Scotia Gas Networks plc

Annual report

for the year ended 31 March 2007

Registered Number: 04958135

Scotia Gas Networks plc

Annual report

for the year ended 31 March 2007

Contents

Scotia Gas Networks plc

Directors and advisers

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Registered number
04958135

Scotia Gas Networks plc

Operating and financial review for the year ended 31 March 2007

This operating and financial review sets out the main trends and factors underlying the development and performance of the Company and its subsidiary undertakings (together the "Group") during the year ended 31 March 2007 as well as those matters which are likely to affect our future development and performance

The Directors, in preparing this operating and financial review, have sought to comply with the Accounting Standard Board's 2006 Reporting Statement Operating and Financial Review as far as it applies to the circumstances of the Group

The business, its objectives and strategy

The Group operates the regulated gas transportation businesses for the Southern and Scotland region gas distribution networks, two of eight regional gas distribution networks in the United Kingdom Our gas distribution networks comprise approximately 74,000 kilometres of gas mains delivering natural gas to approximately 4 0 million domestic, commercial and industrial customers in the Southern region and to approximately 1 7 million domestic, commercial and industrial customers in Scotland The Southern network stretches from Milton Keynes in the north, to Dover in the east and Lyme Regis in the west, including London boroughs to the south of the River Thames, whilst the Scotland network distributes gas in all of Scotland to 75% of households, including remote areas through the Scottish independent undertakings at Stornoway, Wick, Thurso, Oban and Campbeltown

Scotia Gas Networks plc ("the Company" or "SGN") is owned by a consortium made up of Scottish and Southern Energy plc, Borealis Infrastructure Europe (UK) Limited which is indirectly wholly owned by the Ontario Municipal Employees Retirement System and OTPPB Investments (UK) Limited which is owned by Ontario Teachers' Pension Plan Board

The regulated businesses are regulated by the Office of Gas and Electricity Markets ("Ofgem")

History

On 1 June 2005, the Company acquired the entire share capital of Southern Gas Networks Limited and Scotland Gas Networks Limited These companies had acquired the trade and assets of the Southern and Scotland region gas distribution networks respectively from their then parent, Transco plc, on 1 May 2005 (Transco plc subsequently changed its name to National Grid Gas plc) Southern Gas Networks Limited and Scotland Gas Networks Limited subsequently re-registered as public limited companies and changed their names to Southern Gas Networks plc and Scotland Gas Networks plc respectively

Objectives and strategy

The Group's principal objectives are to deliver natural gas safely, reliably and efficiently across the gas distribution networks and to provide the highest standard of service to our stakeholders, whilst delivering value to our shareholders Our strategy therefore places the highest emphasis on ensuring our activities are carried out safely and that the networks operate in a reliable and efficient manner, so that benchmarks and regulatory targets can be exceeded to the benefit of all of our stakeholders

Growth in the Group's Regulatory Asset Value ("RAV") is achieved by the efficient delivery of capital and replacement expenditure programmes and therefore our financial objectives are set to ensure our regulatory targets are achieved or outperformed

Our financing objective is to ensure an efficient capital structure that mitigates interest rate risk through maintaining a minimum of 75% of debt, excluding shareholders' loans, at either fixed rates of interest or index linked In addition we have undertaken not to exceed a debt to RAV ratio for the regulated businesses of 77 5%

External and regulatory environment

The management and operation of the Group's transportation assets are subject to a series of legislative requirements which require us to ensure that our assets are managed and operated in a safe and reliable manner We must also ensure that arrangements are in place to respond to emergency situations and to ensure hazardous work is carried out safely and with minimum disruption

The primary legislation controlling the Group's activities as a gas transporter is the Gas Act 1986 Under the Gas Act, we hold licences which allow us to operate the gas distribution networks we own These businesses are regulated by the Office of Gas and Electricity Markets ("Ofgem"), and Ofgem has established price control mechanisms that govern the amount of revenue that can be earned by regulated businesses, typically covering five year price control periods Ofgem assess the revenue and investment plans of the businesses in order to determine an efficient level of expenditure and the quality of service requirements for the networks are also taken into account A cost of capital for the required investment in the networks is also determined

The current price control period covers the one year extension period to 31 March 2008, and in December 2007 Ofgem will publish its final proposals for the next full five year review covering the period from 1 April 2008 to 31 March 2013 We believe the policy framework for shrinkage gas, pensions deficits and capital and replacement expenditure have all been satisfactorily dealt with in the context of the one-year review period

The Group is also subject to safety legislation which is enforced by the Heath and Safety Executive ("HSE") in the UK The organisation processes and procedures are covered in a safety case which is subject to acceptance by HSE

Market climate

The UK is in a period where gas supply patterns are moving to a position where more reliance is placed on imported gas The decline in UK continental shelf gas reserves and the UK energy policy taking cognisance of climate change is driving this shift towards greater use of imported gas

Factors affecting the business

Our principal activity is the operation of highly complex infrastructure networks As a consequence there are a number of factors that may influence the development and performance of the business and the financial returns we can achieve The principal factors that influence the business are as follows

Regulatory price controls

As outlined above, the prices we can charge for the use of our networks are determined in accordance with regulator approved price controls The outcome of the five year review will have a significant impact on the revenues we obtain In addition, the arrangements may include certain targets set by the regulator whereby we are able to earn additional revenues by outperforming the targets, or we may be penalised if we do not meet them. Consequently, our regulatory price controls have a significant influence on our overall financial performance and on shareholder returns

Additionally, the regulatory price controls include an allowed rate of return for the investment we make in the networks The level of the allowed rate of return determines the extent to which investment to increase the quality and capacity of the networks is economically viable

Safety and reliability of the networks

Our ability to operate the networks safely and reliably is of the highest importance to us Our performance in these areas affects the costs we incur and our overall financial performance

Efficiency

Our objective is to ensure that gas is delivered as efficiently as possible through our networks This allows us to limit price increases and improve our own financial performance

Interest rates

The costs of financing our operations are affected by changes in interest rates as some of our borrowings are held at floating rates We hedge our exposure to changes in interest rates by holding both fixed rate and index linked borrowings and by holding derivative financial instruments (interest rate swaps) where necessary to achieve the desire profile of interest rate risk

Seasonality and gas volumes

Changes in the quantities of gas delivered through our networks may result in an increase or decrease in our collected revenues, with the impact of changing volumes partly offset by changes in costs or sometimes they may result in an under or over recovery against our allowable revenue Where there is an under or over recovery against our allowable revenue there is a corresponding adjustment to revenues in future period revenues i e such changes in volumes simply lead to timing differences as to when revenue is earned Gas volumes are affected by weather, consumer demand and network availability In respect of weather this leads to gas volumes being typically higher during the winter months leading to revenues being weighted more towards the end of the financial year

Principal risks and uncertainties

As well as the opportunities we have to grow and develop our business, we face certain risks and uncertainties in achieving our objectives The principal risks and uncertainties we have identified are as follows

- Regulatory price control treatments of certain costs, and allowed regulatory rate of return on investments,
- Changes in laws or regulation affecting our business, for example environmental or health and safety law or regulation,
- Breaches of laws or regulation affecting our business, or breaches of our licence conditions,
- Failure of the network or other critical non-network operations,
- Pension scheme funding requirements, and
- Changes in tax allowances or rates

We also outline our principal financial risks in the Directors' Report on pages 12 and 13 The Board of Directors reviews the principal risks and uncertainties facing the business and considers the risk management processes in place, which are designed to safeguard assets and to manage, rather than eliminate, material risks to the achievement of our business objectives These reviews recognise that any such process can provide only reasonable, and not absolute, assurance against material misstatement or loss Further details of the processes the Board of Directors have in place are set out in the Corporate Governance Statement on pages 15 to 20

Stakeholders

We have a range of external stakeholders including gas consumers, our employees, suppliers and contractors, our regulator Ofgem and local governments and communities We adopt an open and constructive approach, both in terms of the way we operate, the services we provide and the impact that our activities have on each of our stakeholders We encourage and enable our employees to be active citizens in the communities in which they live and work, through schemes which support staff who are either raising money for, or giving their time to, UK charities, local community or youth sports groups We match eligible fund raising by individual members of staff

Key performance indicators

We measure the achievement of our objectives through the use of quantitative assessments, and where quantitative measures are less relevant through the use of qualitative assessments The principal key performance indicators ("KPI's") which we use to assess whether we have achieved our principal operating objectives are set out below

Key performance indicator	**Description**	**Year ended 31 March 2007**	Year ended 31 March 2006
EBITDA[1]	Earnings before interest, tax, depreciation and goodwill amortisation	**£116 7 million**	£153 8[2] million
Adjusted EBITDA[1]	EBITDA excluding replacement expenditure	**£291 4 million**	£277 4[2] million
Capital expenditure	Additions to tangible fixed assets	**£120.4 million**	£109 2[2] million
Replacement expenditure	The cost of planned maintenance of mains and services	**£174 7 million**	£123 6[2] million
Debt to RAV ratio[3]	The Group's debt to RAV ratio	**71.6%**	73 9%
Employee lost time incidents	Incidents resulting in employees taking time off work (per 100,000 hours worked)	**0.21**	0 25[4]
Serious or potentially serious RTA's	Number of serious or potentially serious road traffic accidents per 100 vehicles, where the Group's driver is deemed to be at fault	**0.39**	0 65[4]
Customer satisfaction	Results from customer satisfaction surveys (5 = very satisfied) – planned interruptions	**3 95[5]**	3 93[4]
Customer satisfaction	Results from customer satisfaction surveys (5 = very satisfied) – unplanned interruptions	**3 99[5]**	3 98[4]
Escapes attendance	Proportion of uncontrolled escapes attended in one hour – percentage (target 97%)	**97 4**	97 9

1 EBITDA is a non-statutory measure, and is calculated by adding back goodwill amortisation and depreciation to operating profit

2 10 month trading period ended 31 March 2006

3 "RAV" is defined as Ofgem Regulatory Asset Value of the Southern and Scotland networks plus additions in excess of current allowances expected to be recovered in future periods Debt for the purposes of the Debt to RAV ratio excludes shareholders' loans and liabilities arising from derivative financial instruments The percentages stated are as at 31 March 2007 and 31 March 2006 respectively

4 12 month period ended 31 March 2006

5 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2006 for the Southern and Scotland networks

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In considering our financial performance we use EBITDA and Adjusted EBITDA EBITDA is calculated by adding back goodwill amortisation and depreciation, which are non-cash costs, from operating profit Adjusted EBITDA is calculated by adding back goodwill amortisation, depreciation and 100% of replacement expenditure to operating profit Replacement expenditure which, under our UK GAAP accounting policy, is written off to the profit and loss account as a charge to operating profit as it is incurred, improves the future safety and reliability of the networks through the replacement of older gas pipes with modern pipes Ofgem treats 50% of projected replacement expenditure as recoverable during the year and 50% as recoverable over future years Accordingly, we believe the use of these adjusted measures best illustrates the underlying performance of the business

Resources

Our principal resources are our assets and our people

Our distribution networks comprise approximately 74,000 kilometres of gas mains, together with associated services, plant and machinery and storage facilities

