not provided for | 1,415 | - |
| | <u>1,415</u> | <u>-</u> |

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

| Group | Land and buildings | |
|------------------------------|--------------------|---------------|
| | 2005 £'000 | 2004 £'000 |
| Expiry date: | | |
| - between two and five years | 234 | - |
| - after five years | 683 | - |
| | <u>917</u> | <u>-</u> |

The group has a total commitment of £13.1m over the term of the bonds in relation to the financial guarantee from FGIC UK Limited to cover the guaranteed bonds included within long term borrowings in note 16.

The group has also entered in to a Guarantee and Reimbursement Agreement with FGIC UK Limited ("FGIC") in relation to the bonds issued by Northern Gas Networks Finance Plc ("the Issuer") in November 2005 of £505m. 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 and indemnifies FGIC against any loss or liability suffered by it if any obligation guaranteed by it 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 Asset Services Agreement 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 £1.1bn.

Notes to the accounts (continued)

26 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 Asset Services Agreement. The scheme was set up following the acquisition of the business and the first full actuarial valuation will be carried out in 2007. The value on acquisition and at 31 December 2005 was calculated by a qualified actuary. The major assumptions used for the actuarial valuation were:

| | 31 December 2005 | 31 May 2005 |
|---|---------------------|----------------|
| Rate of increase in salaries | 3.30% | 3.20% |
| Rate of increase in pensions in payment | 2.80% | 2.70% |
| Discount rate | 4.70% | 5.10% |
| Inflation assumption | 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 2005 % | 31 December 2005 £'000 | 31 May 2005 % | 31 May 2005 £'000 |
|-------------------------------------|--------------------------|------------------------------|---------------------|-------------------------|
| Equities | 7.00 | 82,500 | 7.30 | 143,200 |
| Gilts & Bonds | 4.20 | 81,800 | - | - |
| Cash | 4.50 | 3,300 | - | - |
| Total fair value of assets | | 167,600 | | 143,200 |
| Present value of scheme liabilities | | (197,300) | | (168,100) |
| Deficit in the scheme | | (29,700) | | (24,900) |
| Related deferred tax asset | | 8,910 | | 7,470 |
| Net pension liability | | <u>(20,790)</u> | | <u>(17,430)</u> |

The contribution rate for 2005 was 23% of pensionable earnings and the agreed contribution rate from December 2005 is 31% of pensionable earnings.

Notes to the accounts (continued)

26 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

| | 2005 £'000 | 2004 £'000 |
|----------------------|---------------|---------------|
| Current service cost | <u>3,700</u> | <u>-</u> |

Analysis of the amount credited to net finance charges

| | 2005 £'000 | 2004 £'000 |
|--|----------------|---------------|
| Expected return on pension scheme assets | 6,200 | - |
| Interest on pension scheme liabilities | <u>(5,100)</u> | <u>-</u> |
| | <u>1,100</u> | <u>-</u> |

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

| | 2005 £'000 | 2004 £'000 |
|---|-----------------|---------------|
| Actual return less expected return on pension scheme assets | 17,000 | - |
| Experience gains and losses arising on the scheme liabilities | 400 | - |
| Changes in assumptions underlying the present value of the scheme liabilities | <u>(22,900)</u> | <u>-</u> |
| | <u>(5,500)</u> | <u>-</u> |

Notes to the accounts (continued)

26 Pension arrangements (continued)

Movement in scheme deficit during the year before deferred tax

| | 2005 £'000 | 2004 £'000 |
|----------------------|-----------------|---------------|
| On acquisition | (24,900) | - |
| Current service cost | (3,700) | - |
| Contributions | 3,300 | - |
| Net finance income | 1,100 | - |
| Actuarial loss | (5,500) | - |
| At 31 December | <u>(29,700)</u> | <u>-</u> |

History of experience gains and losses

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

The group also operates defined contribution schemes for which the pension cost charge for the year amounted to £58,000 (2004 - £nil).

Notes to the accounts (continued)

27 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:

| | 2005 £'000 | 2004 £'000 |
|-------------------------------|---------------|---------------|
| Able Ventures Profits Limited | 517 | - |
| CHED Services Limited | 1,188 | - |
| | <u>1,705</u> | <u>-</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 2005 (2004 - £nil). These amounts all relate to trading balances.

28 Ultimate controlling party

The company is wholly owned by a consortium consisting of:

| <u>Immediate parent undertaking</u> | <u>Ultimate parent undertaking</u> |
|---|------------------------------------|
| Able Ventures Profits Limited | Hutchison Whampoa Limited |
| Alpha Central Profits Limited | Hongkong Electric Holdings Limited |
| Challenger Northern Gas Limited | Not applicable |
| Goldia Resources Limited | Li Ka Shing (Overseas) Foundation |
| SAS Trustee Corporation | Not applicable |
| United Utilities Contract Solutions Limited | United Utilities plc |