

Northern Gas Networks Limited

Annual Report and accounts
for the year ended 31 December 2007

Registered number: 5167070

Directors' report

For the year ended 31 December 2007

The directors present their Annual Report on the affairs of the company, together with the accounts and auditors' report, for the year ended 31 December 2007.

Principal activity

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

Business review

On acquisition of the business in 2005, 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 network 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"). This model is delivering the expected operational results.

The company's financial results for the year are above expectations. Total revenue for the year was £289.5m (2006 - £273.3m) which was impacted by reduced throughput volumes as a result of the warmer than seasonal normal weather experienced in the first half of the year but was largely offset by a price increase from October 2007. Operating profit for the year was £65.2m (2006 - £47.9m).

The company has debt before financing costs of £1,003.0m (2006 - £960.2m) at the year end. This includes a term loan of £366.4m (2006 - £366.4m) repayable on 31 March 2010 with a fixed weighted average rate of 5.535% plus an effective margin of 0.26%, short term facilities of £107.0m (2006 - £64.0m) which carry interest at 6 month LIBOR plus a margin of 0.26%, bonds of £505.0m (2006 - £505.0m) with £250.0m repayable in 2027 and £255.0m repayable in 2035 with interest on the bonds payable at a rate of 4.875%, and an intercompany interest free loan of £24.3m (2006 - £24.3m). This debt structure has given rise to interest payable and similar charges of £49.7m (2006 - £45.5m).

The tax charge for the year was £2.8m (2006 - £5.7m) which represents an effective tax rate of 17% (2006 - 136%).

Directors' report (continued)

Capital expenditure (Capex) for the year was £38.2m (2006 - £44.3m) principally due to investment in network assets and new IT systems used to support many of the company's operational business activities.

Key performance indicators

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

	2007	2006
Post maintenance interest coverage ratio	1.9	1.6
EBITDA interest coverage ratio	2.1	2.0
Senior net debt/Regulatory asset value	67.5%	68.6%
Number of lost time injuries to employees and contractors	8	9
Injuries to members of the general public	10	23
Quarterly customer satisfaction survey for repair and replacement	4.0 out of 5.0	4.0 out of 5.0

Environment

The company 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 company is committed to the protection of the environment in the region it serves. The company'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, its land recycling project at Sheepscar in Leeds.

Principal risks and uncertainties

The company'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 the company 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 company.

Health and safety

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

Directors' report (continued)

Price control

The company now has a price control review outcome agreed for 2008 – 2013 which has determined revenue and cost allowances which will apply for the next five years. After this period, revenue and cost allowances will be subject to review with Ofgem.

Contract and contractor management

As described above, the operation and maintenance of the network, as well as the responsibility for implementing the Capex and Replacement 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 company, 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 company's business reputation or increase costs or 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 and an unexpected increase in costs.

Employees

The success of the company depends to a significant extent on the contribution of its employees and the employees and contractors of UUOL. 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 company in the community it serves.

The company, 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 company's needs.

Future outlook

The directors expect the general level of activity to remain stable given the certainty now provided by the price control outcome to 2013.

Financial risk management objectives and policies

The company'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 company's operations.

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

Directors' report (continued)

The main risks arising from the company'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 minimising interest rate exposures on debt is as follows:

- To maintain a balanced debt portfolio comprising a mixture of fixed rate, floating rate and index-linked debt in order to achieve a degree of symmetry with the Regulator's broad approach to setting cost of debt allowances (each class of debt comprises between 20% and 50% of total debt beyond the end of the current price control period);
- To maintain a debt portfolio consistent with those of comparable utility companies; and
- To synchronise the maturities of fixed rate interest hedges on floating rate debt with the timing of the Regulator's five yearly price control review.

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 are 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 finance leases which have a maturity of less than one year.

Facilities are staggered to maturity to avoid excessive concentrations in any twelve month period 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 £150,000 per share were paid on 25 June 2007 and of £500,000 per share were paid on 28 December 2007 making a total of £650,000 per share for the year (2006 – £600,000).