We directly employed 3,442 people at 31 March 2007 (At 31 March 2006 2,390) We place considerable value on the involvement of employees and have continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Group during the year We continue to invest in the development and training of our people in order to ensure both individual developmental needs and business skill requirements are met

Financial review

We set out below our financial review for the year ended 31 March 2007 The comparative figures presented are for the ten month trading period ended 31 March 2006, as reported in the audited financial statements, unless otherwise stated In certain instances, which are highlighted, the figures for the twelve month period ended 31 March 2006 for the network companies Southern Gas Networks plc and Scotland Gas Networks plc have been presented in order to provide a more meaningful comparison Such information is based on the financial information for the distribution networks for the two months ended 31 May 2005 when they were owned by Transco plc and the ten months ended 31 March 2006 when they were owned by Scotia Gas Networks plc

Turnover for the year ended 31 March 2007 was £594 6 million (ten month trading period ended 31 March 2006 £522 0 million) The majority of turnover is earned from charges made for the provision of gas transportation capacity as well as revenue based upon gas volumes transported in the year During the year the Group transported 162 3 TWh of gas across the two networks, compared to 185 2 TWh in the corresponding twelve month period to 31 March 2006, representing a like for like reduction in volumes of 12% This reduction in volumes has had the effect of reducing our reported turnover compared to the prior period The principal reasons for this are a combination of significantly warmer than average weather at the same time as record levels of wholesale gas prices and a growing awareness of energy efficiency which have led to demand destruction

Adjusted EBITDA for the year ended 31 March 2007 was £291 4 million (ten month trading period ended 31 March 2006 £277 4 million) During the year, the Group has continued to experience significant cost pressures in respect of the purchase of shrinkage gas due to high average gas prices during the year These cost pressures, together with reduced transportation volumes and revenues have reduced Adjusted EBITDA for the year compared to the equivalent twelve month period in the prior year Adjusted EBITDA is calculated by adding back goodwill amortisation of £9 4 million (2006 £8 2 million), depreciation of £75 4 million (2006 £65 3 million) and replacement expenditure of £174 7 million (2006 £123 6 million) to reported operating profit of £31 9 million (2006 £80 3 million) Replacement expenditure is higher this year as we have carried out more planned metallic mains replacement, as part of our major replacement programme, compared to the prior year

Loss for the year before taxation amounted to £170 7 million (year ended 31 March 2006 loss of £293 1 million) and loss for the year after taxation amounted to £154 8 million (year ended 31 March 2006 loss of £233 9 million) The loss before taxation in the prior year included an exceptional loss of £205 0 million arising from the matching out of interest rate swap positions relating to short term acquisition funding (see note 16)

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The Directors do not recommend the payment of any dividends for the year ended 31 March 2007 (2006 £nil)

Treasury policies and capital structure

The Group's operations are financed by a combination of equity and loans from shareholders, bank borrowings and long term bonds The Group's funding and liquidity are managed within a framework of policies and guidelines authorised by the Board of Directors Further details are set out in the Directors' Report on pages 12 and 13

Our key treasury policies are that our debt to RAV ratio for the regulated businesses does not exceed 77 5% and that we maintain a minimum of 75% of debt, excluding shareholders' loans, at either fixed rates of interest or index linked In accordance with these policies we have set a target interest rate profile for long term borrowings, excluding shareholders' loans, of between 80 and 85% of borrowings at either fixed rate or index linked Interest rate swaps are used, where necessary, in order to achieve this desired profile

Financial position

As at 31 March 2007, the Group's total debt (before issue costs), excluding shareholders' loans and liabilities arising from derivative financial instruments, amounted to £2,350 4 million (31 March 2006 £2,219 8 million) and the debt to RAV ratio was 71 6% (31 March 2006 73 9%) Of the total long term borrowings at 31 March 2007, excluding shareholders' loans and after taking into account the effect of interest rate swaps, 81 5% were at either fixed rates of interest or were index linked (31 March 2006 81 3%)

Capital expenditure during the year amounted to £120 4 million (ten month trading period ended 31 March 2006 £109 2 million) Capital expenditure is incurred to ensure that the networks continue to operate at minimum agreed pressures and that sufficient storage capacity is available to meet instances of peak demand, as well as when new connections or increased capacity are added to the networks

In accordance with FRS 17 (Retirement benefits) our balance sheet includes a pension liability, net of related deferred tax, of £46 9 million (31 March 2006 £41 4 million) The net pension liability increased as a result of the latest actuarial valuation carried out by the scheme's actuary as at 31 March 2006, which was completed during the course of the year The Group has agreed to increase the company contribution rate to 37 3% (from 23 3%) with effect from 1 April 2007 Additionally, the Group has agreed to make special pension contributions to repair the deficit amounting to £13 5 million per year from 1 April 2007

Liquidity and cash flows

Liquidity is maintained through a mixture of long term borrowings and short term liquid funds in order that there are sufficient funds available for the Group's current and planned operations Committed facilities are in place in order to provide funding for future capital and replacement expenditure as well as to provide us with sufficient available facilities to meet the seasonal working capital requirements of the Group We expect to issue further long term borrowings during the year ending 31 March 2008 to fund capital and replacement expenditure programmes At 31 March 2007 our committed undrawn working capital facility amounted to £105 0 million (31 March 2006 £105 0 million) This facility expires in October 2010

Net cash inflow from operating activities for the year amounted to £139 3 million (ten month trading period ended 31 March 2006 £175 9 million) The reduction is principally due to the increase in our replacement expenditure during the year The net cash outflow from returns on investments and servicing of finance was £151 8 million (2006 £73 9 million) with the increase attributable to the timing of periodic interest payments following the issue of long term borrowing in October 2005 Net cash outflow for capital expenditure and financial investment was £110 9 million (2006 £65 3 million) reflecting an increased level of capital expenditure during the year compared to the previous period Net cash outflow for acquisitions was £44 3 million (2006 £691 9 million) which represents the payment of deferred consideration in the year in respect of the acquisitions of Southern Gas Networks plc and Scotland Gas Networks plc in the previous year Overall, after taking into account movements in short term deposits and financing items, cash increased by £16 2 million in the year (2006 decrease of £25 0 million)

Dividend policy

Our policy is to distribute to shareholders any available surplus funds, after taking into account the cash requirements needed to continue to invest in the business and the Group's level of gearing, and subject to the availability of distributable profits

Accounting policies

The Group's accounting policies are set out in note 1 to the financial statements These accounting policies have been applied consistently during the year and in the preceding year, and as previously highlighted in this report our operating profit is stated after writing off our expenditure on replacement expenditure during the year

Operational review

Organisational development

During the year, the decision we made last year to replace our existing functionally-based structure with a geographically-based structure was successfully implemented This has enabled a more local and customer-focused management of the business's operations which we believe has led to improved customer service, as demonstrated by a reduction in customer complaints received, and has laid the foundations to achieve future sustainable cost savings We also carry out quarterly postal customer satisfaction surveys covering both planned (replacement) and unplanned (emergency and repair) work which we use to further assess our quality of service performance The results of the surveys are highlighted on page 5

We have also agreed a revised pay agreement with our employees during the year This promotes stability and consistency, helps develop our culture and identity and is an integral part of our goal to own the most efficient, safest and customer-focused gas distribution companies in the UK

Additionally, to support our replacement expenditure programme and other activities in the most efficient way possible, we have as planned, brought more of our work in-house within the Group by in-sourcing contracting and connections services previously supplied by third party contractors Those services which have been brought in-house are now provided by the Group's wholly owned subsidiaries, SGN Contracting Limited and SGN Connections Limited We have also recently established SGN Commercial Services Limited, which in the next financial year will commence its activities in providing services in the competitive market

Information systems

A major reform of our front office systems is also well underway, which have replaced existing legacy systems inherited from National Grid Gas plc with 11 integrated systems designed to support the business This represents a significant investment which has enhanced the operational functionality of our systems in a number of key areas and has reduced the number of interfaces and duplication of data held within our systems In addition, significant investment has been made in enhancing data quality and security with extensive validation and error checking built into the new systems and transmission of mobile data is encrypted to protect the data security of our customers Modern security and virus management measures and intrusion protections have also been implemented representing a significant enhancement to those built into the legacy systems We believe this investment in information systems will enable standards of customer service, safety and operational efficiency to be improved We have also ensured the new systems have in built flexibility to ensure future upgrades can be delivered in an efficient manner

We continue to receive corporate and management services from Scottish and Southern Energy plc, which has ensured synergies are maximised

Safety

Injury performance

The Group's over-riding goal is to distribute gas safely and reliably and we work hard to ensure a safe workplace for our workforce with everyone striving towards eliminating injuries This year we have reduced our lost time injury performance rate to 0 21 injuries per 100,000 hours (2006 0 25)

Scotia Gas Networks plc

With the Group having successfully achieved targets set for 2006/2007 we are setting the bar even higher with the aim to reduce all injuries to 0 18 per 100,000 hours over the next twelve months and ultimately to zero

The Group also achieved a Royal Society for the Prevention of Accidents Occupational Health and Safety gold award, awarded to recognise and celebrate the achievement of a very high standard of health and safety at work

Road traffic accidents

The Group recognises that driving is a potentially dangerous activity that many of its employees undertake on a daily basis Therefore to improve performance in the area of road traffic accidents, the Group sought to analyse the information available to learn from this and formulated a Driving Safely Campaign From the information gathered by the additional reporting of road traffic accidents and the in-depth investigation of these accidents the Group has been able to communicate the issues and highlight hazardous driving behaviours to our employees We are now making good progress in reducing road traffic accidents, having reduced the number of serious or potentially serious road traffic accidents where the Group's driver is at fault by 40% during 2006/2007

Gas mains replacement programme

We have, in agreement with our regulator Ofgem and the Heath and Safety Executive ("HSE"), embarked on an extensive safety led programme of gas mains replacement across our networks to replace all iron pipes that are located within 30 metres of any property, which includes the replacement of the individual services connecting the premises to the mains network We have a considerable amount of work to carry out and appreciate that this will inevitably cause some disruption However, the polyethylene pipes we are putting in the ground now, if left undisturbed, have a lifespan of at least 80 years, so when the work is complete people will be able to enjoy security of supply from a distribution infrastructure perspective for many years to come In the year ended 31 March 2007 we have increased our investment in replacement activities to £174 7 million, an increase of 16% compared to the equivalent twelve month period ended 31 March 2006

We are committed to working closely with the local authorities and police to plan our work so that it causes the minimum amount of disruption to residents, road users, businesses and traders Wherever possible we will also be using modern minimum-dig techniques which allow us to lay gas mains without digging lengthy trenches in the road, causing less impact on the environment and on the local communities

Gas escapes standards of service

Our engineers respond to reports of suspected gas leaks 24 hours a day, 365 days a year, regardless of who people buy their gas from Our engineers aim to attend all uncontrolled gas escapes within one hour and all controlled gas escapes within two hours A controlled gas escape is one where the person reporting it has confirmed that the gas emergency control valve serving the premises has been turned off and the smell of gas has gone An uncontrolled gas escape covers all others

The Board of Directors has established a Safety, Health and Environmental Advisory Committee which is responsible for monitoring the Group's health and safety performance and ensuring that the health and safety policy statement is adhered to The Committee provides the Board of Directors with reports on any key areas identified

