Transco plc
Annual Report and Accounts 2003/04

Transco

Contents

Chairman's Statement

Operating and financial performance

The Group's financial performance for the year ended 31 March 2004 was particularly strong, with adjusted operating profit* rising by £188 million to £1,124 million. This was mainly due to a £175 million increase in UK gas distribution adjusted operating profit, where controllable costs were £103 million lower than in the previous year and 7% lower than the target set by Ofgem under the current price control.

Replacement expenditure on the UK gas distribution network was £388 million in the year and we earned an estimated £10 million of additional profit during the second year of operation of the incentive mechanism for mains replacement. With approximately 1,600 miles of iron mains decommissioned, we achieved our target for 2003/04, making our network safer.

Our safety performance has continued to improve through the implementation of best practice, resulting in a 22% reduction in lost time injuries in UK gas distribution and a 69% reduction in UK gas transmission. In addition, we once again exceeded all our safety related standards of service.

Security of supply

The UK is entering a period of changing supply patterns for gas. With decreasing UK continental shelf gas reserves, the UK will become a net importer of gas and we have seen increasing activity in providing the necessary import capability. This includes new liquefied natural gas importation facilities, such as the one on the Isle of Grain which National Grid Transco is developing, which will come on-stream in 2005. We continue to see a trend towards greater use of gas in power generation as the UK moves towards a low carbon economy.

Regulation and strategic developments

With effect from 1 April 2004 Transco's distribution price control formula was split into eight separate price controls: one for each our regional networks. Ofgem also recently announced plans to extend these new price control formulae by an additional year so that the next price control will now start in April 2008.

Our plans for the possible sale of up to four of our regional distribution networks have progressed steadily over the past year. Although we may sell up to four networks, if this maximises shareholder value, we remain committed to a substantial gas distribution business in Britain and we will continue to be the largest operator of gas distribution assets in the country. We expect to announce the results of this process this summer with any sales due for completion in early 2005.

We have begun our 'Way Ahead' restructuring programme in the networks that we will retain. This involves a move to a more centralised structure that will enable us to place increased emphasis on safety and efficiency, and the deployment of best practice across the organisation, and facilitates our aim to be the best in the world at balancing cost, performance and risk. Any network that is currently part of the sale process, but is not subsequently sold, will be incorporated into the Way Ahead programme later this year. This will enable us to deliver major reductions in controllable operating expenditure.

Outlook

Transco's overriding priority remains to deliver its regulatory contract whilst maintaining the drive for continuous improvement for safety, reliability and service standards, thereby securing a fair return for shareholders on Transco's increasing regulatory value. We have made excellent progress in the second year of the regulatory contract, delivered by the initial restructuring undertaken in 2002, coupled with savings from the Merger and our continued investment in technology.

Roger Urwin Chairman

* Excludes impact of exceptional items.

Directors' Report and Operating and Financial Review

Operating Review

Introduction

Overview of Transco

Transco is a part of National Grid Transco, an international energy delivery business.

Transco owns, operates and develops Britain's natural gas transmission and distribution systems, which deliver gas to around 21 million consumers.

Our business operations are divided into three segments:

- UK gas distribution, which comprises Transco's local transmission and distribution pipeline business in Britain and is organised into eight regional networks;
- UK gas transmission, which operates the national transmission system (NTS) and which is managed jointly with National Grid Transco's electricity transmission activities; and
- other activities, which mainly comprises Transco's regulated gas metering activities.

This operating review focuses on the performance of individual business segments, including a consideration of the business environment within which each of our businesses operates, the operational performance of that business and the financial performance of each business segment. In the opinion of management, it is appropriate to consider the financial performance of each business segment in the context of its operational performance and related business issues for the period concerned.

The financial review beginning on page 7 primarily focuses on the financial impact of matters that do not arise from operating performance or are better discussed in the wider Group context and is not intended to be duplicative of the operating review. Consequently, it focuses on items in our Group accounts which we believe are the most material, such as interest, taxation, exceptional items and Group cash flows.

The operating review and the financial review should be read together to obtain a complete understanding of our results of operations and financial condition during the years under review.