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 (resigned 8 October 2007)

H Lam Kam

K Sum Tso

N McGee

A Hunter

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

C Cornish (appointed 12 April 2007, resigned 2 December 2007)

J Dorrian (appointed 8 October 2007)

S Fraser (appointed 2 December 2007)

The Board of Directors

The daily operations of the business are managed by the Senior Management Team (SMT) and the Chief Executive Officer (CEO). All significant decisions are referred to the Board of Directors.

The Board of Directors meet at least five times a year. The number of Board meetings held during the year and attendees at the Board meetings is detailed below:

2007		2006	
Date	Attendees	Date	Attendees
8 January	8 out of 9	9 January	9 out of 9
5 March	9 out of 9	3 April	9 out of 9
21 May	7 out of 9	3 July	8 out of 9
4 July	8 out of 9	9 October	9 out of 9
3 September	9 out of 9	17 November	9 out of 9
12 November	9 out of 9		

The effectiveness of systems and internal controls are reviewed on an ongoing basis by the SMT who formally report into the CEO bi-annually. The Board is ultimately responsible for the system of internal controls and for the review of effectiveness.

The Board consider the business a going concern at the time of approval of the Annual Report and accounts.

Directors' report (continued)

Supplier payment policy

The company's policy 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 company at 31 December 2007 were equivalent to 18 (2006 – 14) days' purchases, based on the average daily amount invoiced by suppliers during the year.

Charitable and political contributions

During the year the company made charitable donations of £53,594 (2006 - £4,520), principally to local charities serving the communities in which the company operates. Charitable donations included a project called Northern Green Networks which provided £50,000 to local community groups within the network region to support environmental schemes. No political donations were made (2006 - £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 employees becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Employee consultation

The company 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 company.

Directors' report (continued)

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,



B Scarsella

13 March 2008

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 of the profit or loss of the company for that year. 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 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 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 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 company'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 Limited

We have audited the accounts of Northern Gas Networks Limited for the year ended 31 December 2007 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the statement of accounting policies and the related notes 1 to 22. 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 Directors' Report, and consider the implications for our report if we become aware of any apparent misstatements within it.

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 company's circumstances, consistently applied and adequately disclosed.

Independent auditors' report (continued)

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 company's affairs as at 31 December 2007 and of its profit 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

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Leeds

17 March 2008

Profit and loss account

For the year ended 31 December 2007

	Notes	2007 £'000	2006 £'000
Turnover	1	289,529	273,326
Cost of sales		(12,542)	(20,866)
Gross profit		276,987	252,460
Other operating expenses	2	(211,761)	(204,538)
Operating profit		65,226	47,922
Profit on disposal of fixed assets	4	-	941
Finance charges (net)	3	(48,520)	(44,663)
Profit on ordinary activities before taxation	4	16,706	4,200
Tax on profit on ordinary activities	7	(2,776)	(5,706)
Profit (loss) for the year	18	13,930	(1,506)

The above results arise from continuing operations.

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

Statement of total recognised gains and losses

For the year ended 31 December 2007

	Notes	2007 £'000	2006 £'000
Profit (loss) for the year		13,930	(1,506)
Actuarial gain relating to the pension scheme	21	10,260	400
Deferred tax attributable to actuarial gain		(2,873)	(120)
Total recognised gains (losses) relating to the year		21,317	(1,226)

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

Balance sheet

31 December 2007

	Notes	2007 £'000	2006 £'000
Fixed assets			
Intangible assets - goodwill	9	153,836	157,947
Tangible assets	10	1,380,939	1,379,782
Investments	11	154	154
		<u>1,534,929</u>	<u>1,537,883</u>
Current assets			
Debtors - due within one year	12	47,062	45,096
Cash at bank and in hand		1,193	4,809
		<u>48,255</u>	<u>49,905</u>
Creditors: Amounts falling due within one year	13	<u>(196,201)</u>	<u>(150,243)</u>
Net current liabilities		<u>(147,946)</u>	<u>(100,338)</u>
Total assets less current liabilities		1,386,983	1,437,545
Creditors: Amounts falling due after more than one year	14	(917,851)	(909,759)
Provisions for liabilities and charges excluding pension liability	16	<u>(116,577)</u>	<u>(121,570)</u>
Net assets excluding pension liability		<u>352,555</u>	<u>406,216</u>
Pension liability	21	<u>(9,606)</u>	<u>(19,584)</u>
Net assets including pension liability		<u>342,949</u>	<u>386,632</u>
Capital and reserves			
Called-up share capital	17	-	-
Profit and loss account	18	<u>342,949</u>	<u>386,632</u>
Shareholders' funds	19	<u>342,949</u>	<u>386,632</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 3 March 2008 and signed on its behalf by:



B Scarsella

Director

Statement of accounting policies

31 December 2007

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

Basis of accounting

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

The company is exempt from the requirement of FRS1 (revised) "Cash flow statements" to present a cash flow statement as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited, which prepares consolidated accounts which are publicly available.