Environment

The Group is committed to the protection and enhancement of the environment and consideration for the environment is a feature of all our business activities We are always looking for new ways to minimise the environmental impact of our activities

We constantly benchmark our environmental performance, allowing us to identify new opportunities, share best practice and achieve continual improvements During the year a number of employee briefings, campaigns and training events were held with the specific aim of increasing our employees' knowledge and awareness of environmental matters, as well as health and safety issues

This process of continual development provides our staff with the information and competence they need to recognise and manage all significant environmental issues, risks, incidents and opportunities which they are faced with, thereby proactively avoiding pollution to land, air or water and protecting or enhancing our environment

As part of our commitment to the environment we also work in partnership with conservation charities, schools and a wide range of community groups The Board of Directors has established a Safety, Health and Environmental Advisory Committee which is responsible for monitoring the Group's environmental performance and ensuring that the environmental policy statement is adhered to The Committee provides the Board of Directors with reports on any key areas identified

Our targets for 2006/2007 included reducing methane emissions through leakage and active pressure management, reducing paper usage in our offices and operational sites, reducing commercial fuel usage and reducing our impact on the environment through reusing excavated materials and reducing the use of virgin aggregate Progress to date has been positive

We are developing a dynamic environmental strategy and ten year plan which can be revised to meet changes in internal or external policy or public / industry expectations as and when necessary In line with our ambition to achieve environmental excellence, we will go beyond legislative compliance by seeking to meet internationally accepted good practice wherever we operate This is reflected in our achievements during 2006/2007 and our retention of ISO 14001 (environmental management system standard) which is itself a recognition of continuously reducing our impact on the environment We will be setting equally challenging environmental objectives and targets for 2007 and 2008 in accordance with our environmental strategy and ten year environmental improvement plan

Future developments

Regulation

The Group is currently engaged in a process with Ofgem which will determine revenues and allowances for the next five years (commencing 1 April 2008)

Investment

Longer-term priorities include continued major replacement investment to replace metallic mains with polyethylene mains, a programme which has been developed in consultation with the HSE and Ofgem In addition, continued major investment to upgrade the gas network is expected in order to meet instances of peak demand The efficient and economic delivery of this capital investment will further increase the Group's RAV

Further details

Further details on the long term development plans of Southern Gas Networks plc and Scotland Gas Networks plc can be found in each company's long term development statement published in accordance with Special Condition D3 of its Gas Transporter Licence and available on the Group's website www scotiagasnetworks co uk Our long term development plan sets out the forecast gas demand over the ten year period and outlines our capital investment plans which are required to ensure the continued operation of the networks in accordance with our licence conditions

Approved by the Board of Directors and signed on its behalf by

Colin W Hood
Director
20 July 2007

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Directors' report
for the year ended 31 March 2007

The Directors present their report and the audited consolidated financial statements for the year ended 31 March 2007 The financial statements consolidate the financial statements of the Company and its subsidiary undertakings (together the "Group")

The comparative period presented is the year ended 31 March 2006, which includes a ten month trading period to 31 March 2006 arising from the acquisitions of Southern Gas Networks plc and Scotland Gas Networks plc on 1 June 2005

Principal activities

The Company's principal activity is to act as an investment holding company and it does not trade

The Group's principal activity is the development, administration, maintenance and operation of the Southern and Scotland regional gas distribution systems and the supply of transportation services It will continue in this activity for the foreseeable future

Review of business

The review of business for the year, including an analysis using key performance indicators, together with a description of the principal risks and uncertainties facing the Group are set out in the operating and financial review on pages 2 to 10

Future developments

The Group's longer-term priorities include continued major replacement investment to replace metallic mains with polyethylene mains, a programme which has been developed in consultation with the Health and Safety Executive and the Office of Gas and Electricity Markets ("Ofgem") In addition, continued major investment to upgrade the gas networks is expected in order to meet instances of peak demand The efficient and economic delivery of this capital investment will further increase the Group's Regulated Asset Value (the regulated asset value attributed to each of the Distribution Networks by Ofgem)

The Group is currently engaged in a process with Ofgem which will determine revenues and allowances for the next five years (commencing 1 April 2008)

Results and dividends

The consolidated profit and loss account is set out on page 24

The Directors do not recommend the payment of any dividends for the year ended 31 March 2007 (2006 £nil)

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Directors

The Directors of the Company who served during the year ended 31 March 2007, all of whom have been directors for the whole of the year, except where noted, are listed below

Gregor Alexander	
Tanya M Covassin	
Stephen Dowd	(appointed 24 November 2006)
Colin W Hood	
Graham G Juggins	(resigned 21 July 2006)
Ronald K Lepin	(resigned 24 November 2006)
Robert McDonald	(appointed 21 July 2006)
James McPhillimy	
Michael Nobrega	(resigned 10 March 2007)
Sebastien B Sherman	(appointed 10 March 2007)
Robert Watters	

Directors' interests

None of the Directors who held office at the end of the year had an interest in the shares or loan stock of the Company or any other Group undertaking at the end of the financial year, or at any time during the financial year subsequent to their appointment as a director of the Company

Directors' indemnity

The Company has purchased and maintained throughout the financial year directors' and officers' liability insurance in respect of all Group companies, their Directors and senior officers

Financial risk management

The Group's funding, liquidity and exposure to interest rate and foreign exchange risks are managed within a framework of policies and guidelines authorised by the Board of Directors

Interest rate risk

The Group has interest bearing liabilities, and it is the Group's policy to maintain a target interest rate profile for long term borrowings of between 80 and 85% of borrowings at either fixed rate or index linked, excluding borrowings from shareholders The Group uses interest rate swaps, where necessary, in order to achieve this desired profile

Liquidity risk

The Group maintains a mixture of long term funding and short term liquid funds in order that there are sufficient funds available for the Group's current and planned operations

Foreign exchange risk

The Group has certain borrowings denominated in Euros In accordance with the Group's policy, cross currency swaps have been used to fully hedge the Euro denominated borrowings into Sterling

Credit risk

Credit risk is managed through the Uniform Network Code, part of the regulatory framework applying to the gas business in the UK Under the Network Code, all shippers must obtain a Code Credit Limit from the gas distribution networks prior to the commencement of trading The Code Credit Rules describe how that limit is determined, the security that the Group may require from a shipper to support its Code Credit Limit and the process the Group will use to monitor utilisation against that limit

Pricing risk

The Group's transportation charges are subject to price control formulae set within the regulatory regime The Group's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance (such as actual transportation volumes) and therefore the maximum allowed annual revenue is not known until the end of the relevant period However, transportation tariffs are set on a prospective basis based upon expected transportation volumes, so actual revenue received or receivable in any one year may differ from the maximum allowed revenue Where revenues received or receivable differ from the maximum allowed annual revenue, adjustments are made to future prices to reflect this over or under recovery

Charitable contributions

The Group made charitable donations of £32,100 in the year (year ended 31 March 2006 £4,400) in support of community and employee initiatives across its operations There were no political donations in either the current or prior year

Employees

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 Group Participation by employees generally is encouraged through team meetings, briefings, an internal magazine and an intranet site Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests

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 their employment within the Group continues and that appropriate training and development 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 to that of other employees

Creditors payment policy

The Group's current policy concerning the payment of its creditors and other suppliers is to

- agree the terms of payment with those creditors/suppliers when agreeing the terms of each transaction,
- ensure that those creditors/suppliers were made aware of the terms of payment by inclusion of the relevant terms in contracts, and
- pay in accordance with its contractual and other legal obligations

The payment policy applies to all payments to creditors/suppliers for revenue and capital supplies of goods and services without exception

The following disclosures for creditor days relate only to trade creditors as required by the Companies Act 1985 At 31 March 2007, the Group had an average of 34 days (2006 39 days) outstanding in its trade creditors The Company has not traded in either the current or prior year and accordingly has no trade creditors

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Auditors

Each of the Directors at the date of this report confirms that

1) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware, and

2) the Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself 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 provision of section 234ZA of the Companies Act 1985

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting

By Order of the Board

Colin W Hood
Director
20 July 2007

Scotia Gas Networks plc

Corporate governance statement

The Board of Directors is committed to the highest standards of corporate governance and believes that strong governance improves the performance of the business and enhances shareholder value This report sets out the key governance principles and practices of the Company and of the Group

As an unlisted company, Scotia Gas Networks plc is not subject to the UK Financial Reporting Council's Combined Code on Corporate Governance (the "Combined Code"), and the Board of Directors does not believe that all of the guidance set out in the Combined Code is applicable to the Company This statement sets out those areas within the Combined Code which the Board of Directors believe to be applicable to the Company

Organisation and structure

On 1 June 2005, the Company acquired the entire share capital of Southern Gas Networks Limited and Scotland Gas Networks Limited These companies had acquired the trade and assets of the Southern and Scotland region gas distribution networks respectively from their then parent, Transco plc, on 1 May 2005 (Transco plc subsequently changed its name to National Grid Gas plc) Southern Gas Networks Limited and Scotland Gas Networks Limited subsequently re-registered as public limited companies and changed their names to Southern Gas Networks plc and Scotland Gas Networks plc respectively

The Company is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by the Ontario Municipal Employees Retirement System

The Board of Directors is the same for the Company and its subsidiaries Scotland Gas Networks plc, Southern Gas Networks plc, SGN Contracting Limited and SGN Connections Limited

As a commercial joint venture, the composition of the Board of Directors reflects the above shareholders' interests in the consortium Each of the Directors is an employee of a shareholder or an affiliate of a shareholder of the Company As the relationship of the shareholders is governed by the Shareholders' and Governance Agreement, any conflict of interest in the position of the Directors would be addressed in accordance with the provisions of the Shareholders' and Governance Agreement Directors are nominated to the Board of Directors in accordance with the terms of the Shareholders' and Governance Agreement The Directors have been briefed on the duties that will be conferred on them under the Companies Act 2006

Board Membership

The Board consists of seven non-executive Directors in addition to the non-executive Chairman During the year, there were a number of changes to the composition of the Board Graham Juggins stood down as a Board member on 21 July 2006 and Robert McDonald joined the Board on that date Stephen Dowd joined the Board on 24 November 2006 to replace Ronald Lepin who departed on that date On 10 March 2007 Michael Nobrega stood down to be replaced by Sebastien Sherman

Chairman

The Articles of Association allow the Board to appoint one of their number as Chairman At the 10 May 2005 board meeting Colin Hood was appointed Chairman for a two year period starting on that date At the 24 May 2007 board meeting Colin Hood was re-appointed as Chairman for a further one year period from that date

Chief Executive and Senior Executives

The Board of Directors is comprised entirely of non-executive Directors Executive responsibility rests jointly with John Morea, Chief Operating Officer ("COO") and Surinder Toor, Chief Financial Officer ("CFO") and as such, it is considered that no Chief Executive is required The COO and CFO are each employed by the Group and are not Directors of the Company They are supported by an executive committee which meets on a monthly basis and are responsible for managing the operations of the business

Biographical details for all the Directors and Senior Executives are shown on page 20

