

# **Wales & West Utilities Limited**

## **DIRECTORS' REPORT AND FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED 31 MARCH 2007**

**Registered No. 05046791**



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## **DIRECTORS AND ADVISORS**

**Duncan Whyte (A, R, H)**                      Chairman  
**Graham Edwards (H)**                      Chief Executive Officer  
**Peter Antolik**  
**Stephen Box (A, H)**  
**Raymond A. Clamp (A, H)**  
**Philip Garling (R)**  
**Howard Higgins (A, R, H)**  
**Alan Kadic (R)**  
**Martin Baggs (R)**

**Steven Bickerton**    (Alternate Director to Philip Garling)  
**Charles Hazelwood** (Alternate Director to Graham Edwards)  
**Graeme Bevans**     (Alternate Director to Alan Kadic)

*(A) Member of the Audit Committee*  
*(R) Member of the Remuneration Committee*  
*(H) Member of the Health & Safety Committee*

## **COMPANY SECRETARY AND REGISTERED OFFICE**

Christopher Talbot  
Wales & West House, Spooner Close, Celtic Springs, Coedkernew, Newport NP10 8FZ

## **AUDITORS**

PricewaterhouseCoopers LLP  
1 Kingsway, Cardiff CF10 3PW

## **PRINCIPAL BANKERS**

Barclays Bank plc

## **REPORT OF THE DIRECTORS**

The directors have pleasure in presenting their third annual report to shareholders, together with the audited financial statements for the year ended 31 March 2007 as presented on pages 13 to 39

### **PRINCIPAL ACTIVITIES AND BUSINESS REVIEW**

The Company is principally engaged in the management of gas transportation assets. The Company provides gas distribution and meter work services throughout Wales and the South West of England.

### **RESULTS AND OPERATING PERFORMANCE**

The loss on ordinary activities before taxation amounted to £125.4m (2006 £93.5m). The loss attributable to shareholders amounted to £99.9m (2006 £93.5m).

The results of Wales and West Utilities Ltd ("the Company") for the year ended 31 March 2007 are set out in the Profit and Loss account on page 13.

The Company replaced 403km of gas mains, along with the related gas services and service pipes running from the gas mains to the properties of gas consumers at a cost of £56.1m (2006 315km at a cost of £50.1m). The work was undertaken either because mains were identified as requiring replacement under a programme defined by the Health & Safety Executive where all metallic mains within 30 metres of a dwelling are being replaced with plastic alternatives over a period of 30 years, because the overall condition of the metallic main warranted replacement or because of a request (usually through a local authority as a result of a highways project) to move the gas infrastructure. A further £0.9m (2006 £0.6m) was spent on Local Transmission System replacement projects. Under UK Generally Accepted Accounting Principles these costs are charged as an operating cost.

In addition, the Company invested £52.8m (against which consumers contributed £13.7m) on expanding and improving the gas distribution network.

### **BUSINESS REVIEW**

The Company's operating performance over the past year has been good, with all standards of performance being achieved. In particular, targets for mains abandoned and replaced were met, as were targets in response to reported possible gas escapes, both in one and two hour time frames. The standards for achieving connections quotations and for completing connections activities within agreed timescales were also both met. The numbers of complaints were 18% lower than last year.

There were two lost time injuries to employees during the year, which was 50% lower than the year ended 31 March 2006. This level of performance places the Company at the fore-front of the gas sector and compares favourably with leading world-class organisations.

In addition to successfully meeting all operational standards for the year, the Company also achieved its targeted cost reductions for the year.

As planned, the Company also relocated to its new head office at Celtic Springs, Coedkernew, Newport in June 2006.

### **HISTORY AND DEVELOPMENT**

The Company is a regulated gas transportation business owning and operating the principal gas distribution network in Wales and the South West of England consisting of some 32,000 kilometres of pipelines. The Company operates under a Gas Transporter's licence granted by the Gas and Electricity Markets Authority and is responsible for the safety, development, maintenance and daily operation of the gas distribution network which it owns. Gas is transported on behalf of approximately 30 gas shippers through the Company's distribution pipelines to around 2.4 million consumers.

The Company is a private company. Details of the immediate and ultimate parent companies are set out in note 27 to the statutory financial statements.

## **BUSINESS ENVIRONMENT**

The Gas Distribution and Transmission Network in Great Britain comprises the National Transmission System and eight gas distribution networks. The National Transmission System is owned and operated by companies within the National Grid plc Group.

At or around the time that the Company acquired the Wales and South West local distribution zones, National Grid Group also sold three other distribution networks to independent operators, retaining four local gas distribution networks. Together these companies therefore represent the great majority of the gas transmission and distribution network in Great Britain.

There are however other independent gas transporters who operate within the principal area of the Company's operation and the Company has contractual arrangements in place with them to ensure the safe passage of gas to their networks.

In addition to its gas distribution role, the Company also has obligations under its gas transporter's licence to

- provide 24 hour emergency response to all public reported gas escapes in Wales and South West England, irrespective of the cause (the significant majority of which are unrelated to the Company's distribution network)
- connect gas consumers to the distribution network, unless the consumer chooses to use another party to provide the connection, and
- to provide meters to certain consumers if the consumer's gas supplier has not made alternative arrangements.

And under contractual arrangements with gas suppliers to

- provide and maintain gas meters for consumers.

## **REGULATORY ENVIRONMENT**

The gas distribution business of the Company is regulated by the Office of Gas & Electricity Markets (Ofgem). Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority, which makes all major decisions and sets policy priorities for Ofgem. The mechanism for regulation of the Company's activities in gas distribution and metering is derived from

- the Gas Act 1986 (as amended), and
- under the terms of its gas transporter's licence granted under Section 7 of this Act, and
- the Utilities Act 2000.

The Company is also regulated by the Health and Safety Executive.

As a regulated business the Company is subject to price controls set by Ofgem which define its allowed revenues. The price control under which the Company operated for the year to 31 March 2007 expired at that date. This control defined allowed revenue in respect of operating expenditure, capital expenditure, replacement expenditure and a return on the Company's investment in the gas infrastructure asset. In January 2007 the Company accepted Ofgem's Final Proposals for a one year price control for the year from 1 April 2007 to 31 March 2008.

The Company is currently engaged in a further price control review process with Ofgem which will define revenues from 1 April 2008 until 31 March 2013. Ofgem's Initial Proposals, containing indicative allowances for all eight of the gas distribution businesses, are expected to be issued on 29 May 2007. An update to Ofgem's Initial Proposals will be issued in September 2007 followed by Final Proposals in December 2007. These proposals, effected through modifications to the Company's licence, will define the Company's regulated revenue for the price control period, unless the Company requests that the Final Proposals be referred to the Competition Commission.

## **KEY PERFORMANCE MEASURES**

The Company uses a number of key measures of operational and financial performance to plan and monitor its business activities which are principally focused on the safe and effective operation of the gas network infrastructure asset. Measures of operational performance include:

- Process safety – safety of the gas transportation assets
- Occupational safety & health - Injuries, near misses and ill health
- Environment – Waste disposal, energy usage and use of natural resources
- The management of controllable costs in relation to the regulated business
- Achievement of capital and replacement programme targets, and
- The reliability of the gas distribution network and other customer facing quality of service measures

The Directors believe that safety is paramount and, as a fundamental part of this, that all work related injuries and illnesses are preventable. Consequently the Company measures the level of injuries, incidents and near misses as a key operational performance indicator. In addition, process safety measures have been devised to measure both the 'health' of the assets and their impact on the environment and the communities in which the Company works. Contractor performance is measured in the same way as direct employees.

Operational reliability is a core measure of the Company's success, and it is fundamental to the Company's relationships with Ofgem and the public. Reliability of the gas distribution network is monitored in a number of ways, including the number and duration of interruptions to consumers' gas supplies. The Company is required by Ofgem to meet a number of different service targets ("Overall Standards"), including attendance at gas escapes, notifying consumers in advance of planned interruptions and responding to complaints. The Company's licence also requires it to meet certain service targets for connections. Performance against these standards is reported to senior management every month and is reportable to Ofgem on a quarterly basis. Compensation payments are made to consumers under the Gas (Standards of Performance) Regulations 2005, in the regrettable event that certain service standards are not met.

The Company measures service quality to assess the performance of management and staff in serving consumers, including a quarterly survey which is undertaken by an independent market research company, the results of which are published on the Company's website and are reported to Ofgem.

All key regulatory standards of performance were achieved in the year to 31 March 2007 during a challenging period of transition that has seen operational processes and IT systems transferred from NG plc to the Company. Operations and back office functions were also reorganised.

