

Northern Gas Networks Finance Plc

Annual Report and accounts
for the year ended 31 December 2006

Registered number: 5575923

Directors' report

For the year ended 31 December 2006

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 2006.

Principal activity

The company's principal activity is to raise funds for Northern Gas Networks Limited.

Business review

The company was incorporated in 2005 to raise funds in the financial markets for Northern Gas Networks Limited.

No new funds have been raised in the year. As shown in the company's profit and loss account on page 7, the company has not made a profit or loss in the year.

The balance sheet on page 8 of the accounts shows that the company's financial position at the year end is consistent with the prior year. Details of amounts owed by its parent company are shown in note 3 on page 10.

The company is managed as part of the overall group. For this reason, the company's directors believe that further key performance indicators for the company are not necessary or appropriate for an understanding of the development, performance or position of the business. The performance of the group, including the company, is discussed in the Northern Gas Networks Holdings Limited Annual Report which does not form part of this report.

Principal risks and uncertainties

The company is financed by bonds, the proceeds of which were loaned to its parent company. Any interest rate exposure to the company is borne by the parent company.

Group risks and uncertainties are discussed in the Northern Gas Networks Holdings Limited group Annual Report which does not form part of this report.

The directors do not expect the company to make a profit or loss in the forthcoming year.

Financial risk management objectives and policies

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

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

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.

Directors' report (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 price control periods. This ensures that interest rate hedges are reset in the same economic environment prevailing at the time the regulator is resetting the industry's weighted average cost of capital.

Currency risk

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

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

Dividends

The directors do not recommend payment of a dividend (2005 - £nil).

Directors

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

W Shurniak (Chairman)

B Scarsella

F R Frame

D V Latham

H Lam Kam

K Sum Tso

N McGee (appointed 4 July 2006)

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

E Bing Sing Kwan (resigned 1 December 2006)

G A I Waters (deceased 23 December 2006)

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

C Cornish (appointed 12 April 2007)

Directors' report (continued)

Directors' interests

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

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,



Director

23 May 2007

B Scarsella

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 period. In preparing these accounts, the directors are required to:

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

We have audited the accounts of Northern Gas Networks Finance Plc for the year ended 31 December 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Accounting Policies and the related notes 1 to 11. These accounts have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

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

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

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

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

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements 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 2006 and of its result 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

23 May 2007

Profit and loss account

For the year ended 31 December 2006

		Year ended 31 December 2006 £'000	Three month period ended 31 December 2005 £'000
Operating profit		-	-
Finance charges (net)	1	-	-
Profit on ordinary activities before taxation	2	-	-
Tax on profit on ordinary activities		-	-
Profit for the financial year		-	-

The above results arise from continuing operations.

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

There are no recognised gains or losses in the year.

Balance sheet

31 December 2006

	Notes	2006 £'000	2005 £'000
Current assets			
Debtors			
– due within one year	3	7,105	3,350
– due after one year	3	505,000	505,000
		<u>512,105</u>	<u>508,350</u>
Creditors: Amounts falling due within one year	4	<u>(7,999)</u>	<u>(4,182)</u>
Net current assets		<u>504,106</u>	<u>504,168</u>
Creditors: Amounts falling due after more than one year	5	<u>(504,056)</u>	<u>(504,118)</u>
Net assets		<u>50</u>	<u>50</u>
Capital and reserves			
Called-up share capital	7	50	50
Profit and loss account	8	-	-
Shareholders' funds	9	<u>50</u>	<u>50</u>

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

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



B Scarsella

Director

23 May 2007

Statement of accounting policies

31 December 2006

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

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.

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'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 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.

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.

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.

Notes to the accounts

31 December 2006

1 Finance charges (net)

	Year ended 31 December 2006 £'000	Three month period ended 31 December 2005 £'000
Interest payable and similar charges	25,259	3,299
Interest receivable and similar income	(25,259)	(3,299)
	<u>-</u>	<u>-</u>

Interest receivable and similar income is all received from the parent undertaking. All interest payable and similar charges incurred are recharged to the parent undertaking.

Interest payable and similar charges

	Year ended 31 December 2006 £'000	Three month period ended 31 December 2005 £'000
Guaranteed Bonds	25,259	3,299
	<u>25,259</u>	<u>3,299</u>

2 Directors remuneration and auditors fee

The directors did not receive any remuneration in relation to their services to the company during the current year or prior period. The total remuneration received by the directors during the year was £500,000 (2005 - £292,000) which was paid by other group companies for their services to other group companies. The audit fee of £5,000 (2005 - £5,000) will be borne by Northern Gas Networks Limited.