Timeliness and quality of Board information

The Board of Directors meets regularly and has a schedule of matters specifically reserved to it for decision and has in place policies setting out which decisions are taken by the Board of Directors and which may be delegated to management The Board has sought to ensure that Directors are properly briefed on issues arising at board meetings by establishing procedures for distributing board papers one week in advance of meetings, considering the adequacy of the information provided before making decisions, adjourning meetings or deferring decisions when Directors have concerns about the information available to them and making the Company Secretary responsible to the Board for the timeliness and quality of information All Directors have access to the advice and services of the Company Secretary

During the year, the Chairman conducted a comprehensive evaluation of the performance of the Board, its three Committees and individual Directors The Chairman then discussed these matters which each Director and the Company Secretary during a series of individual meetings The outcome was that generally the Board set clear objectives, it monitored performance well and was focused on the correct areas This review will continue to be carried out on an annual basis

Internal controls

The Board of Directors is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness along with the review of risk management processes The Group's system of internal control and embedded risk management, which has been in place throughout the year, helps to safeguard the assets and is designed to manage, rather than eliminate, material risks to the achievement of the business objectives These reviews recognise that any such system can provide only reasonable, and not absolute, assurance against material misstatement or loss

Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the business, to the materiality of the risks inherent in the business, and to relative costs and benefits of implementing specific controls

Control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting, the appointment of suitably qualified staff in specialised business areas, and continuing investment in high quality information systems These methods of control are subject to periodic review as to their implementation and continued suitability

Internal audit

The Board of Directors has established the scope of the internal audit function which is responsible for reviewing the effectiveness of the Group's systems of internal control and reports to the Audit Committee of the Board The internal audit manager reports to the Audit Committee on the audit programme, progress against the programme and any follow-up actions

Scotia Gas Networks plc

Board Committees

The Board has three committees that meet regularly The Company Secretary acts as secretary at each of these committees

Audit Committee

The Audit Committee has terms of reference which sets out its principal responsibilities These are

- ensuring that the financial reports represent an accurate, clear and balanced assessment of the Group's position and prospects,
- monitoring the adequacy and effectiveness of financial reporting, internal controls and risk management systems for the identification, assessment and reporting of risks,
- monitoring and reviewing the internal audit function,
- making recommendations to the Board of Directors relating to the appointment, reappointment and removal of the external auditors,
- reviewing the effectiveness of the external audit process, and
- reviewing audit and non-audit fees and services provided by the auditors and ensuring the provision of non-audit services do not impair the independence of the external auditor

As part of its activities, the Audit Committee reviews and approves key regulatory filings prior to their issue to Ofgem

The membership of the Committee is as follows

- Robert Watters (Committee Chairman)
- Gregor Alexander
- Stephen Dowd

Ron Lepin resigned from the Board on the 24 November 2006 and Stephen Dowd joined the Board on that date This change is also reflected in the membership of the Audit Committee

The Chairman of the Audit Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed such as risk management, internal control, internal audit reports and any issues arising from its review of the financial statements

The Audit Committee meets at least three times a year and at least once a year the Committee's performance, constitution and terms of reference is reviewed to ensure it is operating effectively The Board considers that the membership of the Audit Committee as a whole has sufficient recent and relevant financial experience to discharge its functions Gregor Alexander has particular relevant financial experience in his executive career Currently he is the Finance Director of Scottish and Southern Energy plc

Safety, Health and Environmental Advisory Committee

The Safety, Health and Environmental Advisory Committee is responsible to the Board of Directors for

- Being assured that the health and safety policy statement and environmental policy statement are being adhered to,
- Setting of health and safety, and environmental targets to improve the Group's performance,
- Monitoring health and safety and environmental performance against planned targets and identified key improvement areas, and
- Encouraging greater awareness of the importance of health, safety and the environment and higher achievement in safety and environmental performance

The membership of the Committee is as follows
- James McPhillimy (Committee Chairman)
- Tanya Covassin
- Sebastien Sherman
- John Morea (COO)
- Steve Gay (Head of Operations)

Michael Nobrega resigned from the Board on 10 March 2007 and Sebastien Sherman joined the Board on that date This change is also reflected in the membership of the Safety, Health and Environmental Advisory Committee

Remuneration Committee

The Remuneration Committee has terms of reference which sets out its principal responsibilities These are

- To determine and agree with the Board of Directors the Group's framework or broad policy for executive and senior management remuneration The Committee shall have delegated authority for setting the remuneration of the COO, CFO and their direct reports, and
- To review the ongoing appropriateness and relevance of the remuneration policy

The membership of the Committee is as follows
- James McPhillimy (Committee Chairman)
- Tanya Covassin
- Sebastien Sherman

Michael Nobrega resigned from the Board on 10 March 2007 and Sebastien Sherman joined the Board on that date This same change is also reflected in the membership of the Remuneration Committee

Scotia Gas Networks plc

Directors' remuneration

The Directors did not receive any remuneration for their services to the Company, or to the Group, during the year ended 31 March 2007 or in the prior year Accordingly there is no further information disclosed

Membership and attendance

The attendance of the Board of Directors and the Board committees during the year is as set out below

	Board meetings		Audit Committee meetings		Remuneration Committee meetings		Safety, Health and Environmental Committee meetings	
	Attended	Possible	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander	6	6	6	6	-	-	-	-
Tanya M Covassin	6	6	1[A]	-	2	2	2	3
Stephen Dowd *	3	3	1	2	-	-	-	-
Colin W Hood	6	6	-	-	-	-	-	-
Graham G Juggins **	2	2	-	-	-	-	-	-
Ronald K Lepin **	3	3	4	4	-	-	-	-
Robert McDonald *	4	4	-	-	-	-	-	-
James McPhillimy	6	6	1[B]	-	2	2	3	3
Michael Nobrega **	4	5	-	-	1	1	2	3
Sebastien Sherman *	1	1	-	-	-	1	-	-
Robert Watters	6	6	5	6	-	-	-	-

* Robert McDonald, Stephen Dowd and Sebastien Sherman were appointed to the Board on 21 July 2006, 24 November 2006 and 10 March 2007 respectively

** Graham Juggins, Ronald Lepin and Michael Nobrega resigned from the Board on 21 July 2006, 24 November 2006 and 10 March 2007 respectively

[A] Standing in for Stephen Dowd
[B] Standing in for Robert Watters

Going concern

The Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future The financial statements are therefore prepared on the going concern basis

Scotia Gas Networks plc

Directors' and Senior Executives' biographies and responsibilities

Colin Hood, Chairman
Colin was appointed Chairman of SGN in May 2005 He is Chief Operating Officer of Scottish and Southern Energy plc and is also a Fellow of the Institute of Engineering and Technology

Gregor Alexander, Director
Gregor joined the Board of SGN at its inception He is Finance Director of Scottish and Southern Energy plc and previously worked with the accountancy firm Arthur Andersen He is also a member of the Audit Committee

Tanya Covassin, Director
Tanya joined the Board of SGN at its inception She is Director, Infrastructure at Ontario Teachers' Pension Plan Board Tanya is a member of the Remuneration Committee and a member of the Safety, Health and Environmental Advisory Committee

Stephen Dowd, Director
Stephen joined the Board of SGN in November 2006 He is Vice President, Infrastructure at Ontario Teachers' Pension Plan Board Stephen is a member of the Audit Committee

Robert McDonald, Director
Robert joined the Board of SGN in July 2006 He is Director of Regulation at Scottish and Southern Energy plc and has previously worked with the industries' regulatory body

James McPhillimy, Director
Jim joined the Board of SGN at its inception He is Director of Human Resources at Scottish and Southern Energy plc Jim is Chairman of the Remuneration Committee as well as Chairman of the Safety, Health and Environmental Advisory Committee

Sebastien Sherman, Director
Sebastien joined the Board of SGN in March 2007 He is Vice President at Borealis Infrastructure Management Sebastien is a member of the Remuneration Committee and a member of the Safety, Health and Environmental Advisory Committee

Robert Watters, Director
Robert joined the Board of SGN at its inception He is the Senior Vice President at Borealis Infrastructure Management Robert is Chairman of the Audit Committee and a Chartered Accountant having previously worked with an international accounting firm

John Morea, Chief Operating Officer
John joined SGN in May 2005 from Scottish and Southern Energy plc where he was Director of Distribution having previously been Head of Operations for Southern Electric plc He has extensive experience of electricity distribution, managing business change and delivering significant improvements in business efficiency He has twice taken distribution companies to the efficiency frontier, with Southern Electric plc in 1999 and Scottish and Southern Energy plc in 2004 John has over 20 years experience within the utilities industry He is a companion of the Institute of Gas Engineers and Managers, a member of the Institute of Engineering and Technology and he holds a MBA

Surinder Toor, Chief Financial Officer
Surinder joined SGN in March 2005 from American Electric Power where he was Managing Director of European Operations having previously been Finance Director He oversaw the integration of Fiddler's Ferry and Ferrybridge acquisitions and cost reduction programmes Prior to American Electric Power, Surinder was a consultant in Arthur Andersen's Energy and Utility Group focusing on transaction support and risk management Surinder also previously held positions at Powergen plc and Coopers & Lybrand He is a Chartered Accountant and holds a master's degree in Engineering, Economics and Management

Ailsa Gray, Company Secretary
Ailsa joined the Board of SGN at its inception She is Deputy Company Secretary of Scottish and Southern Energy plc

Scotia Gas Networks plc

Statement of Directors' responsibilities

United Kingdom company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the Group as at the end of the financial year and of the profit or loss of the Group for that year In preparing those financial statements, 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 financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company or Group 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 the Group and enable them to ensure that the financial statements comply with the Companies Act 1985 They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Independent auditors' report to the members of Scotia Gas Networks plc

We have audited the Group and parent company financial statements (the "financial statements") of Scotia Gas Networks plc for the year ended 31 March 2007 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and Company balance sheets, the consolidated cash flow statement, the reconciliation of net cash flow to movement in net debt and the related notes 1 to 27 These financial statements 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 financial statements 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 financial statements 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 financial statements 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 financial statements

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 as described in the contents section, and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements 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 financial statements It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent Company's affairs as at 31 March 2007 and of the Group's loss for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
20 July 2007

Scotia Gas Networks plc

Consolidated profit and loss account for the year ended 31 March 2007

	Notes	Year ended 31 March 2007 £'m	Year ended 31 March 2006 Before exceptional items £'m	Year ended 31 March 2006 Exceptional items (note 4) £'m	Year ended 31 March 2006 Total £'m
Turnover	2	**594 6**	522 0	-	522 0
Net operating costs	3	**(562.7)**	(441 7)	-	(441 7)
Operating profit	3	**31.9**	80 3	-	80 3
Income from fixed asset investments	12	**0 3**	-	-	-
Interest receivable and similar income	6	**4.3**	5 6	-	5 6
Interest payable and similar charges	7	**(207.2)**	(174 0)	(205 0)	(379 0)
Loss on ordinary activities before taxation	4	**(170.7)**	(88 1)	(205 0)	(293 1)
Tax on loss on ordinary activities	8	**15 9**	(2 3)	61 5	59 2
Loss for the financial year	19	**(154 8)**	(90 4)	(143 5)	(233 9)

The above results relate to continuing operations In the prior year, the operating results arose entirely from acquisitions during the year (see note 23)

Scotia Gas Networks plc

Consolidated statement of total recognised gains and losses for the year ended 31 March 2007