Key operational performance measures were,

- 97% targets for responding to gas escapes in both 1 hour (97.2%) and 2 hour (98.7%) timeframes met
- the regulatory standards for Connections (quotations & physical completion of jobs) activities achieved well within target timescales,

- response to complaints well within the target regulatory standard, and
- 18% reduction in overall consumer complaints compared with the previous year, and 50% reduction in complaints to Energywatch

Key financial performance measures were,

- Operating cash flow, including management of working capital
- controllable costs

## **HEALTH, SAFETY AND ENVIRONMENT**

### ***Safety***

The Company's objective is to achieve zero work-related injuries, zero work-related ill health and zero injuries to the public. Over the last year, there were 2 lost time injuries, giving a 12 month frequency rate of 0.06 LTI's/100,000 hours worked. This represents a 50% reduction during the year compared with the twelve months ended 31 March 2006.

The Company continues to make progress in the management of occupational illnesses with a comprehensive health surveillance programme for industrial employees.

The safety challenge is significant. With a deployed work force (including contractors) of around 2000, a multi-million pound replacement programme and the Company's core role of managing the safe and secure delivery of gas, the Company meets this challenge by having a comprehensive management system designed and certified to standards such as ISO 14001, with a structured risk management process at its core.

The Company believes that its safety performance leads the sector and that valued position is targeted at being maintained through continued, vigilant implementation of its health, safety and environmental procedures. Nurturing a safety aware culture within the Company's workforce that sees clear accountability resting with line management, employees and contract partners is a key element of the Company's successful record.

### ***Environment***

The Company is also proud of its environmental achievements. In addition to maintaining certification to ISO 14001, it retained the prestigious Green Dragon Award for the Company's Welsh region at the highest level – an award only achieved by a handful of companies. By utilising and developing industry-wide best practices, the Company has reduced its environmental impact. Key areas for focus have been climate change, the disposal of waste to land fill and the use of quarried stone. Protecting the environment is a key focus for the Company going forward, constantly looking for ways to minimise the environmental impact of its past, present and future activities.

The Company continues to manage its portfolio of contaminated land. These sites are principally former manufacturing gas plants and can sometimes have a complex mix of contamination dating back over 100 years. The Company's remediation programme has a main focus on managing environmental risk.

## **PRINCIPAL RISKS AND UNCERTAINTIES**

The management of the business and the execution of the Company's strategy are subject to a number of risks. The key business risks facing the Company are set out below.

### ***Operational***

- Maintenance of the gas distribution network and security of supply,
- Health & Safety compliance,
- Appropriate investment in the network asset, and
- Meeting mains replacement targets

### ***Regulatory***

- Compliance with the Company's licence obligations and standards of service, and
- Impact of future price controls determined by Ofgem, including the effect of incentive mechanisms

### ***Employee***

- Retention of key individuals or the ability to recruit people with the right experience and skills from the local community

Risks are reviewed by the board and senior management and appropriate processes put in place to monitor and mitigate them. If more than one event occurs, it is possible that the overall effect of such events would compound the possible adverse effects on the Company.

## **FINANCIAL RISK MANAGEMENT**

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt and commodity market prices, credit risk, liquidity risk and interest rate risk. The Company has in place a risk management programme that seeks to limit the adverse effects on the financial performance of the Company by monitoring levels of debt finance and related finance costs. The Company also uses derivative financial instruments to manage interest rate costs.

Given the size of the Company, the Directors have not delegated the responsibility of monitoring financial risk management to a sub-committee of the Board. The policies set by the Board are implemented by the Company's finance department.

### ***Commodity Price risk***

The Company is exposed to commodity price risk through the purchase of "shrinkage gas" as a result of its operations. Shrinkage gas is that gas which the Company consumes during its operational activity and comprises gas used by the gas distribution business, the gas which leaks from the distribution network and gas stolen from the network. This risk is managed through appropriate commodity purchase in the forward market.

### ***Credit risk***

The Company has implemented policies that require appropriate credit checks on potential customers before sales are made. The amount of exposure to any individual counterparty is subject to a limit, which is reassessed on a regular basis.

The amount of credit given to Gas Shippers is governed by Uniform Network Code ("UNC") regulations and guidelines. This provides for defined levels of unsecured credit with Gas Shippers based on Investment Grade Ratings ("IGRs") with any excess credit amounts being secured by Letters of Credit, Parent Company Guarantees or by way of Prepayment.

The value at risk is monitored on a daily basis and is again regulated by UNC criteria allowing a maximum credit limit usage of 85% (2006 85%) which, if exceeded, allows the Company to apply sanctions.

The Company's overall exposure is also monitored and approved having regard to the levels of exposure within each IGR category.

### ***Financing and Interest rate cashflow risk***

The Company actively maintains long term debt finance that is designed to ensure the Company has sufficient available funds for operations.

The Company has both interest bearing assets and interest bearing liabilities. Interest bearing assets are cash, which bear interest at variable rates. The Company has a policy of hedging debt through interest rate swaps in order to fix interest rates and give greater certainty over future cashflows.



## **FINANCIAL REVIEW**

### *Basis of accounting*

The accounts present the Company's results for the period ended 31 March 2007 and the financial position as at 31 March 2007 and 2006. They have been prepared using the accounting policies shown on pages 17 to 20, in accordance with generally accepted accounting practices in the United Kingdom.

As the Company acquired the assets, liabilities and activity of the Wales and South West Gas Distribution Network from Transco plc on 1 May 2005, the comparative results shown in the profit and loss account, cashflow statement and related notes show the trading activity for the eleven months since that date. Accordingly it is not possible to compare the results of the business for a full comparative year.

There were no changes in accounting policies adopted during the year.

### *Segmental reporting*

In addition to providing the overall results and financial position in the financial statements, the Company provides a breakdown of those results and balances into a number of different business segments as required by the License within the Regulatory Accounts.

### *Liquidity, resources and capital expenditure*

Net cash inflow from operations amounted to £62.9m (2006 £465.1m), including intercompany creditors of £16.8m (2006 £367.5m), and was augmented by new long term loans of £39.0m (2006 £861.1m).

Capital purchases absorbed net cash of £35.2m (2006 £51.5m) and net financing costs amounted to £68.3m (2006 £50.1m).

During the comparative year, the funds invested were used to repay the intercompany loan with National Grid group of £1,195.4m which was acquired with the business.

### *Cash flow forecasting*

Both short term and long term cashflow forecasts are produced frequently to assist in identifying the liquidity requirements of the Company.

### *Debt*

Details of net debt are disclosed in note 9 and 10 and gross debt in note 12. Details of the Company's approach to financial risk management are set out in the Report of the Directors on page 6.

### *Shareholder funds*

Shareholder funds at 31 March 2007 amounted to a deficit of £182.2m (2006 £61.7m) as a result of a retained loss of £99.9m (2006 £93.5m) of issued and fully paid share capital of £nil (2006 £30.7m) and reserves movement on the Pensions provision loss of £20.6m (2006 gain £1.1m).

The Directors consider that the company has performed satisfactorily during the year.

Details of the ownership of the Company are included in note 27. Details of movements in the authorised and issued share capital of the Company are included in Note 17.

## **DIVIDEND ON ORDINARY SHARES**

The Directors do not recommend the payment of a dividend (2006 Nil) in respect of the period.

## **FUTURE DEVELOPMENTS**

The Company does not envisage any changes in the activity of the Company for the foreseeable future. Other than those matters referred to above, including the forthcoming Price Control Review, there were no significant developments within the Company that occurred during the financial year under review.

## **FIXED ASSETS**

Following the acquisition of the Wales and South West gas distribution business, freehold land and buildings are carried in the accounts at fair value of £1.9m (2006 £2.7m).

In the opinion of the Directors there was no significant difference between the book values of property and market values at 31 March 2007.

Investment in the network is essential for ensuring the security of the gas supply and the safety of the public. Gross capital expenditure in the Company's network was £52.8m (2006 £66.2m) offset by capital contributions of £13.7m (2006 £13.7m) and net replacement expenditure was £57.0m (2006 £50.7m) in the year to 31 March 2007.

## **DIRECTORS**

The names of the current directors of the Company are shown on page 1.

Changes in directors during the period up to the date of signature of the statutory accounts are shown below all other directors served throughout the period.

James Dickson		Resigned 12 September 2006
Raymond A. Clamp	Appointed 21 September 2006	
Wayne Leamon		Resigned 23 November 2006
Peter Antolik	Appointed 23 November 2006	
David Owens (Alternate)		Resigned 30 November 2006
Christopher Koski		Resigned 13 April 2007
Graeme Bevans (Alternate)	Appointed 13 April 2007	
Alan Kadic	Appointed 13 April 2007	
Martin Stanley		Resigned 17 May 2007
Martin Baggs	Appointed 17 May 2007	

## **DIRECTORS' SERVICE CONTRACTS AND REMUNERATION**

Details of directors' remuneration are set out in note 2(a).