The company is not required to prepare group accounts as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited which prepares consolidated accounts which are publicly available.

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 year 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 company taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in years 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 years 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 company 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 company. 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 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 year 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 company, 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 year 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 year and reduced by payments made in the year.

Derivative financial instruments

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

Notes to the accounts

31 December 2007

1 Segment information

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

2 Other operating expenses

	2007 £'000	2006 £'000
Distribution costs	201,244	196,180
Administrative expenses	10,517	8,358
	<u>211,761</u>	<u>204,538</u>

3 Finance charges (net)

	2007 £'000	2006 £'000
Interest payable and similar charges	49,683	45,522
Less: investment income	(704)	(981)
Other finance (income) charges	(459)	122
	<u>48,520</u>	<u>44,663</u>

Interest payable and similar charges

	2007 £'000	2006 £'000
Bank loans and overdrafts	24,668	20,836
Intercompany interest payable	25,124	25,259
Finance leases and hire purchase contracts	204	204
	<u>49,996</u>	<u>46,299</u>
Finance costs capitalised	(313)	(777)
	<u>49,683</u>	<u>45,522</u>

Finance costs have been capitalised based on a capitalisation rate of 6.25% (2006 - 6.25%).

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Investment income

	2007 £'000	2006 £'000
Income from fixed asset investments	202	147
Interest receivable and similar income	502	834
	<u>704</u>	<u>981</u>

Other finance (income) charges

	2007 £'000	2006 £'000
Unwinding of discount on provisions (see note 16)	16	22
Net return on pension scheme (see note 21)	(475)	100
	<u>(459)</u>	<u>122</u>

4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	2007 £'000	2006 £'000
Depreciation and amounts written off tangible fixed assets		
- owned	36,107	33,732
- held under finance leases and hire purchase contracts	910	1,533
Amortisation of goodwill	4,111	4,126
Profit on disposal of fixed assets	221	941
Operating lease rentals - other	176	175
Fees payable to the company's auditors for the audit of the company's annual accounts	<u>58</u>	<u>56</u>

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 of the parent company are required to disclose such fees on a consolidated basis.

Notes to the accounts (continued)

4 Profit on ordinary activities before taxation (continued)

The profit on disposal of fixed assets in 2006 relates to the sale of land in the year and the effect on the tax on profit on ordinary activities in 2006 is an increase of £282,000.

5 Staff costs

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

	2007 Number	2006 Number
Administration	46	28
	<u>46</u>	<u>28</u>

	2007 £'000	2006 £'000
Their aggregate remuneration comprised:		
Wages and salaries	2,865	2,044
Social security costs	307	250
Other pension costs	230	158
	<u>3,402</u>	<u>2,452</u>

Notes to the accounts (continued)

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	2007 £'000	2006 £'000
Emoluments	584	435
Amounts receivable (other than shares and share options) under long-term incentive schemes	132	31
Company contributions to money purchase pension schemes	36	34
	<u>752</u>	<u>500</u>

Pensions

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

	2007	2006
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:

	2007 £'000	2006 £'000
Emoluments	584	435
Amounts receivable (other than shares and share options) under long-term incentive schemes	132	31
Company contributions to money purchase schemes	36	34
	<u>752</u>	<u>500</u>

Transactions

There have been no transactions with directors in the current year or prior year other than as set out above in respect of remuneration.

Notes to the accounts (continued)

7 Tax on profit on ordinary activities

The tax charge comprises:

	2007 £'000	2006 £'000
Current tax		
UK corporation tax	6,326	-
Total current tax	<u>6,326</u>	<u>-</u>
Deferred tax		
Current year - origination and reversal of timing differences	4,335	7,603
Effect of decrease in tax rate on opening liability	(7,082)	-
Adjustments in respect of prior years	(803)	(1,897)
Total deferred tax	<u>(3,550)</u>	<u>5,706</u>
Total tax on profit on ordinary activities	<u>2,776</u>	<u>5,706</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 before tax is as follows.