3 Debtors

	2006 £'000	2005 £'000
Amounts falling due within one year:		
Amounts owed by group undertakings	<u>7,105</u>	<u>3,350</u>
	<u>7,105</u>	<u>3,350</u>
Amounts falling due after one year:		
Amounts owed by group undertakings	<u>505,000</u>	<u>505,000</u>
	<u>505,000</u>	<u>505,000</u>
	<u>512,105</u>	<u>508,350</u>

Notes to the accounts (continued)

3 Debtors (continued)

The amounts owed by group undertakings falling due after one year is an intercompany loan repayable in two tranches at par, £250.0m on 30 June 2027 and £255.0m on 15 November 2035 in line with the related bond repayments (see note 5). Interest is paid annually on 30 June in relation to the £250.0m loan and on 15 November in relation to the £255.0m loan at a rate equivalent to that paid on the related bonds.

4 Creditors: Amounts falling due within one year

	2006 £'000	2005 £'000
Accruals and deferred income	7,999	3,563
Amounts owed to group undertakings	-	619
	<u>7,999</u>	<u>4,182</u>

5 Creditors: Amounts falling due after more than one year

	2006 £'000	2005 £'000
Guaranteed bond due 2027	249,536	249,564
Guaranteed bond due 2035	254,520	254,554
	<u>504,056</u>	<u>504,118</u>

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

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

Notes to the accounts (continued)

6 Derivatives and other financial instruments

Pages 1 and 2 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.

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 interest rate profile of the company's financial assets at 31 December 2006 and 31 December 2005 was as follows:

	Fixed rate	
	2006 £'000	2005 £'000
Intercompany Loan	505,000	505,000
Total	<u>505,000</u>	<u>505,000</u>

Further analysis of the interest rate profile at 31 December 2006 and 31 December 2005 was as follows:

	Fixed rate - 2006	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Intercompany Loan	4.875	25

	Fixed rate - 2005	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Intercompany Loan	4.875	26

Further details of interest rates on long term debtors are given in note 3.

Notes to the accounts (continued)

6 Derivatives and other financial instruments (continued)

Maturity of financial assets

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

	2006 £'000	2005 £'000
In more than five years	505,000	505,000
	<u>505,000</u>	<u>505,000</u>

Fair values

The fair value of the intercompany loan is £507.442m (2005 - £524.988m).

Interest rate profile

The interest rate profile of the company's financial liabilities at 31 December 2006 and 31 December 2005 was as follows:

	Fixed rate	
	2006 £'000	2005 £'000
Borrowings	504,056	504,118
Total	<u>504,056</u>	<u>504,118</u>

Further analysis of the interest rate profile at 31 December 2006 and 31 December 2005 was as follows:

	Fixed rate - 2006	
	Effective fixed interest rate	Weighted average period for which rate is fixed
	%	Years
Borrowings	4.875	25

	Fixed rate - 2005	
	Effective fixed interest rate	Weighted average period for which rate is fixed
	%	Years
Borrowings	4.875	26

Further details of interest rates on long term borrowings are given in note 5.

Notes to the accounts (continued)

6 Derivatives and other financial instruments (continued)

Maturity of financial liabilities

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

	2006 £'000	2005 £'000
In more than five years	504,056	504,118
	<u>504,056</u>	<u>504,118</u>

Fair values

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

	2006		2005	
	Book Value £'000	Fair value £'000	Book value £'000	Fair value £'000
Primary financial instruments held or issued to finance the group's operations				
Guaranteed bonds	504,056	507,442	504,118	524,988

The fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

7 Called-up share capital

	2006 £'000	2005 £'000
<i>Authorised</i>		
50,000 ordinary shares of £1 each	50	50
	<u>50</u>	<u>50</u>
<i>Allotted and called-up</i>		
50,000 ordinary shares of £1 each	50	50
	<u>50</u>	<u>50</u>

The unpaid shares remain outstanding on the intercompany account at 31 December 2006.

Notes to the accounts (continued)

8 Reserves

	Profit and loss account £'000
At 1 January 2006	-
Profit for the financial year	-
	<hr/>
At 31 December 2006	-
	<hr/>

9 Reconciliation of movements in shareholders' funds

	2006 £'000	2005 £'000
Profit for the financial year	-	-
	<hr/>	<hr/>
New shares issued	-	50
	<hr/>	<hr/>
Net addition to shareholders' funds	-	50
	<hr/>	<hr/>
Opening shareholders' funds	50	-
	<hr/>	<hr/>
Closing shareholders' funds	50	50
	<hr/>	<hr/>

10 Financial commitments

The company has a total commitment of £12.6m (2005 - £13.1m) over the term of the bonds in relation to a financial guarantee from FGIC UK Limited ("FGIC") to cover the guaranteed bonds included within long term borrowings in note 5.

The company has also entered in to a Guarantee and Reimbursement Agreement with FGIC in conjunction with its parent, Northern Gas Networks Limited ("NGN"), in relation to those bonds. NGN guarantees the punctual payment of any and all sums and fees due to FGIC and undertakes to pay any amount due from the company but not paid by it. NGN 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)

11 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 Limited is the immediate parent company.

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 consisting of:

Able Venture Profits Limited (40%)
Alpha Central Profits Limited (19.9%)
Goldia Resources Limited (15.2%)
United Utilities Contracts Solutions 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.