## **DIRECTORS' INTERESTS**

There were no significant contracts subsisting during or at the end of the period with the Company in which any director is or was materially interested (other than service contracts).

None of the directors has or has had a beneficial interest in the shares of the Company.

## **POLICY ON THE PAYMENT OF CREDITORS**

It is the Company's policy to comply with terms of payment agreed with suppliers. Where payment terms are not negotiated the Company endeavours to adhere with the suppliers' standard terms.

## **EMPLOYMENT POLICIES**

The Company recognises that its employees are key to both the present and future success of the Company and supports the fundamental belief that to maximise the potential of every individual there must be -

- Investment in training and development
- A supportive working environment
- Employee participation and involvement in business matters

To this end the Company is evolving a framework of comprehensive policies and all employees have the opportunity to discuss their individual performance and development in a focused and proactive way

The Company seeks to maximise staff potential by encouraging employees to consider internal opportunities as part of their personal development. This can only be achieved with knowledge of the Company's business aims and objectives, and keeping employees up to date with the Company's news and views continues to be a high priority. The in-house newspaper supports this endeavour and provides a wide range of information.

The Company continues to formally consult employees at all levels in the spirit of partnership and co-operation and the use of employee opinion and attitude surveys will provide the Company with valuable information upon which to base future policy decisions. In Spring 2007 the Company issued an Employee Survey which aimed to give all staff the opportunity to comment on certain aspects of the business and their employment experience.

The Company offers equality of opportunity and support for disabled employees and maintains good links with external organisations to encourage involvement in the workplace of disabled members of the wider community.

The Company's policy for the employment of disabled persons gives full and fair consideration to all applications for employment made by such persons, having regard to their aptitudes and abilities and to the Company's operational requirements. Once employed, a career plan is developed so as to ensure suitable opportunities for each disabled person. Arrangements are made, where possible, for retaining employees who become disabled, to enable them to perform work identified as appropriate to their aptitudes and abilities in line with the Company's operational requirements.

### *Training & development*

The Company has consistently sought to recruit and retain the best employees in its local geography in order to provide the level of service which is expected.

The Company measures success in this area through employee retention. The Company has had a turnover rate of 5.6% in the year to 31 March 2007. The Chartered Institute of Personnel & Development stated that the average in UK industry during 2006 was 18.3%.

To improve retention rates the Company is focusing its attention on Succession Planning to ensure that key skill and knowledge workers are retained and that there is a plan to replace them upon retirement.

In 2006 a training programme with a focus on Performance Management and Coaching was rolled out to all Line and Senior Managers as well as some key support staff.

Additionally, there is a fully developed training plan in place for Apprentices. This is a 3-4 year training period, depending on the course of study undertaken and an in-house purpose built training centre has been developed to ensure all elements of the technical training are achieved to the Company's standards.

## **CONTRIBUTIONS FOR CHARITABLE AND POLITICAL PURPOSES**

During the year, there have been no political donations, and charitable donations amounted to £25,600 (2006 £4,000) Donations in excess of £200 were made to

Flint & Holywell Rotary Club	£300
Ty Hafan Children's Hospice for Wales	£500
Honeylands Children Centre	£300
Babe's Big Appeal	£300
Free Wheelers Emergency VS	£280
World Vision UK	£300
Motor Neurone Disease Association	£300
Race for life ~ Cancer Research UK	£296
St David's Hall & New Theatre Trust	£1,175
Marie Curie Cancer Care	£590
Emily Prosser Therapy Fund	£300
MacMillan Cancer Relief	£300
Teenage Cancer Trust	£300
Bridgend Samaritans	£220
Send a cow	£263
The Community Foundation Wales	£15,250
Four Lanes District Project Group	£300
Sorted	£300
Prince's Trust	£500
Comic Relief	£207

## **GOING CONCERN**

The Company's accounts have been prepared on the basis that the Company is a going concern In arriving at their decision to prepare the accounts on a going concern basis, the directors have reviewed the Company's budget for 2007/08 and medium term business plans for 2008/09 to 2011/12 including capital expenditure plans This included consideration of the cash flow implications of the plans and comparing these with the Company's cash resources and committed borrowing facilities

## **REGULATORY ACCOUNTS**

The Gas Transporters Licence, under which the Company operates, requires specific accounting statements to be published Copies of the regulatory accounts for the Company will be available from the Company Secretary after 30 September 2007

## **AUDITORS**

Pursuant to Section 386 of the Companies Act 1985, an elective resolution was passed on 8 June 2006 resolving that the Company dispense with the requirement to appoint auditors annually

In the case of each of the persons who are directors at the time when the report is approved under section 234A of the Companies Act 1984

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

**By Order of the Board**



**C Talbot**

**Company Secretary**

**25 May 2007**

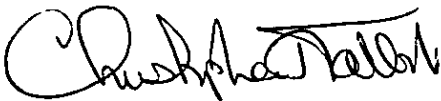
## **STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS**

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of the profit/loss of the Company for the year. In preparing the financial statements, the directors are required to

- select suitable accounting policies and 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 a going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to 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 hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**By Order of the Board**



**C Talbot**  
**Company Secretary**

**25 May 2007**

## **REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF WALES & WEST UTILITIES LIMITED**

We have audited the financial statements of Wales & West Utilities Limited for the year ended 31 March 2007 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes on pages 13 to 39. These financial statements have been prepared under the accounting policies set out therein.

### **Respective responsibilities of directors and auditors**

As described in the Statement of Directors' Responsibilities the Company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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 report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

### **Basis of audit opinion**

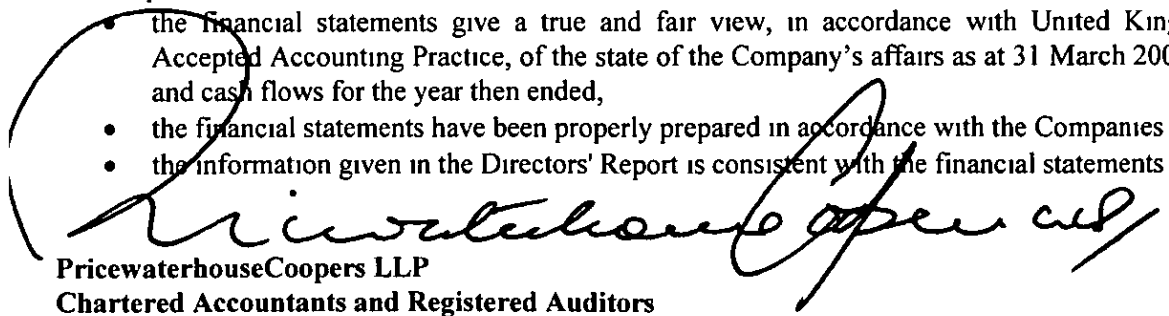
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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 Company's affairs as at 31 March 2007 and of its loss and cash flows 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.



PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Cardiff  
29 May 2007

**PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2007**

	Note	2007 £m	11 months ended 31 March 2006 £m
<b>Turnover:</b>			
Continuing operations		233.8	224.3
<b>Net operating costs</b>	1(a)	<u>(234.3)</u>	<u>(221.5)</u>
<b>Operating (loss)/profit:</b>			
Continuing operations		<u>(0.5)</u>	2.8
Interest receivable	3(a)	9.3	6.2
Other finance income	26	3.9	2.8
Interest payable and similar charges	3(b)	<u>(138.1)</u>	<u>(105.3)</u>
<b>Loss on ordinary activities before taxation</b>		<u>(125.4)</u>	<u>(93.5)</u>
Taxation	4	<u>25.5</u>	-
<b>Loss attributable to ordinary shareholders</b>		<u>(99.9)</u>	<u>(93.5)</u>
Dividends on ordinary shares		-	-
<b>Retained loss for the year/period</b>	18	<u>(99.9)</u>	<u>(93.5)</u>

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES  
FOR THE YEAR ENDED 31 MARCH 2007**

	<b>2007 £m</b>	<b>2006 £m</b>
Loss for the financial year attributable to ordinary shareholders	(99.9)	(93.5)
Actuarial (loss)/gain on pension scheme (note 26)	(20.6)	1.1
Total recognised gains and losses relating to the year	<u>(120.5)</u>	<u>(92.4)</u>

There are no material differences between the profit on ordinary activities before taxation and the retained loss for the year stated above and their historical cost equivalents

**RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS  
FOR THE YEAR ENDED 31 MARCH 2007**

	<b>2007 £m</b>	<b>2006 £m</b>
Total recognised losses for the year	(120.5)	(92.4)
New ordinary share capital issued	-	30.7
Net decrease in shareholders' funds	(120.5)	(61.7)
At 1 April	(61.7)	-
At 31 March	<u>(182.2)</u>	<u>(61.7)</u>

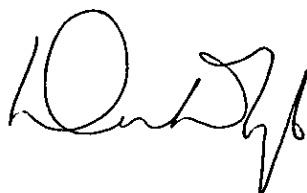


# **BALANCE SHEET AT 31 MARCH 2007**

	Note	2007 £m	2006 £m
<b>Fixed assets</b>			
Tangible assets	5	1,287.5	1,288.7
Investments	6	0.1	0.1
		<u>1,287.6</u>	<u>1,288.8</u>
<b>Current assets</b>			
Stocks and work in progress	7	2.7	2.8
Debtors	8	42.6	36.6
Cash at bank and in hand	21	26.9	29.9
		<u>72.2</u>	<u>69.3</u>
<b>Current liabilities</b>			
Creditors: amounts falling due within one year	9(a)	(485.6)	(446.4)
<b>Net current liabilities</b>		<u>(413.4)</u>	<u>(377.1)</u>
<b>Total assets less current liabilities</b>		874.2	911.7
<b>Creditors: amounts falling due after more than one year</b>	9(b)	(956.8)	(887.7)
<b>Provisions for liabilities and charges</b>	16	(65.3)	(70.4)
<b>Net liabilities before pension liability</b>		(147.9)	(46.4)
<b>Pension liability</b>	26	(34.3)	(15.3)
<b>Net liabilities including pension liability</b>		<u>(182.2)</u>	<u>(61.7)</u>
<b>Capital and reserves</b>			
Called up share capital	17	30.7	30.7
Reserves	18	(212.9)	(92.4)
Equity shareholders' funds		<u>(182.2)</u>	<u>(61.7)</u>
<b>Total shareholders' funds</b>		<u>(182.2)</u>	<u>(61.7)</u>

The financial statements on pages 13 to 39 were approved by the Board of Directors on 25 May 2007 and were signed on its behalf by

Duncan Whyte  
Chairman



Graham Edwards  
Chief Executive Officer



**CASHFLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2007**

	Note	2007 £m	2006 £m
<b>Operating activities</b>			
Net cash inflow from continuing operating activities	19	62.9	465 1
<b>Net cash inflow from operating activities</b>		<u>62.9</u>	<u>465 1</u>
<b>Returns on investments and servicing of finance</b>			
Interest received		5.9	6 2
Interest paid		(74.1)	(56 2)
Interest element of finance leases		(0.1)	(0 1)
<b>Net cash outflow from returns on investments and servicing of finance</b>		<u>(68.3)</u>	<u>(50 1)</u>
<b>Taxation</b>			
UK corporation tax paid		-	-
<b>Tax paid</b>		<u>-</u>	<u>-</u>
<b>Investing activities</b>			
Purchase of tangible fixed assets		(50.0)	(65 2)
Capital contributions received		13.7	13 7
Proceeds of disposal of tangible fixed assets		1.1	-
Grants and contributions received		-	0 8
Long term loans repaid on acquisition of business	24	-	(1,195 4)
<b>Net cash outflow from investing activities</b>		<u>(35.2)</u>	<u>(1,246 1)</u>
<b>Net cash outflow before financing and treasury activities</b>		<u>(40.6)</u>	<u>(831 1)</u>
<b>Financing and treasury activities</b>			
New long term loans	20	39.0	861 1
Capital payments under finance leases	20	(1.4)	(0 1)
<b>Net cash inflow from financing and treasury activities</b>		<u>37.6</u>	<u>861 0</u>
<b>(Decrease)/increase in cash and cash equivalents</b>	21	<u>(3.0)</u>	<u>29 9</u>

## **PRINCIPAL ACCOUNTING POLICIES**

The financial statements have been prepared in accordance with Accounting Standards applicable in the United Kingdom and comply with the Companies Act 1985. A summary of the principal Company accounting policies, which have been consistently applied, is shown below.

### **CHANGES IN ACCOUNTING POLICY**

There have been no changes in accounting policy during the year.

### **BASIS OF ACCOUNTING**

These financial statements have been prepared in accordance with the historical cost convention as modified for the fair valuation exercise undertaken on the acquisition of the gas distribution business.

The Directors are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they adopt the going concern basis in the preparation of these financial statements.

### **ACQUISITIONS AND DISPOSALS**

The results of businesses acquired during the year are dealt with in the financial statements from the date of acquisition of those businesses. Where appropriate, adjustments are made to bring different accounting policies of newly acquired companies into line with the existing Company accounting policies.

Goodwill arising from the purchase of businesses, representing the excess of the fair value of the purchase consideration (including costs of acquisition) over the fair value of net assets acquired, is amortised over its expected future economic life.

### **RELATED PARTY TRANSACTIONS**

The Company is a 100% owned subsidiary of MGN Gas Networks (Senior Finance) Limited and is included in the consolidated financial statements of MGN Gas Networks (UK) Ltd. Consequently, under the terms of FRS 8 "Related Party Transactions", the Company is exempt from disclosing related party transactions with entities that are part of the MGN Gas Networks (UK) Limited group.

### **TURNOVER**

Turnover represents the sales value derived from the distribution of gas together with the sales value derived from the provision of other services to customers during the year and excludes Value Added Tax.

Turnover from the distribution of gas is partially derived from the value of units supplied during the year and includes an estimate of the value of units supplied between the date of the last meter reading and the year end. No liability is recognised when revenues received or receivable exceed the maximum amount permitted by regulatory agreement and reductions will be made to future prices to reflect this over-recovery.

## **TANGIBLE FIXED ASSETS AND DEPRECIATION**

Tangible fixed assets are included in the balance sheet at their cost less accumulated depreciation. Cost includes payroll and finance costs incurred which are directly attributable to the construction of tangible fixed assets.

Fixed assets acquired with the acquisition of the Wales & West gas distribution business are included at fair value.

Tangible fixed assets include assets in which the Company's interest comprises legally protected statutory or contractual rights of use.

Additions represent the purchase or construction of new assets and extensions or significant increases in the capacity of existing tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and amortised on a straight line basis to the profit and loss account over the estimated economic lives of the assets.

No depreciation is provided on freehold land and assets in the course of construction. Other tangible fixed assets are depreciated, principally on a straight line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of tangible fixed assets are, in general, shown below.

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

Principal depreciation periods are

Freehold buildings	up to 50 years
Leasehold properties	over the period of the lease
Gas distribution network assets	
Mains, services and regulating equipment	30 to 65 years
Storage	40 years
Meters	10 to 33 years
Vehicles, mobile plant and equipment	3 to 10 years

Assets in the course of construction are not depreciated until commissioned. All assets are depreciated on a straight line basis over their estimated economic life.

## **IMPAIRMENT OF FIXED ASSETS**

Impairments of fixed assets are calculated as the difference between the carrying values of the net assets of income generating units, including, where appropriate, investments and goodwill, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the net amount that can be generated through sale of the assets. Value in use represents the present value of expected future cashflows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

Impairment reviews are carried out if there is some indication that an impairment may have occurred, or where otherwise required, to ensure that fixed assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the profit and loss account and, where material, are disclosed as exceptional.

## **LEASED ASSETS**

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor and the finance charges being written off to the profit and loss account over the period of the lease in reducing amounts in relation to the written down amount. The assets are depreciated over the shorter of their estimated useful life and the lease period.

All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the profit and loss account in the year to which they relate.

## **GRANTS, CUSTOMER CONTRIBUTIONS AND INFRASTRUCTURE CHARGES**

Grants, customer contributions and infrastructure charges relating to gas infrastructure assets and expenditure on other fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Certain contributions noted above are wholly or partially refundable if an agreed volume of gas is distributed to them. Such contributions are included in provisions until there is no further liability to make refunds.

## **INVESTMENTS**

Long term investments held as fixed assets are stated at cost less amounts written off or provided to reflect permanent diminutions in value. Those held as current assets are stated at the lower of cost and net realisable value.

## **STOCKS AND WORK IN PROGRESS**

Stocks are stated at the lower of cost and net realisable value which takes account of any provision necessary to recognise damage and obsolescence.

## **COSTS OF RAISING FINANCE**

Under the provisions of FRS4 "Capital Instruments", costs associated with the raising of relevant finance are accounted for as a deduction from the amount of the consideration received. The costs are then amortised over the life of the instrument.