	2007 £'000	2006 £'000
Profit on ordinary activities before tax	<u>16,706</u>	<u>4,200</u>
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2006 – 30%)	5,012	1,260
Effects of:		
Expenses not deductible for tax purposes	6,224	6,343
Utilisation of tax losses	(803)	(2,760)
Capital allowances in excess of depreciation	(2,988)	(4,551)
Other timing differences	(1,108)	(292)
Adjustments in respect of prior year	(11)	-
Current tax charge for the year	<u>6,326</u>	<u>-</u>

The company earns its profits in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 30% (2006 – 30%).

The company'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 Dividends paid on equity shares

	2007 £'000	2006 £'000
Equity shares		
- interim dividend paid of £150,000 (2006 - £150,000) per ordinary share	15,000	15,000
- interim dividend paid of £500,000 (2006 - £450,000) per ordinary share	50,000	45,000
	<u>65,000</u>	<u>60,000</u>

9 Intangible fixed assets – goodwill

£'000

Cost

At 1 January 2007 and 31 December 2007

164,457

Amortisation

At 1 January 2007

6,510

Charge for the year

4,111

At 31 December 2007

10,621

Net book value

At 31 December 2007

153,836

At 31 December 2006

157,947

Notes to the accounts (continued)

10 Tangible fixed assets

	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 2007	2,987	1,396,945	4,435	32,607	77	1,437,051
Additions	-	30,511	2,683	563	4,469	38,226
Disposals	-	-	(430)	-	-	(430)
Transfers	-	-	-	77	(77)	-
At 31 December 2007	<u>2,987</u>	<u>1,427,456</u>	<u>6,688</u>	<u>33,247</u>	<u>4,469</u>	<u>1,474,847</u>
Depreciation						
At 1 January 2007	466	50,375	2,748	3,680	-	57,269
Charge for the year	279	31,612	1,247	3,879	-	37,017
Disposals	-	-	(378)	-	-	(378)
At 31 December 2007	<u>745</u>	<u>81,987</u>	<u>3,617</u>	<u>7,559</u>	<u>-</u>	<u>93,908</u>
Net book value						
At 31 December 2007	<u>2,242</u>	<u>1,345,469</u>	<u>3,071</u>	<u>25,688</u>	<u>4,469</u>	<u>1,380,939</u>
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>
Leased assets included above:						
Net book value						
At 31 December 2007	<u>366</u>	<u>-</u>	<u>285</u>	<u>-</u>	<u>-</u>	<u>651</u>
At 31 December 2006	<u>406</u>	<u>-</u>	<u>1,207</u>	<u>-</u>	<u>-</u>	<u>1,613</u>

Short leasehold included within land and buildings above has a cost of £442,000 (2006 - £442,000), depreciation charge in the year of £40,000 (2006 - £35,000), accumulated depreciation of £76,000 (2006 - £36,000) and a net book value of £366,000 (2006 - £406,000).

Leased assets included within motor vehicles above have a cost of £3,292,000 (2006 - £3,723,000), depreciation charges in the year of £870,000 (2006 - £1,533,000), accumulated depreciation of £3,007,000 (2006 - £2,516,000) and a net book value of £285,000 (2006 - £1,207,000).

Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £1,451,000 (2006 - £1,138,000).

Notes to the accounts (continued)

11 Investments

	2007 £'000	2006 £'000
Subsidiary undertakings	50	50
Other investments	104	104
	<u>154</u>	<u>154</u>

The company has an investment in the following subsidiary undertaking:

Subsidiary undertaking	Country of incorporation	Principal activity	Holding	%
Northern Gas Networks Finance Plc	England & Wales	Financing	49,999 ordinary shares of £1	100

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

Subsidiary undertakings

£'000

Cost and net book value

At 1 January 2007 and 31 December 2007

50

Other investments

£'000

Cost and net book value

At 1 January 2007 and 31 December 2007

104

Notes to the accounts (continued)