	Notes	**Year ended 31 March 2007 £'m**	Year ended 31 March 2006 £'m
Loss for the financial year	19	**(154.8)**	(233 9)
Cash flow hedges (net of tax)	19	**8 5**	2 9
Actuarial loss on defined benefit pension scheme	26	**(3.7)**	(5 0)
Movement on deferred tax relating to pension scheme		**1 1**	-
Total recognised losses for the year		**(148 9)**	(236 0)

Scotia Gas Networks plc

Balance sheets as at 31 March 2007

		Group		Company	
	Notes	**31 March 2007 £'m**	31 March 2006 £'m	**31 March 2007 £'m**	31 March 2006 £'m
Fixed assets					
Intangible assets - goodwill	10	**464.5**	473 9	**-**	-
Tangible assets	11	**3,214.9**	3,169 9	**-**	-
Investments	12	**0.2**	0 2	**948 4**	948 4
		3,679 6	3,644 0	**948.4**	948 4
Current assets					
Debtors	13	**62.8**	64 9	**119.1**	101 9
Short term deposits		**30.2**	132 3	**30 2**	132 3
		93.0	197 2	**149 3**	234 2
Creditors: amounts falling due within one year	14	**(325 9)**	(269 1)	**(147.8)**	(198 2)
Net current (liabilities)/assets		**(232.9)**	(71 9)	**1.5**	36 0
Total assets less current liabilities		**3,446 7**	3,572 1	**949 9**	984 4
Creditors: amounts falling due after more than one year	15	**(2,785 2)**	(2,784 1)	**(563 6)**	(573 7)
Provisions for liabilities	17	**(479 2)**	(484 2)	**-**	-
Deferred income	11	**(50 3)**	(28 4)	**-**	-
Net assets excluding pension liabilities		**132 0**	275 4	**386 3**	410 7
Defined benefit pension liabilities	26	**(46 9)**	(41 4)	**-**	-
Net assets including pension liabilities		**85 1**	234 0	**386 3**	410 7
Capital and reserves					
Called up share capital	18	**470.0**	470 0	**470.0**	470 0
Hedge reserve	19	**11.4**	2 9	**-**	-
Profit and loss account	19	**(396 3)**	(238 9)	**(83 7)**	(59 3)
Shareholders' funds	20	**85 1**	234 0	**386 3**	410 7

The financial statements were approved by the Board of Directors on 20 July 2007 and were signed on its behalf by

Colin W Hood
Director

Gregor Alexander
Director

Scotia Gas Networks plc

Consolidated cash flow statement for the year ended 31 March 2007

	Notes	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Net cash inflow from operating activities	21	**139.3**	175 9
Returns on investments and servicing of finance			
Interest paid		**(153 6)**	(77 3)
Interest received		**1.5**	3 4
Dividends received from fixed asset investments		**0 3**	-
Net cash outflow from returns on investments and servicing of finance		**(151 8)**	(73 9)
Taxation	27	**26.6**	-
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(133.6)**	(91 7)
Sale of tangible fixed assets		**0.2**	-
Customer contributions received		**22 5**	26 4
Net cash outflow for capital expenditure and financial investment		**(110.9)**	(65 3)
Acquisitions			
Purchase of subsidiary undertakings	23	**(44.3)**	(691 9)
Net cash outflow for acquisitions		**(44 3)**	(691 9)
Net cash outflow before management of liquid resources and financing		**(141.1)**	(655 2)
Management of liquid resources			
Decrease/(increase) in short term deposits	22	**102.1**	(132 3)
Net cash inflow/(outflow) from management of liquid resources		**102 1**	(132 3)
Financing			
Issue of ordinary share capital		**-**	427 7
(Repayment)/drawdown of shareholders' loans	22	**(46 0)**	579 6
Issue of bonds		**-**	2,210 4
Repayment of other borrowings		**-**	(2,453 3)
Drawdown of bank borrowings	22	**120.0**	2,250 0
Repayment of bank borrowings		**-**	(2,250 0)
Payments in respect of financial instruments	22	**(18.8)**	-
Capital element of finance lease payments		**-**	(1 9)
Net cash inflow from financing		**55.2**	762 5
Increase/(decrease) in cash	22	**16 2**	(25 0)

Scotia Gas Networks plc

Reconciliation of net cash flow to movement in net debt

	Notes	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Increase/(decrease) in cash in the year		**16.2**	(25 0)
(Decrease)/increase in short term deposits		**(102.1)**	132 3
Movement in borrowings		**(55.2)**	(334 8)
Change in net debt resulting from cash flows		**(141.1)**	(227 5)
Debt arising from acquisitions		**-**	(2,453 3)
Finance leases acquired		**-**	(1 9)
Other non-cash changes	22	**(45 7)**	(192 3)
Net debt at beginning of year		**(2,877 7)**	(2 7)
Net debt at end of year	22	**(3,064.5)**	(2,877 7)

Notes to the financial statements for the year ended 31 March 2007

1 Principal accounting policies

The financial statements have been prepared in accordance with applicable accounting standards in the United Kingdom and the Companies Act 1985

The financial statements of the Group present the results for the year ended 31 March 2007 The comparative period presented is the year ended 31 March 2006, which includes a ten month trading period to 31 March 2006 arising from the acquisition of Southern Gas Networks plc and Scotland Gas Networks plc by the Company on 1 June 2005

A summary of the more significant Group accounting policies, which have been applied consistently in both years, are as follows

Basis of preparation

These financial statements have been prepared under the historical cost convention except that assets and liabilities were stated at fair value when acquired, and certain derivative financial instruments are also recorded at fair value

Reclassification

Liabilities which have arisen from onerous financial instruments contracts (interest rate swaps) have been classified within provisions for liabilities within the balance sheet (see notes 16 and 17 for further details) The Directors consider that it is appropriate to record these obligations within provisions for liabilities as the obligation to make settlement payments on the swaps extend over a number of years Previously, these amounts were recorded within creditors amounts falling due within one year, and the balance sheet presentation in the prior year has accordingly been amended for consistency of presentation

Basis of consolidation

The financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 March each year Subsidiaries are those entities controlled by the Group or the Company

Subsidiaries acquired are consolidated in the financial statements of the Group from the date that control commences until the date control ceases, using the acquisition method of accounting

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements

Turnover

Turnover is stated net of value added tax and is attributable to the continuing activity of transportation of natural gas and the provision of related services Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end

Where revenues received or receivable differ from the amount permitted by regulatory agreements, adjustments will be made to future prices to reflect this over or under recovery

Replacement expenditure

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

Taxation

Current tax, including UK corporation 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 or a right to pay less tax in the future have occurred at the balance sheet date, with the following exceptions

- provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses,
- provision is made for gains on revalued fixed assets only where there is a commitment to dispose of the revalued assets and the attributable gain can neither be rolled over nor eliminated by capital losses, and
- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted

Deferred tax is measured on an undiscounted basis

Intangible assets – goodwill

Goodwill is capitalised and amortised on a straight line basis to the profit and loss account over its expected useful life Goodwill represents the excess of the fair value of the consideration paid for the acquisition of businesses over the fair value of the separable net assets acquired

The useful life of goodwill related to acquired businesses has been estimated to be 50 years

A review for impairment of goodwill is carried out at the end of each financial year Impairment reviews comprise a comparison of the carrying amount of the goodwill with its recoverable amount (the higher of net realisable value and value in use) To the extent that the carrying amount exceeds the recoverable amount, the goodwill is impaired and an impairment loss is recognised in the profit and loss account

Fixed asset investments

Fixed asset investments are stated at cost less a provision for any impairment in value Costs of the investments include all costs directly related to the acquisition of the investments

Tangible fixed assets

Tangible fixed assets are stated at cost less depreciation and any provision for impairment The cost is the purchase cost of the asset, together with any directly attributable costs of acquisition In respect of assets purchased as part of a business combination, the cost is the fair value of the assets acquired

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable

Depreciation is provided on all tangible fixed assets other than freehold land, at rates calculated to write off the cost of each asset evenly over its expected useful life, as follows

Freehold buildings	Up to 50 years
Leasehold buildings	Over the shorter of lease term and 50 years
Plant and machinery	
Mains and services	60 to 80 years
Regulating equipment	30 to 50 years
Gas storage	40 years
Motor vehicles and office equipment	3 to 10 years

Grants and contributions

Capital grants and customer contributions in respect of additions to fixed assets are treated as deferred income and released to the profit and loss account over the estimated useful lives of the related assets

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate Deferred income in respect of revenue grants and contributions is included within creditors amounts falling due within one year

Finance leases

Assets held under finance leases, 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 payments are recorded as liabilities, while the interest elements are charged to the profit and loss account

Operating leases

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

Pensions

Defined benefit pension scheme

The amounts charged to the profit and loss account are the current service costs and gains and losses on settlements and curtailments They are included within staff costs 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 the assets are shown as a net amount of other finance costs or credits within interest payable or receivable Actuarial gains and losses are recognised immediately in the consolidated statement of total recognised gains and losses

The defined benefit scheme is 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

Defined contribution pension schemes

The Group also operates defined contribution pension schemes The assets of the schemes are held separately from those of the Group in independently administered funds The amounts charged to the profit and loss account represent the contributions payable to the schemes in the period Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation Provisions are discounted where the impact of discounting the expected future cash flows is material

Financial instruments

The Group's funding, liquidity and exposure to interest rate risks are managed within a framework of policies and guidelines authorised by the Board of Directors In accordance with these policies financial derivative instruments are used to manage interest rate and currency exposure

Where appropriate these instruments are recorded at fair value and accounted for as described below

Trade debtors

Trade debtors are initially recognised at fair value Appropriate allowances for estimated irrecoverable amounts are recognised where the estimated cash flows are less than the carrying amount

Derivative financial instruments and hedge accounting

The Group uses interest rate swaps and foreign exchange forward contracts to hedge interest rate and foreign currency risk arising on debt instruments

Changes in fair value of derivatives that are designated and are effective as hedges of future cash flows are recognised directly in equity within the hedge reserve Changes in fair value of derivatives that are designated and are effective as fair value hedges are recognised in the profit and loss account but effectively offset changes in fair value of the hedged item

Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the profit and loss account as they arise

Financial assets and financial liabilities are offset where they are settled net as a matter of practice and there is legal right to offset

Borrowings

All borrowings are initially stated at the fair value of the consideration received after deduction of issue costs Issue costs together with other finance costs such as premiums on redemption are charged to the profit and loss account over the term of the borrowings and represent a constant proportion of the balance of capital repayments outstanding Accrued finance costs attributable to borrowings are included in accrued charges within current liabilities, unless the finance cost is only repayable on redemption, in which case the accrued finance costs are included within the carrying value of borrowings Accrued issue costs are netted against the carrying value of borrowings

2 Segmental reporting

Turnover arises entirely in the United Kingdom and is attributable to the continuing activity of transportation of natural gas and the provision of related services, which the Directors consider represents a single class of business

3 Cost of sales, gross profit and distribution costs

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Turnover	**594 6**	522 0
Cost of sales	**(60.2)**	(61 6)
Gross profit	**534.4**	460 4
Distribution costs	**(503.1)**	(380 6)
Other operating income	**0.6**	0 5
Operating profit	**31.9**	80 3