## **DECOMMISSIONING AND ENVIRONMENTAL COSTS**

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

## **FINANCIAL INSTRUMENTS**

Derivative financial instruments (“derivatives”) are used by the Company for the management of interest rate exposures and commodity price risks in respect of expected gas usage. The principal derivatives used include interest rate swaps and forward purchases relating to the purchase of gas.

All transactions are undertaken, or maintained, with a view to providing a commercial hedge of the interest or commodity price risks associated with the Company’s underlying business activities and the financing of those activities. Amounts payable or receivable in respect of interest rate swaps are recognised in the profit and loss account over the economic lives of the agreements or underlying position being hedged, either within net interest or disclosed separately where deemed exceptional.

Those derivatives relating to interest rates that are directly associated with a specific transaction and exactly match the underlying cashflows relating to the transaction are accounted for on the basis of the combined economic result of the transaction including the related derivative.

## **PENSION COSTS**

The Company operates defined contribution and defined benefit pension schemes.

The pension costs in respect of the defined contribution pension schemes comprise contributions payable in respect of the period.

The assets of the defined benefit scheme are measured using closing market values. Pension scheme liabilities are measured using the projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

The increase in the net present value of the liabilities of the defined benefit scheme expected to arise from employee service in the period is charged to operating profit. The net of the expected return on the scheme’s assets and the increase during the period in the present value of the schemes’ liabilities, arising from the passage of time, are included in net interest payable or other finance income, as appropriate.

Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

## **DEFERRED TAXATION**

Provision is made for deferred taxation, using the liability method, on all material timing differences to the extent that it is probable that a liability or asset will crystallise.

Deferred tax assets are only recognised to the extent that they are considered recoverable.

Deferred tax balances are not discounted.

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**1 (a) Net operating costs**

Net operating costs include

	Note	2007 £m	2006 £m
<u>Continuing operations</u>			
Staff costs	2(b)	54.3	44.9
Own work capitalised		(11.7)	(4.4)
Depreciation			
Own assets	5	52.3	49.9
Assets held under finance leases	5	0.9	1.7
Less amortisation of customer contributions		(0.5)	(0.2)
Profit on disposal of fixed assets		(0.3)	-
Replacement expenditure		57.0	50.7
Rentals under operating leases			
Hire of plant and equipment		1.0	0.5
Other		1.1	0.1

Own work capitalised includes direct labour and ancillary costs

**(b) Auditor remuneration**

**Services provided by the auditor**

During the year the company's obtained the following services from the group's auditor at costs as detailed below

	2007 £000	2006 £000
<u>Audit Services</u>		
Fees payable to company auditor for the audit	70.0	70.0
<u>Non Audit Services</u>		
Fees payable to the company's auditor and its associates for other services		
Other services pursuant to legislation	25.0	25.0
Tax Services	7.0	7.0
	<u>102.0</u>	<u>102.0</u>
	2007 £000	2006 £000
<u>Fees in respect of the pension scheme</u>		
Audit of pension scheme	9.0	7.0
	<u>9.0</u>	<u>7.0</u>

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**2 Directors and employees**

**(a) Directors' emoluments and interests**

Directors' emoluments

	2007	2006
	£000	£000
Fees	80.0	80 0
Salary payments (including benefits in kind)	251.0	196 7
Performance related bonus	250.0	92 0
Pension contributions	22.5	-
Contributions in lieu of pension	38.5	47 9
	<u>642.0</u>	<u>416 6</u>

All directors make their own pension arrangements, accordingly no retirement benefits are accruing to the directors

No director had any interest over shares in the Company

Highest paid director

	2007	2006
	£000	£000
Salary payments (including benefits in kind)	251.0	196 7
Performance related bonus	250.0	92 0
Pension contributions	22.5	-
Contributions in lieu of pension	38.5	47 9
	<u>562.0</u>	<u>336 6</u>

**(b) Staff costs**

	2007	2006
	£m	£m
Wages and salaries	41.2	34 9
Social security costs	3.8	3 1
Pension costs	9.3	6 9
	<u>54.3</u>	<u>44 9</u>

Of the above, £8 9m (2006 £3 2m) has been charged to capital

**(c) Average monthly number of employees during the year (including directors)**

	2007	2006
	Number	Number
Regulated gas distribution activities	1,281	1,149
Other activities	2	2
	<u>1,283</u>	<u>1,151</u>

The comparative staff numbers above are the weighted average staff numbers for Wales & West Utilities Limited for the eleven month period post Wales & West Utilities Ltd acquiring the Wales and South West gas distribution network business from Transco plc



**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**3 Interest**

**(a) Interest receivable**

	2007	2006
	£m	£m
On interest rate swaps	8.6	5.6
Other interest receivable	0.7	0.6
	<u>9.3</u>	<u>6.2</u>

**(b) Interest payable and similar charges**

	2007	2006
	£m	£m
On external loans	64.3	52.6
On group loans	70.7	51.6
On finance leases	0.1	0.1
On unwinding of discounts on provisions	1.9	-
Other	1.1	1.0
	<u>138.1</u>	<u>105.3</u>

**4 Taxation**

**(a) Analysis of charge/(credit) in the year**

	2007	2006
	£m	£m
<b>The charge/(credit) for taxation is made up as follows:</b>		
<b>Current tax</b>		
UK corporation tax on profits of the year	(16.2)	-
Adjustments in respect of previous periods	(9.3)	-
<b>Total current tax (Note 4(b))</b>	<u>(25.5)</u>	<u>-</u>
<b>Deferred tax</b>		
Origination and reversal of timing differences	-	-
<b>Total deferred tax (Note 16)</b>	<u>-</u>	<u>-</u>
<b>Total tax on profit on ordinary activities</b>	<u>(25.5)</u>	<u>-</u>

The £25.5m reflects amounts due from Group undertakings in respect of group relief surrendered for the two years ended 31 March 2007

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**4 Taxation (continued)**

**(b) Factors affecting the current tax charge /(credit) for the year**

The current tax assessed for the year is different to the standard rate of corporation tax in the UK of 30%  
The differences are explained below

	2007 £m	2006 £m
Loss before tax	(125.4)	(93.5)
Loss multiplied by standard rate of corporation tax in the UK of 30% (2006 30%)	(37.6)	(28.1)
Effects of		
Timing differences between taxable and accounting profit		
Accelerated capital allowances	-	-
Other timing differences	-	-
Tax losses	-	-
Prior year charge/(credit)	(9.3)	-
Permanent differences	4.5	18.8
Losses group relieved for no payment	-	9.3
Deferred tax asset not recognised	17.3	-
FRS17 deferred tax movement not recognised	(0.4)	-
<b>Current tax charge/(credit) for year (Note 4(a))</b>	<b>(25.5)</b>	<b>-</b>

In 2007 the company received payment of £9.3m for group relief surrendered in 2006

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**5 Tangible fixed assets**

	Freehold land and buildings £m	Leasehold land and buildings £m	Gas distribution network assets £m	Vehicles, plant and equipment £m	Assets under construction £m	Total £m
<b>Cost or valuation</b>						
At 1 April 2006	2.7	-	1,275.4	31.9	30.3	1,340.3
Additions	-	-	-	-	52.8	52.8
Disposals	(0.8)	-	-	-	-	(0.8)
Transfers in year	-	1.3	32.0	26.6	(59.9)	-
At 31 March 2007	<b>1.9</b>	<b>1.3</b>	<b>1,307.4</b>	<b>58.5</b>	<b>23.2</b>	<b>1,392.3</b>
<b>Accumulated depreciation</b>						
At 1 April 2006	-	-	47.1	4.5	-	51.6
Charge for the year	-	-	48.5	4.7	-	53.2
At 31 March 2007	-	-	<b>95.6</b>	<b>9.2</b>	-	<b>104.8</b>
<b>Net book value</b>						
At 31 March 2007	<b>1.9</b>	<b>1.3</b>	<b>1,211.8</b>	<b>49.3</b>	<b>23.2</b>	<b>1,287.5</b>
At 31 March 2006	2.7	-	1,228.3	27.4	30.3	1,288.7
<b>Analysis of net book value at 31 March 2007</b>						
Owned	1.9	1.3	1,211.8	48.6	23.2	1,286.8
Held under finance lease	-	-	-	0.7	-	0.7
	<b>1.9</b>	<b>1.3</b>	<b>1,211.8</b>	<b>49.3</b>	<b>23.2</b>	<b>1,287.5</b>

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**6 Fixed asset investments**

	<b>Unlisted investments £m</b>
<b>Cost</b>	
At 31 March 2006 and 2007	<b>0.1</b>
<b>Amounts written off</b>	
At 31 March 2006 and 2007	<b>-</b>
<b>Net book value</b>	
At 31 March 2006 and 2007	<b>0.1</b>

The fixed asset investment represents the Company's shareholding in xoserve Limited. The Company's shareholding represents 10% of the issued share capital of xoserve Limited.