12 Debtors – due within one year

	2007 £'000	2006 £'000
Trade debtors	7,341	7,268
Prepayments and accrued income	39,721	36,133
UK corporation tax	-	1,695
	<u>47,062</u>	<u>45,096</u>

13 Creditors: Amounts falling due within one year

	2007 £'000	2006 £'000
Bank loans	107,000	64,000
Obligations under finance leases and hire purchase contracts	218	425
Payments received on account	12,409	8,396
Trade creditors	2,318	9,291
Amounts owed to group undertakings	5,086	4,437
Other taxation and social security	5,273	1,805
Accruals and deferred income	59,465	61,869
Defined contribution pension scheme accrual	24	20
UK corporation tax	4,408	-
	<u>196,201</u>	<u>150,243</u>

Bank loans are a working capital facility of £25.0m repayable on 31 January 2008, a revolving credit facility of £52.0m repayable on 31 January 2008 and a revolving credit facility of £30.0m repayable on 23 January 2008. All carry interest at 6 month LIBOR plus a margin of 0.26%.

Notes to the accounts (continued)

14 Creditors: Amounts falling due after more than one year

	2007 £'000	2006 £'000
Term loan	365,438	365,024
Amounts owed to group undertakings	529,328	529,328
Obligations under finance leases and hire purchase contracts	-	12
Deferred income	23,085	15,395
	<u>917,851</u>	<u>909,759</u>

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

The amounts owed to group undertakings is an interest free loan of £24.3m, which is only repayable after the term loan has been fully repaid and an interest bearing loan of £505.0m, with £250.0m repayable in 2027 and £255.0m repayable in 2035. Interest is payable at a rate of 4.875% plus a margin to cover related costs.

15 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 company 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 undertakings 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 company has no financial assets other than sterling cash deposits of £1,193,000 (2006 - £4,809,000) which are part of the financing arrangements of the company. The sterling cash deposits comprise monies held in bank accounts.

After taking into account interest rate swap contracts entered into by the company, the interest rate profile of the company's financial liabilities at 31 December 2007 was as follows:

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

	Floating rate 2007 £'000	Fixed rate 2007 £'000	Interest free 2007 £'000	Total 2007 £'000
Borrowings	365,438	612,000	24,328	1,001,766
Finance leases	-	218	-	218
Total	365,438	612,218	24,328	1,001,984

The profile at 31 December 2006 for comparison purposes was as follows:

	Floating rate 2006 £'000	Fixed rate 2006 £'000	Interest free 2006 £'000	Total 2006 £'000
Borrowings	365,024	569,000	24,328	958,352
Finance leases	-	437	-	437
Total	365,024	569,437	24,328	958,789

Further analysis of the interest rate profile at 31 December 2007 and 31 December 2006 is as follows:

	2007		
	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings - Bank Loans	6.6	6.2	0.07
Borrowings - Intercompany Loan	-	4.875	24
Finance leases	-	15	1

	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 - Intercompany Loan	-	4.875	25
Finance leases	-	15	4

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

Further details of interest rates on long term borrowings are given in note 14.

Maturity of financial liabilities

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

	2007 £'000	2006 £'000
In one year or less	107,218	64,425
In more than one year but not more than two years	-	12
In more than two years but not more than five years	365,438	389,352
In more than five years	529,328	505,000
	<u>1,001,984</u>	<u>958,789</u>

Borrowing facilities

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

	2007 £'000	2006 £'000
Expiring in more than two years	<u>46,564</u>	<u>89,564</u>

Fair values

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

	2007		2006	
	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 and revolving credit facilities	107,000	107,000	64,000	64,000
Long term borrowings	365,438	357,140	365,024	358,362
Intercompany loans	529,328	533,048	529,328	543,774
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	-	17,446	-	1,477

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

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.