Cost of sales includes the cost of shrinkage gas purchases together with certain other direct cost of sales Distribution costs include the costs of operating the distribution network together with depreciation, goodwill amortisation and replacement expenditure

4 Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging/(crediting)

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Auditors' remuneration	**0.3**	0 3
Goodwill amortisation	**9.4**	8 2
Depreciation		
- owned assets	**74.1**	59 6
- leased assets	**1.3**	5 7
Profit on disposal of fixed assets	**(0 2)**	-
Replacement expenditure	**174.7**	123 6
Impairment of trade debtors	**0 4**	0 4
Rentals under operating leases – other assets	**1.3**	1 5
Exceptional item – losses on swap contracts (see note 16)	**-**	205 0

Auditors' remuneration for the Group comprises £190,000 (2006 £173,000) in respect of statutory and regulatory audit services, £67,000 (2006 £120,000) in respect of other services pursuant to legislation and £23,500 (2006 £56,000) in respect of taxation services Auditors' remuneration in respect of statutory audit services for the Company amounted to £11,000 (2006 £15,000)

In addition to the above services, the Group's auditors acted as auditors to the Scotia Gas Networks Pension Scheme, and fees of £7,500 (2006 £nil) have been charged by the auditors to the Group in respect of these services

5 Employee information and directors' emoluments

The Group had 3,442 full time equivalent employees as of 31 March 2007 (31 March 2006 2,390) The average monthly number of full time equivalent employees during the year was 3,124 (year ended 31 March 2006 1,698 employees, including the period prior to 1 June 2005 when the Group did not have any employees)

The Directors did not receive any remuneration for their services to the Group during the year, or during the prior year No retirement benefits are accruing in the year or in the prior year to any Directors under money purchase or defined benefit schemes, in respect of their services to the Group

Staff costs for the Group durng the year are as follows

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Staff costs		
Wages and salares	**101.9**	57 9
Socal securty costs	**9.0**	4 8
Pension costs (see note 26)	**20 4**	12 1
	131 3	74 8

The average monthly number of full time equvalent employees employed by the Company durng the year was 55 (year ended 31 March 2006 36 employees, includng the penod pror to 1 June 2005 when the Company dd not have any employees) The staff costs for these employees are borne by the Company's subsdiary undertakngs

6 Interest receivable and similar income

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Interest receivable on short term deposits	**1.5**	3 4
Other finance income		
Expected return on pension scheme assets (see note 26)	**21.7**	15 6
Interest on pension scheme liabilities (see note 26)	**(18.9)**	(13 4)
	2.8	2 2
	4 3	5 6

7 Interest payable and similar charges

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Bank loans	**4.9**	43 4
Index linked bond interest	**30 8**	13 1
Other interest payable on bonds	**82 4**	35 5
Shareholders' loan interest (see note 27)	**71.6**	60 6
Other interest payable	**16.3**	21 4
Unwind of discounts in provisions (see note 17)	**1.2**	-
	207 2	174 0
Exceptional loss on swap contracts (see note 16)	**-**	205 0
	207 2	379 0

8 Tax on loss on ordinary activities

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Analysis of tax credit in the year		
United Kingdom		
Corporation tax at 30% (2006 30%)		
Adjustment in respect of prior year – surrender of tax losses	**26 2**	-
Total current tax credit	**26 2**	-
Deferred tax		
Deferred tax credit for the year	**18.7**	59 2
Adjustments in respect of prior year	**(29.0)**	-
Total deferred tax (charge)/credit for the year	**(10.3)**	59 2
Total tax credit on loss on ordinary activities	**15 9**	59 2

Factors affectıng the current tax credıt

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Loss on ordınary actıvıtıes before tax	**(170.7)**	(293 1)
Loss on ordınary actıvıtıes multıplıed by standard rate of corporatıon tax ın the UK of 30%	**(51.2)**	(88 0)
Effects of		
Deferred tax on accelerated capıtal allowances	**(4 9)**	(3 1)
Deferred tax on unutılısed losses	**18.4**	61 9
Depreciatıon on non-qualıfyıng assets	**8.2**	8 4
Other short term tımıng dıfferences	**5.2**	0 4
Tax losses not recognısed	**17.8**	18 3
Expenses not deductıble for tax purposes	**6.5**	2 1
Adjustment ın respect of prıor year – surrender of tax losses	**(26.2)**	-
Current tax credıt	**(26 2)**	-

9 Loss of the Company for the financial year

The Company's loss for the year amounted to £24 4 mıllıon (year ended 31 March 2006 £59 3 mıllıon) The Dırectors have taken advantage of the exemptıon avaılable under sectıon 230 of the Companıes Act 1985 and accordıngly no separate profıt and loss account ıs presented ın respect of the Company

10 Intangible fixed assets

Group	Goodwill £'m
Cost	
At 1 April 2006 and at 31 March 2007	**482 1**
Accumulated amortisation	
At 1 April 2006	8 2
Charge for the year	9 4
At 31 March 2007	**17 6**
Net book value	
At 31 March 2007	**464.5**
At 31 March 2006	473 9

The goodwill which arose on the acquisitions of Scotland Gas Networks plc and Southern Gas Networks plc is being amortised on a straight line basis over 50 years This is the period over which the Directors estimate that the value of the underlying businesses acquired are expected to exceed the value of the underlying assets

A review for impairment of goodwill is carried out at the end of each financial year No impairment loss has been recorded in either the current or the prior year

Scotia Gas Networks plc

11 Tangible fixed assets

Group	Land and buildings £'m	Plant and machinery £'m	Motor vehicles and office equipment £'m	Total £'m
Cost				
At 1 April 2006	7 9	3,203 4	23 9	3,235 2
Reclassifications	1 2	(8 8)	7 6	-
Additions	8 5	78 9	33 0	120 4
At 31 March 2007	**17.6**	**3,273.5**	**64.5**	**3,355.6**
Depreciation				
At 1 April 2006	0 4	57 0	7 9	65 3
Reclassifications	-	0 5	(0 5)	-
Charge for the year	0 5	72 6	2 3	75 4
At 31 March 2007	**0.9**	**130 1**	**9.7**	**140.7**
Net book value				
At 31 March 2007	**16 7**	**3,143.4**	**54 8**	**3,214 9**
At 31 March 2006	7 5	3,146 4	16 0	3,169 9

Included within motor vehicles and office equipment are assets held under finance leases with a net book value of £1 5 million (2006 £2 8 million)

The Group net book value of land and buildings comprises	**31 March 2007 £'m**	31 March 2006 £'m
Freehold properties	**16 1**	6 9
Short leasehold properties	**0 6**	0 6
Net book value	**16.7**	7 5

The Company has no tangible fixed assets in either year

The Group has received customer contributions relating to plant and machinery In accordance with the Group's accounting policy the assets are capitalised within fixed assets and recognised as deferred income in the balance sheet The deferred income is released to the profit and loss account over the estimated lives of the related assets The amount deferred under this policy was as follows

Deferred income	**31 March 2007 £'m**	31 March 2006 £'m
Customer contributions brought forward	**28.4**	-
Customer contributions held by subsidiaries at acquisition	-	2 0
Customer contributions received in year	**22.5**	26 4
Amortisation in year	**(0 6)**	-
	50.3	28 4

The Company has no deferred income

12 Fixed asset investments

	Group £'m	**Company £'m**
Cost and net book value		
Shares in Group undertakings		
At 1 April 2006 and at 31 March 2007	-	948 4
Other investments		
At 1 April 2006 and at 31 March 2007	0 2	-
	0 2	**948 4**

Other fixed asset investments

Other fixed asset investments relate to the Group's investments in Xoserve Limited, which provides transportation transactional services on behalf of all the major gas network transportation companies The Group holds 23 1% (2006 23 1%) of the ordinary shares of Xoserve Limited

During the year the Group received dividends of £326,000 (2006 £nil) in relation to this investment

Scotia Gas Networks plc

Interests in Group undertakings
Details of the principal subsidiary undertakings at the end of the year, which are directly wholly owned by the Company are as follows

Name of subsidiary	Description of shares held	Country of registration	Principal activities
Southern Gas Networks plc	160,174,772 ordinary shares of £1 each	England & Wales	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services
Scotland Gas Networks plc	49,392,787 ordinary shares of £1 each	Scotland	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services
SGN Contracting Limited	1 ordinary share of £1	England & Wales	Supply of contracting services
SGN Connections Limited	1 ordinary share of £1	England & Wales	Supply of gas connections services
SGN Commercial Services Limited	1 ordinary share of £1	England & Wales	Supply of commercial services

13 Debtors

	Group		Company	
	31 March 2007 £'m	31 March 2006 £'m	**31 March 2007 £'m**	31 March 2006 £'m
Amounts falling due within one year				
Trade debtors	**37.1**	46 9	-	-
Amounts owed by Group undertakings	-	-	**95.5**	83 4
Prepayments and accrued income	**8.6**	13 9	**0.2**	-
Derivative financial instruments (see note 16)	**17.1**	4 1	-	-
Other debtors	-	-	**23.4**	18 5
	62.8	64 9	**119.1**	101 9

14 Creditors: amounts falling due within one year

	Group		Company	
	31 March 2007 £'m	31 March 2006 £'m	**31 March 2007 £'m**	31 March 2006 £'m
Bank loans and overdrafts	**128 8**	25 0	**9.3**	25 5
Trade creditors	**43.3**	32 1	**-**	-
Amounts owed to Group undertakings	**-**	-	**113.6**	104 8
Other amounts owed to shareholders (see note 27)	**0 4**	0 6	**-**	-
Other taxation and social security	**13.7**	42 1	**0.1**	-
Other creditors	**3.3**	48 4	**0.7**	44 3
Accrued interest	**57.3**	63 0	**23.6**	23 6
Other accruals	**55.3**	50 8	**0.5**	-
Deferred income	**13 2**	7 1	**-**	-
Derivative financial instruments (see note 16)	**10.6**	-	**-**	-
	325.9	269 1	**147.8**	198 2

15 Creditors: amounts falling due after more than one year

	Group		Company	
	31 March 2007 £'m	31 March 2006 £'m	**31 March 2007 £'m**	31 March 2006 £'m
Bonds:				
Fixed rate and index linked.			-	-
£257m 4 75% fixed rate due 2017	**255.4**	254 6	-	-
£165m 2 127% index linked due 2022	**168.6**	164 5	-	-
£225m 4 875% fixed rate due 2034	**223 6**	224 2	-	-
£215m 4 875% fixed rate due 2020	**214.0**	213 8	-	-
£150m 2 066% index linked due 2025	**153.2**	149 5	-	-
£375m 4 875% fixed rate due 2029	**373.2**	372 7	-	-
£250m 2 013% index linked due 2035	**255 4**	249 0	-	-
	1,643 4	1,628 3	-	-
Floating rates.				
Euro 365m floating rate loan note due 2010	**246.0**	250 1	-	-
£233m floating rate loan note due 2015	**232.4**	232 2	-	-
£50m floating rate loan note due 2015	**49 9**	49 9	-	-
£50m floating rate loan note due 2015	**49 9**	49 9	-	-
	578.2	582 1	-	-
Total bonds	**2,221.6**	2,210 4	-	-
Shareholders' loans (see note 27)	**563 6**	573 7	**563 6**	573 7
	2,785 2	2,784 1	**563.6**	573 7