In addition, the company has a non-trading wholly owned subsidiary, Wales & West Utilities Pension Scheme Trustees Ltd which was incorporated on 21 March 2006. The Company owns all of the issued share capital of Wales & West Pension Scheme Trustees Ltd, which comprises 2 shares of £1 each.

**Consolidated financial statements**

The Company has taken the advantage of section 228(1) of the Companies Act 1985 not to produce consolidated financial statements as it is a wholly owned subsidiary of MGN Gas Networks (Senior Finance) Limited.

**7 Stocks and work in progress**

	<b>2007 £m</b>	<b>2006 £m</b>
Raw materials and consumables	<b>2.7</b>	<b>2.8</b>

The replacement cost of stocks is not materially different from their carrying value.

**8 Debtors**

	<b>2007 £m</b>	<b>2006 £m</b>
<b>Amounts falling due within one year:</b>		
Trade debtors	<b>34.2</b>	<b>33.2</b>
Prepayments and accrued income	<b>8.4</b>	<b>3.4</b>
	<b>42.6</b>	<b>36.6</b>

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**9 Creditors**

	Note	2007 £m	2006 £m
<b>(a) Amounts falling due within one year:</b>			
Payments received on account		27.6	27.6
Obligations under finance leases	11	0.5	1.4
Trade creditors		20.0	13.8
Amounts owed to parent undertakings		384.3	367.5
Other taxation and social security		8.7	10.5
Other creditors		1.7	0.5
Capital expenditure contributions		3.0	0.3
Accruals and deferred income		39.0	24.0
Grants received		0.8	0.8
		<u>485.6</u>	<u>446.4</u>
<b>(b) Amounts falling due after more than one year:</b>			
Other loans	10	906.8	864.3
Liability for index linked swap contracts		24.5	9.0
Obligations under finance leases	11	0.2	0.7
Capital expenditure contributions		24.2	13.7
Accruals and deferred income		1.1	-
		<u>956.8</u>	<u>887.7</u>

**10 Other loans**

	2007 £m	2006 £m
Repayable as follows		
Between two and five years	<u>906.8</u>	<u>864.3</u>

The Company's obligations under its loan facility agreements are repayable other than by instalment and are secured by fixed and floating charges over its assets

Floating interest rates on these loans are hedged by interest rate swaps, which range between 2.98% and 5.35% (2006 2.98% and 5.35%) Variable interest rates on loans varied between 0.4% and 1.0% above LIBOR (2006 0.4% to 1.0% above LIBOR)

**11 Finance leases**

	2007 £m	2006 £m
Amounts due under finance leases are payable as follows		
Within one year	0.5	1.4
Between one and two years	0.2	0.7
	<u>0.7</u>	<u>2.1</u>

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**12 Gross borrowings**

	2007 £m	2006 £m
Finance leases	0.7	2.1
Gross value of other loans	918.0	879.0
	<u>918.7</u>	<u>881.1</u>

The maturity profile of the group's gross borrowings, excluding bank overdrafts, but including finance leases, was as follows

	2007 £m	2006 £m
In one year or less, or on demand	0.5	1.4
In more than one year but not more than two years	0.2	0.7
In more than two years but not more than five years	918.0	879.0
	<u>918.7</u>	<u>881.1</u>

The difference between gross borrowings as disclosed above and net borrowings as disclosed in notes 10 and 11 reflect the unamortised element of the debt arrangement fees of £11.2m (2006 £14.7m)

**13 Financial instruments and risk management**

**(a) Interest rate swaps**

The Company has entered into interest rate swap arrangements in order to manage the interest rate exposure of the Company and not for trading or speculative purposes

The Company's outstanding interest rate swap arrangement had a notional principal balance of £964m (2006 £964m), with a termination date of 31 May 2013 (2006 31 March 2013), with interest rates ranging between 2.98% and 5.35% (2006 2.98% to 5.35%)

**(b) Interest rate composition of gross borrowings**

After taking account of the interest rate swaps entered into by the Company, the fixed and floating interest rate profile of the Company's gross borrowings, including intra-group indebtedness, was

	2007 £m	2006 £m
Fixed rate	1,210.3	1,216.2
Floating rate	39.0	-
<b>Total</b>	<u>1,249.3</u>	<u>1,216.2</u>

**(c) Interest rate profile of fixed rate borrowings**

After taking account of the interest rate swaps entered into by the Company, the weighted average interest rate profile of the Company's gross borrowings, including intra-group indebtedness, together with the weighted average period for which the rate is fixed was

Currency	Weighted average interest rate		Weighted average period for which rate is fixed	
	2007 %	2006 %	2007 Years	2006 Years
Sterling	8.77	10.13	3.2	4.2

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**13 Financial instruments and risk management (continued)**

**(d) Maturity profile of financial instruments with no interest paid**

	Weighted average period until maturity			
	2007 £m	2006 £m	2007 Years	2006 Years
Liability for index-linked swap contracts	24.5	9.0	6.1	6.8

**(e) Borrowing facilities**

Undrawn committed borrowing facilities were

	2007 £m	2006 £m
Committed borrowing facilities available	1,152.0	1,152.0
Drawn	(918.0)	(879.0)
<b>Undrawn facilities as at 31 March 2007 expiring after 31 May 2010</b>	<b>234.0</b>	<b>273.0</b>

At the Company's option, £1,055m (2006 £1,055m) of the committed facilities can be extended to 31 May 2015

**(f) Fair values of financial instruments**

In the table below, the fair value of short term borrowings, current asset investments, cash at bank and in hand and bank loans approximates to book values due to the short maturity of these instruments

The fair values of long term instruments have been determined by reference to prices available from the financial markets on which these borrowings are traded. The fair values fundamentally represent the change in anticipated future interest rates, to the dates of maturity of the borrowings, between the date on which those long term borrowings were raised and the year end. This increased liability will only materialise if the Company ceases trading and future anticipated interest rates remain at year end levels.

	Book value £m	Fair value £m
<b>Primary financial instruments held or issued to finance the Company's operations:</b>		
Short term borrowings	0.7	0.7
Long term borrowings	918.0	918.0
Cash at bank and in hand	(26.9)	(26.9)
	<b>891.8</b>	<b>891.8</b>
<b>Derivative financial instruments held to manage the interest rate profile and matched by primary financial instruments:</b>		
Interest rate swaps	40.0	32.4
	<b>931.8</b>	<b>924.2</b>

The fair value of derivative financial instruments matched to primary financial instruments relates to long term borrowings with a book value of £906.8m (2006 £864.3m) which have been included within the primary financial instruments issued to finance the Company's operations at a fair value of £918m (2006 £879m), which is the redemption value of those borrowings. The difference between gross borrowings as disclosed above and net borrowings as disclosed in notes 10 and 11 reflect the unamortised element of the debt arrangement fees of £11.2m (2006 £14.7m).

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 MARCH 2007**

**13 Financial instruments and risk management (continued)**

**(g) Losses on derivative financial instruments**

The fair value of losses on derivative financial instruments is not recognised in the financial statements. These instruments are held to manage the Company's interest rate exposures and the resultant fixed interest charges are made in the accounting periods to which they relate. The table below analyses the composition of the fair value losses (note 13(f)). Of these losses £32.4m (2006 £50.3m) are entirely notional and would only materialise if the Company were to cease trading.

	<b>Total losses £m</b>
At 1 April 2006	(50.3)
Acquired in the year	-
Movement in fair value	17.9
<b>At 31 March 2007</b>	<b>(32.4)</b>
<b>Of which:</b>	
Losses expected to be included in 2007/08	(5.3)
Losses expected to be included in 2008/09 or later years	(27.1)
Losses not expected to be included in 2008/09 or later years	-
	<b>(32.4)</b>

**14 Capital commitments**

	<b>2007 £m</b>	<b>2006 £m</b>
Contracted for but not provided in the financial statements	2.9	4.8

In order to meet regulatory and service standards, the Company has longer term capital expenditure obligations within the regulated gas distribution business, which include investments to meet shortfalls in performance and condition, and to provide for new demands and growth.

The recent regulatory review period ended on 31 March 2007. The regulator, Ofgem, has then opted to introduce a one year regulatory period followed by a five year regulatory period. The determination for the one year regulatory period has been agreed and includes capital and replacement investment of £93.5m (in 2005/6 prices). Currently the determination of investment for the five year regulatory period has not been set.