Gains and losses on hedges

The company 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:

	2007			2006		
	Gains £'000	Losses £'000	Net £'000	Gains £'000	Losses £'000	Net £'000
Unrecognised gains and losses on hedges at 1 January	24,199	(25,676)	(1,477)	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	24,199	(25,676)	(1,477)	17,436	(2,238)	15,198
Gains and losses arising in the year that were not recognised in the year	(13,315)	(2,654)	(15,969)	6,763	(23,438)	(16,675)
Unrecognised gains and losses on hedges at 31 December	<u>10,884</u>	<u>(28,330)</u>	<u>(17,446)</u>	<u>24,199</u>	<u>(25,676)</u>	<u>(1,477)</u>
Of which:						
Gains and losses expected to be recognised in 2008	<u>7,637</u>	<u>-</u>	<u>7,637</u>	<u>-</u>	<u>-</u>	<u>-</u>
Gains and losses expected to be recognised in 2009 or later	<u>3,247</u>	<u>(28,330)</u>	<u>(25,083)</u>	<u>24,199</u>	<u>(25,676)</u>	<u>(1,477)</u>

Notes to the accounts (continued)

16 Provisions for liabilities and charges excluding pension liability

	Deferred taxation £'000	Environmental restoration £'000	Other £'000	Total £'000
At 1 January 2007	105,317	7,279	8,974	121,570
Charged to profit and loss account	(5,038)	221	(43)	(4,860)
Utilised in the year	(11)	(136)	(2)	(149)
Adjustment arising from discounting	-	7	9	16
At 31 December 2007	<u>100,268</u>	<u>7,371</u>	<u>8,938</u>	<u>116,577</u>

Deferred tax

Deferred tax is provided as follows:

	2007 £'000	2006 £'000
Accelerated capital allowances	99,177	105,259
Other timing differences	1,091	58
Provision for deferred tax	<u>100,268</u>	<u>105,317</u>

Deferred tax in respect of the defined benefit pension scheme is disclosed in note 21.

Environmental restoration

Estimated environmental restoration costs are provided where the company 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)

17 Called-up share capital

	2007 £	2006 £
<i>Authorised</i>		
100 ordinary shares of £1 each	100	100
	<hr/>	<hr/>
	100	100

	2007 £	2006 £
<i>Allotted, called-up and fully-paid</i>		
100 ordinary shares of £1 each	100	100
	<hr/>	<hr/>
	100	100

18 Reserves

	Profit and loss account £'000
At 1 January 2007	386,632
Profit for the year	13,930
Actuarial gain relating to the pension scheme	10,260
UK deferred tax attributable to actuarial gain	(2,873)
Dividends paid on equity shares	<hr/> (65,000)
At 31 December 2007	<hr/>342,949

Notes to the accounts (continued)

19 Reconciliation of movements in shareholders' funds

	2007 £'000	2006 £'000
Profit (loss) for the year	13,930	(1,506)
Other recognised gains and losses related to one year (net)	7,387	280
Dividends paid on equity shares	(65,000)	(60,000)
Net movement in shareholders' funds	(43,683)	(61,226)
Opening shareholders' funds	386,632	447,858
Closing shareholders' funds	<u>342,949</u>	<u>386,632</u>

20 Financial commitments

Capital commitments are as follows:

	2007 £'000	2006 £'000
Contracted for but not provided for	8,111	-
	<u>8,111</u>	<u>-</u>

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

	<u>Land and buildings</u>	
	2007 £'000	2006 £'000
Expiry date		
- within one year	-	47
- between two and five years	53	-
- after five years	386	683
	<u>439</u>	<u>730</u>

The company has entered into a Guarantee and Reimbursement Agreement with FGIC UK Limited ("FGIC") in conjunction with its subsidiary Northern Gas Networks Finance Plc ("the Issuer") in relation to the bonds issued by that company in November 2005 of £505.0m. The company 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 company 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.

Notes to the accounts (continued)

20 Financial commitments (continued)

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 Capex and Replacement programmes has been contracted out to UUOL. The total value of the contract, to its expiry date, is estimated to be £0.8bn (2006 – £0.9bn).