The shareholder loans, which are subordinated, are redeemable at par on 31 May 2015, or may be redeemed at par by the Company on or after 1 June 2006 by giving due notice Interest accrues at a fixed rate of 12 5% per annum and the Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to shareholders

Of the above borrowings, amounts falling due after more than five years total £2,539 2 million (2006 £2,534 0 million) and £246 0 million (2006 £250 1 million) falls due after more than two years but not more than five years The Company's borrowings fall due in more than five years

The above borrowings are stated after the deduction of issue costs of £8 8 million (2006 £9 4 million) Certain interest costs in respect of index linked bonds are not payable until the principal amount of the bond is repaid and are included within the carrying value of the borrowings stated above The amount included in the carrying value of the borrowings at 31 March 2007 is £13 7 million (2006 £nil)

16 Financial instruments

Derivative financial instruments

The Group's funding, liquidity and exposure to interest rate and foreign exchange risks are managed within a framework of policies and guidelines authorised by the Board of Directors In accordance with these policies, and in accordance with covenants set out as part of bond issues made by the Group, financial derivative instruments are used to manage interest rate and currency exposure

In the prior year, the Group entered into interest rate swap contracts with an aggregate notional principal amount of £2,000 0 million to fix the bulk of the Group's interest cost over an average period of 15 years In October 2005, permanent long term capital markets debt was issued to replace floating rate short term loans At that point these swaps became obsolete and consequently matching swaps were transacted (under which the Group received fixed rate interest) to close out the position Mark to market valuation of the swaps at the time of the bond issue demonstrated losses of £205 0 million which crystallised at the time of matching out the swaps These losses were recognised in the consolidated profit and loss account for the year ended 31 March 2006 Changes in the fair value of these swaps are recognised in the profit and loss account as they arise The corresponding obligation in respect of these swaps is recorded as an onerous contract provision in the balance sheet (see note 17)

In order to achieve the Group's target interest rate profile for long term borrowings of between 80 and 85% of borrowings at either fixed rate or index linked, excluding borrowings from shareholders, the Group has maintained further interest rate swaps during the year These interest rate swaps have the effect of converting a net notional principal amount of £168 0 million from floating rates to fixed rates

The Group has used hedge accounting in respect of cash flow hedges, to the extent that they qualify for hedge accounting Gains on those cash flow hedges which qualify for hedge accounting are recognised within equity (see note 19) These gains will reverse in the consolidated profit and loss account in the period to October 2015, being the life of the swaps

The Group has also entered into cross currency swaps (which have been designated as fair value hedges) with an aggregate notional principal amount of Euro 365 0 million, which has the effect of converting the Group's Euro 365 0 million floating rate loan note into a floating rate Sterling obligation

The fair values of the Group's derivative financial instruments are as follows

	31 March 2007		31 March 2006	
	Assets £'m	**Liabilities £'m**	Assets £'m	Liabilities £'m
Interest rate swaps – cash flow hedges	**17 1**	-	4 1	-
Currency swaps – fair value hedges	-	**(3.2)**	3 8	(1 3)
Other interest rate swaps	-	**(194.5)**	-	(205 0)
Other derivative financial instruments	-	**(0 1)**	-	-
	17.1	**(197.8)**	7 9	(206 3)

The Company has no derivative financial instruments

Borrowings

The exposure of the Group's borrowings to interest rate changes, after taking account of interest rate swaps is as follows

	31 March 2007			31 March 2006		
	Bonds and other borrowings £'m	**Shareholders' loans £'m**	**Total £'m**	Bonds and other borrowings £'m	Shareholders' loans £'m	Total £'m
Borrowings at floating rates						
Falling due						
Within one year	**120.0**	**-**	**120 0**	-	-	-
After more than one year	**578.2**	**-**	**578.2**	582 1	-	582 1
Total	**698.2**	**-**	**698.2**	582 1	-	582 1
Effect of interest rate swaps	**(168 0)**	**-**	**(168.0)**	(168 0)	-	(168 0)
	530.2	**-**	**530.2**	414 1	-	414 1
Borrowings at fixed rates and index linked						
Falling due after more than one year	**1,643 4**	**563 6**	**2,207 0**	1,628 3	573 7	2,202 0
Effect of interest rate swaps	**168.0**	**-**	**168 0**	168 0	-	168 0
	1,811.4	**563.6**	**2,375.0**	1,796 3	573 7	2,370 0
	2,341 6	**563 6**	**2,905.2**	2,210 4	573 7	2,784 1

The fair values of short term deposits and other short term financial assets and liabilities approximate to their book values The fair value of bonds and other borrowings are as follows

	31 March 2007		31 March 2006	
	Fair value £'m	**Book value £'m**	Fair value £'m	Book value £'m
Bonds and other borrowings	**2,190.7**	**2,221.6**	2,225 3	2,210 4
Shareholders' loans	**550.2**	**563 6**	568 6	573 7

The effective interest rates of the Group's financial instruments are

	31 March 2007 %	31 March 2006 %
Bank and other short term borrowings	**5.7**	-
Bonds	**5 5**	5 0
Shareholders' loans	**12 5**	12 5
Short term deposits	**5.3**	4 5

In addition to the above, the Group has an annual obligation amounting to 1 0% (2006 1 0%) in respect of interest on onerous financial instruments (interest rate swaps) which have an aggregate notional principal amount of £2,000 0 million (see note 17) As explained above, these interest rate swaps were transacted in the prior year in line with the Group's interest rate hedging policy

17 Provisions for liabilities

Group	Onerous financial instruments £'m	Restructuring costs, other onerous contracts and other £'m	Environmental £'m	Deferred tax £'m	Total £'m
At 1 April 2006	205 0	23 2	22 8	233 2	484 2
Arising during the year	1 7	6 1	2 7	-	10 5
Utilised during the year	(19 5)	(0 4)	-	-	(19 9)
Released during the year	-	(12 2)	-	-	(12 2)
Net movement in deferred tax	-	-	-	15 4	15 4
Amortisation of discount	-	-	1 2	-	1 2
At 31 March 2007	**187 2**	**16 7**	**26 7**	**248 6**	**479.2**

The onerous financial instruments provision relates to interest rate swap contracts which the Group holds (see note 16) The provision recorded at each balance sheet date represents the aggregate fair value of the swap contracts held The provision will be utilised as cash settlement payments are made over the life of the swaps over the next eighteen years

The restructuring costs, other onerous contracts and other provision represent the cost of executing certain restructuring plans and a provision for other legal and constructive obligations held by the Group This provision is expected to be utilised over the next fifteen years

The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Group has a legal obligation to restore sites at the balance sheet date The provision has been discounted and is stated at the present value of the expenditure expected to be required to settle the obligation This provision is expected to be utilised over the next twenty years

The net movement on the deferred tax provision has arisen as a result of a surrender of tax losses during the year (see note 27), offset by other movements in the year

The Company has no provisions in either year

Deferred taxation recognised in the financial statements (excluding deferred tax recognised in respect of pension liabilities (see note 26)) is as follows

	Group		Company	
	31 March 2007 £'m	31 March 2006 £'m	**31 March 2007 £'m**	31 March 2006 £'m
Accelerated capital allowances	**(299 8)**	(298 3)	-	-
Deferred tax asset on losses	**52 1**	65 9	-	-
Deferred tax on cash flow hedges	**(5.1)**	(1 2)	-	-
Other timing differences	**4 2**	0 4	-	-
	(248 6)	(233 2)	-	-

The Group has unrecognised deferred tax assets in respect of unutilised tax losses of £35 5 million (2006 £18 3 million) Deferred tax assets have been recognised in respect of tax losses to the extent that it is considered probable that these assets will be recovered. Deferred tax assets have not been recognised in respect of unutilised tax losses in the Company amounting to £35 5 million (2006 £17 8 million)

In accordance with FRS 19 ("Deferred tax"), deferred tax has been measured based upon a corporation tax rate of 30%, being the tax rate enacted at the balance sheet date The government have announced a reduction in the corporation tax rate to 28% with effect from 1 April 2008, which will have the effect of reducing both the deferred tax provision and the effective rate of tax once the change is brought into law

18 Called up share capital

	31 March 2007		31 March 2006	
	Number	**£'m**	Number	£'m
Authorised				
'A' ordinary shares of £1 each	**4,000,000,000**	**4,000**	4,000,000,000	4,000
'B' ordinary shares of £1 each	**2,000,000,000**	**2,000**	2,000,000,000	2,000
'C' ordinary shares of £1 each	**2,000,000,000**	**2,000**	2,000,000,000	2,000
		8,000		8,000

	31 March 2007		31 March 2006	
	Number	**£'m**	Number	£'m
Allotted, called up and fully paid				
'A' ordinary shares of £1 each	**235,025,002**	**235.0**	235,025,002	235.0
'B' ordinary shares of £1 each	**117,512,501**	**117.5**	117,512,501	117 5
'C' ordinary shares of £1 each	**117,512,501**	**117.5**	117,512,501	117 5
Total ordinary shares of £1 each	**470,050,004**	**470.0**	470,050,004	470 0

The 'A', 'B' and 'C' ordinary shares rank pari passu in all respects

19 Reserves

	Hedge reserve		Profit and loss account	
	Group £'m	Company £'m	Group £'m	Company £'m
At 1 April 2006	2 9	-	(238 9)	(59 3)
Loss for the financial year	-	-	(154 8)	(24 4)
Cash flow hedges (net of related tax)	8 5	-	-	-
Actuarial loss on defined benefit pension schemes (net of related tax)	-	-	(2 6)	-
At 31 March 2007	**11 4**	**-**	**(396 3)**	**(83.7)**

20 Reconciliation of movements in Group shareholders' funds

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Loss for the financial year	**(154.8)**	(233 9)
Issue of share capital	-	470 0
Cash flow hedges (net of related tax)	**8 5**	2 9
Actuarial loss on defined benefit pension scheme (net of related tax)	**(2 6)**	(5 0)
Net (decrease)/increase in shareholders' funds	**(148 9)**	234 0
Opening shareholders' funds	**234.0**	-
Closing shareholders' funds	**85.1**	234 0

21 Cash flow from operating activities

Reconciliation of operating profit to net cash inflow from operating activities

Continuing operations	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Operating profit	**31 9**	80 3
Depreciation charge	**75 4**	65 3
Amortisation of deferred income	**(0 6)**	-
Profit on sale of fixed assets	**(0.2)**	-
Goodwill amortisation	**9.4**	8 2
Decrease/(increase) in debtors	**15.1**	(5 3)
Increase in creditors	**7 9**	24 5
Movement in provisions	**0 4**	2 9
Total net cash inflow from operating activities	**139.3**	175 9

22 Analysis of net debt

	1 April 2006 £'m	Cash flow £'m	Non-cash changes £'m	31 March 2007 £'m
Bank overdraft	**(25.0)**	16 2	-	**(8.8)**
Debt due within one year				
- Bank loans	-	(120 0)	-	**(120.0)**
- Financial instruments	-	-	(10 6)	**(10.6)**
Debt due after more than one year				
- Bonds	**(2,210.4)**	-	(11 2)	**(2,221 6)**
- Shareholders' loans	**(573.7)**	46 0	(35 9)	**(563 6)**
Onerous financial instruments	**(205.0)**	19 5	(1 7)	**(187.2)**
Other financial instruments	**4.1**	(0 7)	13 7	**17 1**
Short term deposits	**132.3**	(102 1)	-	**30 2**
	(2,877 7)	**(141 1)**	**(45 7)**	**(3,064.5)**