**15 Leasing commitments**

	<b>Land and buildings</b>		<b>Others</b>	
	<b>2007 £m</b>	<b>2006 £m</b>	<b>2007 £m</b>	<b>2006 £m</b>
At 31 March 2007 there were revenue commitments, in the ordinary course of business in the next year to the payment of rentals on non cancellable operating leases expiring:				
Within one year	-	0.4	0.6	0.1
Between two and five years	0.6	0.4	0.4	0.7
After five years	0.6	0.7	-	-
	<b>1.2</b>	<b>1.5</b>	<b>1.0</b>	<b>0.8</b>



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**16 Provisions for liabilities and charges**

	Note	2007 £m	2006 £m
Insurance provision	(a)	1.6	2.0
Environmental and demolition provisions	(b)	20.4	18.6
Onerous contracts provision	(c)	40.0	45.9
Onerous leases provision	(d)	0.4	0.6
Wayleaves provision	(e)	2.3	2.7
Other provisions	(f)	0.6	0.6
Deferred taxation	(g)	-	-
		<u>65.3</u>	<u>70.4</u>

**(a) Insurance provisions**

	2007 £m	2006 £m
At 1 April	2.0	2.0
Utilised in the year	(0.4)	-
At 31 March	<u>1.6</u>	<u>2.0</u>

The insurance provision is the estimate of liabilities in respect of past events incurred by the business. On the transfer of the business to the Company on 1 May 2005, these liabilities were established at a fair value of £2m. In accordance with insurance industry practice, these estimates were based on experience from previous years and there was, therefore, no identifiable payment date.

**(b) Environmental and demolition provisions**

	2007 £m	2006 £m
At 1 April	18.6	18.6
Unwinding of discount (note 3b)	1.9	-
Utilised in the year	(0.1)	-
At 31 March	<u>20.4</u>	<u>18.6</u>

The environmental provision represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by the Company. The provision has been discounted to its estimated net present value. The anticipated timing of the cashflows for statutory decontamination cannot be predicted with certainty, but it is expected to be incurred over the period 2007 to 2057.

**(c) Onerous contracts provision**

	2007 £m	2006 £m
At 1 April	45.9	50.4
Utilised in the year	(5.9)	(4.5)
At 31 March	<u>40.0</u>	<u>45.9</u>

On acquisition of the Gas Distribution business, the MGN Gas Networks (UK) Limited group acquired an interest rate swap contract from the National Grid group. The contract will be amortised on a straight line basis over the contract life, which ends in 2013.

**(d) Onerous lease provision**

	2007 £m	2006 £m
At 1 April	0.6	-
Charge for the year	-	0.6
Utilised in the year	(0.2)	-
At 31 March	<u>0.4</u>	<u>0.6</u>

The onerous lease provision represents the expected costs incurred in relation to vacant properties owned by the Company. The provision is expected to be utilised in the year ended 31 March 2008.

**NOTES TO THE FINANCIAL STATEMENTS  
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**16 Provisions for liabilities and charges (continued)**

**(e) Wayleaves provisions**

	2007	2006
	£m	£m
At 1 April	2.7	2.7
Utilised in the year	(0.4)	-
At 31 March	2.3	2.7

The wayleaves provision is provided to cover the costs associated with rectifying gas distribution assets which are the subject of ineffective easements or wayleaves. The provision is expected to be utilised over the period until 2020.

**(f) Other provisions**

	2007	2006
	£m	£m
On acquisition of business and at 31 March 2007	0.6	0.6

Other provisions provide for a potential liability in respect of contracts which have repayment clauses in the event that certain future thresholds are achieved. The provision is expected to be utilised over the period until 2016.

**(g) Deferred taxation**

The movement on deferred tax is as follows

	2007	2006
	£m	£m
At start of year	-	-
Profit and loss account	-	-
At end of year	-	-

Deferred tax provided is made up as follows

Accelerated capital allowances	-	-
Other timing differences	-	-
Tax losses carried forward	-	-
	-	-

A deferred tax asset has not been recognised in respect of accelerated capital allowances and total tax losses with a tax value of £30.8m (2006: £10.5m) as there is insufficient evidence that the asset will be recoverable.

**17 Called up share capital**

	2007	2006
	£	£
Authorised		
Ordinary shares of £1 each	30,675,000	30,675,000
Allotted, called up and fully paid		
Ordinary shares of £1 each	30,675,000	30,675,000

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**18 Reserves ~ Profit and loss account**

	£m
At 1 April 2006	(92.4)
Loss retained for the year	(99.9)
Actuarial loss on pension scheme	(20.6)
Movement on deferred tax relating to pension scheme	-
At 31 March 2007	(212.9)
Pension liability recorded in reserves	19.5
Profit and loss reserves excluding pension liability	(193.4)

**19 Net Cash inflow from operating activities**

	2007 £m	2006 £m
<u>Continuing operations</u>		
Operating (loss)/profit	(0.5)	2.8
Depreciation of tangible fixed assets	53.2	51.6
Amortisation of capital contributions	(0.5)	(0.2)
Profit on disposal of fixed assets	(0.3)	-
Net decrease/(increase) in stocks	0.1	(1.8)
Net increase in debtors	(2.5)	(19.1)
Net (decrease)/increase in creditors	10.3	429.5
Difference between pension charge and cash contributions	2.3	1.7
Movements in provisions for liabilities and charges	0.8	0.6
Net cash inflow from operating activities	62.9	465.1

**20 Analysis of changes in financing in the year**

	Share capital		Long term loans & finance lease obligations	
	2007 £m	2006 £m	2007 £m	2006 £m
At 1 April	30.7	-	866.4	-
Finance leases acquired with business	-	-	-	2.2
Long term loans	-	-	39.0	861.1
Long term loan issue costs written back	-	-	3.5	3.2
Finance lease repayments	-	-	(1.4)	(0.1)
Issue of ordinary shares	-	30.7	-	-
At 31 March	30.7	30.7	907.5	866.4

**21 Analysis of changes in cash and cash equivalents in the year**

	2007 £m	2006 £m
At 1 April	29.9	-
Net cash (outflow)/inflow	(3.0)	29.9
At 31 March	26.9	29.9

**NOTES TO THE FINANCIAL STATEMENTS  
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**22 Analysis of cash and cash equivalents**

	2007	2006	2007	2006
			Change in	Change in
	£m	£m	year	year
			£m	£m
Cash at bank and in hand	26.9	29.9	(3.0)	29.9

**23 Reconciliation of net cash flow to increase in net debt**

	2006	2006
	£m	£m
(Decrease)/increase in cash as per cash flow statement	(3.0)	29.9
Increase in loans and finance lease obligations	(39.0)	(861.1)
Amortisation of debt arrangement fees	(3.5)	(3.2)
Finance leases acquired with business	-	(2.2)
Finance lease repayments	1.4	0.1
Increase in net debt	(44.1)	(836.5)
At 1 April	(836.5)	-
At 31 March	(880.6)	(836.5)

**NOTES TO THE FINANCIAL STATEMENTS  
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**24 Acquisition of trade and assets**

On 1 May 2005, Transco plc transferred into the Company the trade, operational assets and liabilities of its gas distribution business relating to Wales and the South West of England area of operation. On the transfer, Wales & West Utilities Limited applied fair values to the assets and liabilities which it acquired as set out below

	Book values prior to acquisition £m	Fixed asset revaluation £m	Environmental provisions £m	Pension provisions £m	Other Revaluations £m	Provisional Fair value to the Company £m
Fixed assets						
Tangible	839.7	434.4	-	-	-	1,274.1
Investments	0.1	-	-	-	-	0.1
Stocks	-	-	-	-	1.0	1.0
Debtors	1.2	-	-	-	-	1.2
Creditors due within one year	(20.3)	-	-	-	(1.3)	(21.6)
Creditors due after more than one year	(3.1)	-	-	-	-	(3.1)
Provisions for liabilities and charges	-	-	(18.6)	(17.5)	(5.3)	(41.4)
<b>Net operating assets acquired</b>	<b>817.6</b>	<b>434.4</b>	<b>(18.6)</b>	<b>(17.5)</b>	<b>(5.6)</b>	<b>1,210.3</b>
Inter-company loan acquired	(1,179.6)	-	-	-	-	(1,179.6)
<b>Net assets acquired</b>	<b>(362.0)</b>	<b>434.4</b>	<b>(18.6)</b>	<b>(17.5)</b>	<b>(5.6)</b>	<b>30.7</b>

**Total  
£m**

**Consideration:**

Shares issue (including costs of acquisition)

**30.7**

**Fair value of net assets acquired:**

Fair value of net assets acquired (as above)

**30.7**

Goodwill

**-**

The fair values attributed to certain assets and liabilities as set out above are final. There was no change to the fair values to those disclosed in the financial statements for the year ended 31 March 2006 and consequential there has been no adjustment to goodwill.