21 Pension arrangements

The company 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 hive down of the business and the first full actuarial valuation will be carried out in 2008. The position at 31 December 2006 and 31 December 2007 was calculated by a qualified actuary. The major assumptions used for the actuarial valuation were:

	31 December 2007	31 December 2006	31 December 2005
Rate of increase in salaries	3.90%	3.50%	3.30%
Rate of increase in pensions in payment	3.40%	3.00%	2.80%
Discount rate	5.50%	4.90%	4.70%
Inflation assumption	3.40%	3.00%	2.80%

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 hive down were:

	31 December 2007 %	31 December 2007 £'000	31 December 2006 %	31 December 2006 £'000	31 December 2005 %	31 December 2005 £'000	1 May 2005 %	1 May 2005 £'000
Equities	7.20	90,981	7.30	86,100	7.00	82,500	7.50	137,900
Gilts & Bonds	4.60	96,603	4.40	90,300	4.20	81,800	-	-
Property	7.20	13,568	-	-	-	-	-	-
Cash	5.30	3,862	4.75	9,800	4.50	3,300	-	-
Total fair value of assets		205,014		186,200		167,600		137,900
Present value of scheme liabilities		(218,356)		(214,177)		(197,300)		(163,900)
Deficit in the scheme		(13,342)		(27,977)		(29,700)		(26,000)
Related deferred tax asset		3,736		8,393		8,910		7,800
Net pension liability		<u>(9,606)</u>		<u>(19,584)</u>		<u>(20,790)</u>		<u>(18,200)</u>

Notes to the accounts (continued)

21 Pension arrangements (continued)

The contribution rate for 2007 was 31.1% (2006 – 31.1%) of pensionable earnings.

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

	2007 £'000	2006 £'000
Current service cost	<u>7,852</u>	<u>7,400</u>

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

	2007 £'000	2006 £'000
Expected return on pension scheme assets	11,204	9,500
Interest on pension scheme liabilities	<u>(10,729)</u>	<u>(9,600)</u>
	<u>475</u>	<u>(100)</u>

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

	2007 £'000	2006 £'000
Actual return less expected return on pension scheme assets	(5,065)	1,000
Experience gains and losses arising on the scheme liabilities	4,052	-
Changes in assumptions underlying the present value of the scheme liabilities	<u>11,273</u>	<u>(600)</u>
	<u>10,260</u>	<u>400</u>

Notes to the accounts (continued)

21 Pension arrangements (continued)

Movement in scheme deficit during the year before deferred tax:

	2007 £'000	2006 £'000
At 1 January	(27,977)	(29,700)
Current service cost	(7,852)	(7,400)
Contributions	11,752	8,823
Net finance income (charge)	475	(100)
Actuarial gain	10,260	400
At 31 December	<u>(13,342)</u>	<u>(27,977)</u>

History of experience gains and losses

	31 December 2007	31 December 2006	31 December 2005	1 May 2005
Difference between the expected and actual return on scheme assets:				
Amount (£'000)	(5,065)	1,000	21,500	-
Percentage of scheme assets	(2%)	1%	13%	-
Experience gains and losses on scheme liabilities:				
Amount (£'000)	4,052	-	400	-
Percentage of the present value of scheme liabilities	2%	-	0%	-
Total actuarial gain (loss) in the statement of total recognised gains and losses:				
Amount (£'000)	10,260	400	(4,400)	-
Percentage of the present value of scheme liabilities	5%	0%	(2%)	-

The company also operates defined contribution schemes for which the pension cost charge for the year amounted to £230,000 (2006 - £158,000).

Notes to the accounts (continued)

22 Ultimate controlling party

The directors regard Northern Gas Networks Holdings Limited, a company incorporated in England and Wales as the ultimate parent company and the ultimate controlling party.

Northern Gas Networks Holdings Limited is the parent company of the largest and smallest group of which the company is a member and for which group accounts are drawn up. Copies of the accounts are available from 1100 Century Way, Thorpe Park Business Park, Colton, Leeds, LS15 8TU.

The Shareholders of Northern Gas Networks Holdings Limited are a consortium comprising of:

PG (April) Limited (40%)

Beta Central Profits Limited (19.9%)

Goldia Resources Limited (15.2%)

United Utilities Energy and Contracting Services Holdings Limited (15%)

Challenger Northern Gas Limited (5.8%)

SAS Trustee Corporation (4.1%)

As a subsidiary undertaking of Northern Gas Networks Holdings Limited, the company has taken advantage of the exemption in FRS 8 "Related party disclosures" from disclosing transactions with other members of the group headed by Northern Gas Networks Holdings Limited.

During the year the company paid legal expenses on behalf of PG (April) Limited and Beta Central Profits Limited worth £15,000 and £8,000 respectively. These debtors remained unpaid as at the 31 December 2007.