Short term deposits comprise short term highly liquid investments with a maturity of three months or less

Non-cash changes noted above represent fair value movements on financial instruments (see note 16) and interest incurred on index linked bonds and on shareholders' loans during the year which has not been paid and has been included within the carrying value of amounts borrowed

23 Acquisitions

On 1 June 2005, the Company purchased the entire share capital of Southern Gas Networks Limited and Scotland Gas Networks Limited These companies acquired the trade and assets of the Scotland and Southern regional gas networks respectively on 1 May 2005 Prior to 1 May 2005 the businesses were part of the business of Transco plc, a subsidiary of National Grid Transco plc

Southern Gas Networks Limited and Scotland Gas Networks Limited subsequently re-registered as public limited companies and changed their names to Southern Gas Networks plc and Scotland Gas Networks plc respectively The acquisitions have been accounted for using the acquisition method of accounting

The table below summarises the book values of the identifiable assets and liabilities acquired for both acquisitions at 1 June 2005, together with the Group's assessment of their fair values at the date of the acquisition The book values are those of the underlying businesses, prior to adjustments arising from their sale by Transco plc The fair value adjustments reflect the assessment of value based upon the regulatory value of the business and the fair value of the working capital and provisions The principal accounting policy alignments reflect the adoption of the Group's policies on deferred taxation and pensions

	Book value £'m	Accounting policy alignment £'m	Revaluation £'m	Fair value to the Group £'m
Tangible fixed assets	1,429 4	-	1,696 6	3,126 0
Fixed asset investments	0 3	-	-	0 3
Working capital	(9 5)	-	(29 7)	(39 2)
Amounts owed to Transco plc	(2,453 3)	-	-	(2,453 3)
Deferred tax	-	(291 2)	-	(291 2)
Other provisions for liabilities	(2 5)	(37 8)	(45 5)	(85 8)
Net assets	**(1,035.6)**	**(329.0)**	**1,621.4**	**256.8**
Goodwill				**482.1**
Total consideration (including acquisition expenses)				**738 9**

Deferred cash consideration of £44 3 million has been paid in the year ended 31 March 2007 (year ended 31 March 2006 cash consideration paid amounted to £691 9 million)

24 Operating lease commitments

The Group has lease agreements in respect of properties for which the payments extend over a number of years

	31 March 2007 £'m	31 March 2006 £'m
Annual commitments under non-cancellable operating leases		
Within one year	-	0 1
Within two to five years	**0 7**	0 7
After five years	**0 7**	0 7
	1.4	1 5

The Company has no operating lease commitments in either year

25 Capital commitments

Capital projects contracted for by the Group but not provided in the financial statements amounted to £8 6 million at 31 March 2007 (31 March 2006 £17 1 million) The Company has no capital commitments at 31 March 2007 (31 March 2006 £nil)

26 Pension commitments

A significant proportion of the Group's employees are members of the Scotia Gas Networks Pension Scheme ("the Scheme") The Scheme provides final salary defined benefits for employees who joined the Lattice Group Scheme prior to 31 March 2002 A defined contribution section was added to the Lattice Group Scheme from 1 April 2002 for employees joining the Lattice Group Scheme from that date Employees of the Group who were previously members of the Lattice Group Scheme transferred to the Scotia Gas Networks Pension Scheme on 1 December 2005

a) Defined benefit scheme

The Scheme is operated by the Company and is funded with assets held in separate trustee administered funds It is subject to independent valuations at least every three years, on the basis of which the qualified actuary determines the rate of employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme

The latest full actuarial valuation was carried out as at 31 March 2006 In accordance with FRS 17, a limited actuarial review has been carried out by Hymans Robertson at 31 March 2007 using the projected unit method

The following financial assumptions have been used

	As at 31 March 2007	As at 31 March 2006	As at 1 June 2005
Discount rate	**5.4% pa**	4 9% pa	5 1% pa
Inflation assumption	**3.1% pa**	2 9% pa	2 7% pa
Rate of increase of salaries	**4 6% pa**	4 4% pa	4 2% pa
Rate of increase of pensions payment	**3.1% pa**	2 9% pa	2 7% pa

The assumptions relating to longevity underlying the pension liabilities are based on standard actuarial mortality tables and include an allowance for future improvements in longevity The assumed life expectancy in years for a member once they reach age 65 are as follows

	As at 31 March 2007 Male	**As at 31 March 2007 Female**	As at 31 March 2006 Male	As at 31 March 2006 Female
Member currently aged 65	**21**	**23**	20	23
Member currently aged 45	**22**	**24**	22	24

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The fair value of the assets ın the scheme, the present value of the lıabılıtıes ın the scheme and the expected rate of return were

	31 March 2007		31 March 2006		1 June 2005	
	Long term rate of return expected	**Value £'m**	Long term rate of return expected	Value £'m	Long term rate of return expected	Value £'m
Equıtıes	**8.0%**	**235.7**	7 7%	220 6	7 9%	203 2
Government bonds	**4 5%**	**64 3**	4 2%	67 5	4 4%	50 8
Corporate bonds	**5.1%**	**31.3**	4 9%	24 4	5 1%	-
Property	**5 5%**	**15.3**	5 2%	-	5 4%	-
Cash	**5.9%**	**1.0**	4 8%	4 4	4 5%	-
Total market value of assets		**347 6**		316 9		254 0
Actuarıal value of lıabılıtıes		**(414.6)**		(376 1)		(308 0)
Defıcıt ın scheme		**(67 0)**		(59 2)		(54 0)
Related deferred tax asset		**20.1**		17 8		16 2
Net pensıon liabilıty		**(46.9)**		(41 4)		(37 8)

Analysıs of the amounts recognısed in the profıt and loss account

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Amount charged to operatıng profit.		
Current servıce cost	**(19 7)**	(11 8)
Analysıs of the amount credıted to fınance income.		
Expected return on pensıon scheme assets (see note 6)	**21 7**	15 6
Interest on pensıon scheme lıabılıtıes (see note 6)	**(18.9)**	(13.4)
Net fınance ıncome	**2 8**	2 2
Net charge to the profıt and loss account	**(16.9)**	(9 6)

Analysis of the amount recognised in the statement of total recognised gains and losses (STRGL)

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Actual return less expected return on pension scheme assets	**(3.4)**	36 5
Experience gains and losses on scheme liabilities	**(31.3)**	-
Changes in financial assumptions underlying the present value of the scheme liabilities	**31.0**	(41 5)
Actuarial loss recognised in STRGL	**(3.7)**	(5 0)

There were no amounts recognised in the statement of total recognised gains and losses for the period from 10 November 2003 (date of incorporation of the Company) to 31 March 2005, and accordingly there were no experience gains and losses for this period

Experience gains and losses	**Year ended 31 March 2007**	Year ended 31 March 2006
Difference between the expected and actual return on scheme assets	**£(3.4)m**	£36 5m
- Percentage of scheme assets at year end	**(1 0)%**	11 5%
Experience gains and losses on scheme liabilities	**£(31.3)m**	-
- Percentage of the present value of scheme liabilities at year end	**(7 5)%**	-
Changes in financial assumptions underlying scheme liabilities	**£31.0m**	£(41 5)m
- Percentage of the present value of scheme liabilities at year end	**7.5%**	(11 0)%
Total actuarial loss recognised in the statement of total recognised gains and losses	**£(3.7)m**	£(5 0)m
- Percentage of the present value of scheme liabilities at year end	**(0.9)%**	(1 3)%

Movement in deficit during the year	**£'m**	£'m
Deficit in scheme at 1 April 2006	**(59 2)**	(54 0)
Movement in year		
- Current service costs	**(19 7)**	(11 8)
- Contributions	**12.8**	9 4
- Other finance income	**2 8**	2 2
- Actuarial loss	**(3.7)**	(5 0)
Deficit in scheme at end of the year	**(67.0)**	(59 2)

The Group's contribution rate during the year was 23 3% of pensionable earnings, which has increased to 37 3% with effect from 1 April 2007 Additionally, the Group has agreed to make special pension contributions to repair the deficit amounting to £13 5 million per year from 1 April 2007

(b) Defined contribution schemes

The amounts recognised in the profit and loss account is as follows

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Amount charged in respect of defined contribution schemes	**0 7**	0 3

27 Related parties

The Company is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by the Ontario Municipal Employees Retirement System

It is the opinion of the Directors that the Group and Company have no single controlling party as the Company is controlled jointly by the consortium

Transactions with shareholders

Amounts owed to shareholders and loans from shareholders are set out below

	Group	
	31 March 2007 £'m	31 March 2006 £'m
Shareholders' loans		
Scottish and Southern Energy plc	**281.8**	286 9
Borealis Infrastructure Europe (UK) Limited	**140.9**	143 4
OTPPB Investments (UK) Limited	**140 9**	143 4
	563.6	573 7
Interest owed to shareholders:		
Scottish and Southern Energy plc	**11 8**	12 0
Borealis Infrastructure Europe (UK) Limited	**5 9**	6 0
OTPPB Investments (UK) Limited	**5 9**	6 0
	23 6	24 0
Other amounts owed to shareholders:		
Scottish and Southern Energy plc	**11 4**	11 0
	11.4	11 0

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The aggregate interest expense charged to the profit and loss account in respect of shareholders' loans was £71 6 million (year ended 31 March 2006 £60 6 million) Interest accrues on the shareholders' loans at a fixed rate of 12 5% per annum, and is payable semi-annually in arrears on 30 November and 31 May each year The Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to shareholders During the year an aggregate amount of £35 9 million (year ended 31 March 2006 £33 7 million) of additional loans were issued in this way

Other than interest charges relating to shareholder loans, the following transactions took place during the year between the Group and the Scottish and Southern Energy plc group of companies ("SSE")

	Year ended 31 March 2007 £'m	Year ended 31 March 2006 £'m
Sales of goods and services	**77 5**	62 1
Purchase of goods and services	**(66 5)**	(52 3)
Sale of tax losses	**26 2**	-

Sales of goods and services to SSE primarily represent gas transportation services At 31 March 2007 an amount of £0 3 million (2006. £nil) was owed by SSE in relation to these services and is included within trade debtors

SSE provide services to the Group in the form of a management services agreement for corporate services The Group also purchases certain items such as consumables stock and shrinkage gas from SSE Included within purchases of goods and services are direct costs in relation to tangible fixed asset and acquisitions projects incurred by SSE which have been recharged to the Group These costs amount to £10 1 million (year ended 31 March 2006 £10 0 million) which have been capitalised in the year

During the year, the Company has surrendered gross tax losses of £98 9 million to SSE relating to the period ended 31 March 2006 for an aggregate cash consideration of £26 2 million Cash received from SSE in respect of the sale of these losses amounted to £26 6 million, and accordingly an amount of £0 4 million is included within other amounts owed to shareholders in the balance sheet