The purchase consideration for the transfer of the business, assets and liabilities from Transco plc amounted to £30.7m and was settled by the Company issuing shares with a nominal value equivalent to £30.7m and through the creation of an inter-company loan.

At deal completion the Company cash settled the estimated inter-company loan, which then amounted to £1,180.3m, with the National Grid group. Subsequent to deal completion, in September 2005, the balance of £15.1m to the agreed inter-company position was cash settled.

**NOTES TO THE FINANCIAL STATEMENTS  
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**25 Directors' and officers' loans and transactions**

No loans or credit transactions with any directors, officers or connected persons subsisted during the year or were outstanding at the end of the year

**26 Pension scheme**

The Company operates one pension scheme which has defined contribution and defined benefit sections

**Defined benefit section**

The Company operates a defined benefit pension scheme, the Wales & West Utilities Pension Scheme ("the Scheme") The Scheme funds are administered by trustees and are independent of the Company's finances Contributions are paid to the Scheme in accordance with the Schedule of Contributions agreed between the Trustees and the Company

The full actuarial valuation as at 31 March 2006 is currently in the process of being carried out The calculations carried out to produce draft results of this valuation were updated to the accounting date by an independent qualified actuary in accordance with FRS17 As required by FRS17, the value of the defined benefit liabilities has been measured using the projected unit method

The key FRS17 assumptions used for the Scheme are set out below, along with the fair value of assets, a breakdown of the assets into the main asset classes, the present value of the FRS17 liabilities and the deficit of assets below the FRS17 liabilities (which equals the gross pension liability)

<b>Assumptions</b>	<b>2007</b>	<b>2006</b>
Price inflation	3.1% pa	2.9% pa
Discount rate	5.2% pa	5.0% pa
Pension increases (LPI)	3.1% pa	2.9% pa
Salary growth	4.35% pa	3.9% pa

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 26 years (2006 24 years) Allowance is made for future improvements in life expectancy For example, a male member who is aged 60 in the year 2007 would be expected to live for a further 27 years (2006 26 years)

**Asset distribution and expected return**

	<b>2007</b>		<b>2006</b>		<b>1 May 2005</b>	
	<b>Expected return % pa</b>	<b>Fair value £m</b>	<b>Expected return % pa</b>	<b>Fair value £m</b>	<b>Expected return % pa</b>	<b>Fair value £m</b>
Equities	8.8	144.3	8.4	133.8	8.5	127.9
Bonds & cash	4.5	23.7	4.2	17.3	n/a	-
Property	6.5	15.8	6.3	13.7	n/a	-
<b>Total</b>		<b>183.8</b>		<b>164.8</b>		<b>127.9</b>

**NOTES TO THE FINANCIAL STATEMENTS  
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**26 Pension scheme (continued)**

**Balance sheet**

	<b>2007</b>	<b>2006</b>	<b>1 May 2005</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Total fair value of assets	183.8	164.8	127.9
FRS17 value of liabilities	(218.1)	(180.1)	(145.4)
Gross pension liability	(34.3)	(15.3)	(17.5)

The scheme is represented on the balance sheet at 31 March 2007 as a liability under FRS17 which amounts to £34.3m (2006 £15.3m)

Over the year to 31 March 2007, contributions by the Company of £5.4m (2006 £4.7m) were made in respect of members of the defined benefit section. In addition, £0.7m (2006 £0.2m) has been set aside by the Company outside of the Scheme during the year in order to meet the Scheme's expenses. The Company paid a further £0.1m (2006 £nil) in respect of lump sum death in service benefits for defined benefit members during the year. This represents total contributions of £7.1m (2006 £5.6m), after allowing for members contributions of £0.9m (2006 £0.7m).

The employer is currently paying contributions to the defined benefit section at the rate of 20.7% of pensionable salaries, plus allowance for expenses, but this contribution rate is currently under review in the light of the preliminary results of the formal actuarial valuation which is being carried out as at 31 March 2006.

The post retirement deficit under FRS17 moved over the year as follows

	<b>2007</b>	<b>2006</b>
	<b>£m</b>	<b>£m</b>
Post retirement deficit at 1 April (on acquisition)	(15.3)	(17.5)
Current service cost (employee and employer)	(9.4)	(7.3)
Contributions (employee and employer)	7.1	5.6
Other net finance income	3.9	2.8
Actuarial (loss)/gain	(20.6)	1.1
Post retirement deficit at end of year	(34.3)	(15.3)

The following amounts have been included within operating profit under FRS17 for the defined benefit section

	<b>2007</b>	<b>2006</b>
	<b>£m</b>	<b>£m</b>
Current service cost (employer's part only)	8.5	6.6
Past service cost	-	-
Total operating charge	8.5	6.6

**NOTES TO THE FINANCIAL STATEMENTS  
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**26 Pension scheme (continued)**

The following amounts have been included as net finance income under FRS17

	2007 £m	2006 £m
Expected return on pension scheme assets	13.1	10.2
Interest on post retirement liabilities	(9.2)	(7.4)
Net return to credit/(charge) to finance income	3.9	2.8

The scheme is now closed to new entrants and, under the method used to calculate pension costs in accordance with FRS17, the cost as a percentage of covered pensionable payroll will tend to increase as the average age of the membership increases

The following amounts have been recognised within the statement of total recognised gains and losses ("STRGL") under FRS17

	Note	2007 £m	2006 £m
Actual return less expected return on scheme assets	(a)	-	21.9
Experience gains and (losses) arising on scheme's liabilities	(b)	(2.1)	-
Gain or (loss) due to changes in assumptions underlying the FRS17 value of scheme liabilities		(18.5)	(20.8)
Actuarial gain/(loss) recognised in the STRGL	(c)	(20.6)	1.1

The history of experience gains and losses is

Note		2007	2006
(a)	Actual return less expected return on scheme assets	-	£21.9m
	Percentage of scheme's assets	0%	13%
(b)	Experience gains and (losses) arising on scheme's liabilities	£(2.1)m	-
	Percentage of the FRS17 value of the scheme's liabilities	(1)%	-
(c)	Total amount recognised in the STRGL	£(20.6)m	£1.1m
	Percentage of the FRS17 value of the scheme's liabilities	9%	1%

**Defined contribution scheme**

The Company also operates a defined contribution scheme for staff

The employer paid a further £0.8m (2006 £0.3m) during the accounting period in respect of defined contribution members



**NOTES TO THE FINANCIAL STATEMENTS  
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**27 Parent company**

The immediate parent company is MGN Gas Networks (Senior Finance) Ltd and the ultimate parent company is MGN Gas Networks (UK) Ltd. Copies of the annual accounts of MGN Gas Network (UK) Ltd may be obtained from The Company Secretary, MGN Gas Networks (UK) Ltd, Wales & West House, Spooner Close, Celtic Springs, Coedkernew, Newport, NP10 8FZ.

**28 Related party transactions**

**(a) Gas purchases**

Under its licence condition, the Company is required to purchase gas to cover certain "own use" activities including own consumption in operating the gas distribution network and shrinkage due to estimated losses from the network.

The Company has contracted with Macquarie Bank Limited ("MBL") to purchase the gas it requires to fulfil these commitments. The contract was awarded to MBL after it won a competitive tender process. These transactions are carried out on an arms length basis and the prices charged are compared to available quoted gas purchases prices to ensure they are competitive. The cost of purchasing this gas amounted to £7.1m (2006 £11.0m) in respect of the year.

**(b) xoserve Limited**

The Company owns 10% (2006 10%) of the issued share capital of xoserve Limited ("xoserve"). xoserve is owned jointly by the UK Gas Distribution companies and National Grid group as owner of the gas transmission business in the UK.

xoserve provides gas throughput (meter reading) and billing information to the Company which is used by the Company in setting its regulated gas distribution charges to gas transporters. The cost to the Company of xoserve providing these services was £3.3m (2006 £2.9m) in respect of the year, of which £0.1m (2006 £nil) was charged to capital.

**(c) Hedging Transactions**

As discussed in Note 13 (a), the Company's outstanding interest rate swap arrangement had a notional principal balance of £964m (2006 £964m), with a termination date of 31 May 2013 (2006 31 March 2013), with interest rates ranging between 2.98% and 5.35% (2006 2.98% to 5.35%).

The swap arrangements are split equally between four counterparty banks, one of which is Macquarie Bank Limited ("MBL"). Consequently, there were £241m of outstanding swap transactions with MBL at 31 March 2007 (2006 £241m). The swap arrangements are on an arms length basis and at the same commercial terms as with the other three counterparty banks.