Adjusted profit measures

Management use 'adjusted' profit measures in considering the performance of the Group's operating segments and businesses. References to 'adjusted operating profit', 'adjusted profit before taxation' and 'adjusted earnings' are stated before exceptional items.

The Directors believe that the use of these adjusted measures better indicates the underlying business performance of the Group than the unadjusted measures because the exclusion of these exceptional items provides a clearer comparison of results from year to year. This is because this method of presentation removes the distorting impact of these items in order to enhance comparability with the reporting practices of other UK companies.

Exceptional items, which are not included in the adjusted measures referred to above, are defined as material items that derive from events that fall within the ordinary activities of the Group, but that require separate disclosure on the grounds of size or incidence for the accounts to give a true and fair view. Such exceptional items include, for example, material restructuring costs. Page 7 contains a discussion of the nature of these exceptional items.

History and development of the business

In October 2002, National Grid Group plc merged with Lattice Group plc and was renamed National Grid Transco plc. Lattice was one of the three successor companies to what was formerly British Gas plc. Its principal business was Transco, the owner and operator of the substantial majority of Britain's gas transportation system.

The UK gas industry was nationalised in 1948 and the British Gas Corporation was established in 1973. British Gas was incorporated as a public limited company in April 1986 and the Government sold substantially all of its shareholding in it to the public in December 1986. In 1997, Centrica, which was then primarily a supplier of gas to end users, was demerged from British Gas which was renamed BG. BG retained the gas transportation and storage businesses, the majority of the exploration and production as well as the international downstream and a number of smaller businesses. In December 1999, BG completed a financial and restructuring programme which resulted in the creation of a new parent company, BG Group, and involved separating its UK regulated business, Transco, from its other businesses. This created a 'ring-fence' around Transco designed to ensure its financial, organisational and managerial independence. In October 2000, Lattice was demerged from BG Group and comprised Transco, together with start-up telecommunications and non-regulated infrastructure services businesses.

Regulatory environment

Transco's businesses are regulated by the Office of Gas and Electricity Markets (Ofgem). Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority (GEMA), which makes all major decisions and sets policy priorities for Ofgem.

Transco is the holder of a gas transporter licence for Britain in respect of its gas transmission, distribution and metering businesses. The regulatory framework is set out in this licence. Transco is subject to two price controls for transmission activities that both run to 31 March 2007. The Transmission Owner price control covers assets and related expenditure. The System Operator price control covers the operation of the transmission system, including balancing of the transmission system and constraint management; providing incentives to promote efficiency. The actual balancing costs derive from services and actions set out in the Network Code, a legal document that defines the obligations, responsibilities and roles of the industry participants. Distribution activities are also covered by price control regulation. From 1 April 2004, each of Transco's eight regional networks became subject to separate price controls covering their activities. Although the separate price control formulae were due to run to 31 March 2007, Ofgem has recently announced its intention to extend them by an additional year. The form of the price controls is discussed in more detail on pages 3, 4 and 5. The annual transportation charging statement sets out the transportation charges for market participants for both transmission and distribution. Ofgem approves the methodology used to determine transportation charges.

Over the last year and as part of its consultations concerning Network Monopoly Price Controls and the electricity distribution price review, Ofgem has proposed changes to the regulatory framework that applies to all energy network monopolies, including Transco. Proposed developments include the introduction of a five year retention of benefits from savings in operating costs, capital expenditure efficiencies and asset disposals, irrespective of when they occur during a price control period (currently, the benefits of cost saving initiatives are returned to customers when a price control is reset). In respect of pension costs, Ofgem has indicated that it sees these as a normal operating cost of the business. Furthermore, Ofgem has suggested that, with effect from 1 April 2002, any efficiently incurred over or underfunding of pension schemes as compared to those assumptions made by Ofgem when price controls were set, will ultimately be passed to consumers. It is expected that the details of how this mechanism will work, together with any adjustments that Ofgem may wish to make in respect of historic pensions issues, will be clarified later in 2004.

UK gas distribution

Background information

Our UK gas distribution business comprises almost all of Britain's gas distribution system. The gas distribution system is organised into eight regional networks and consists of approximately 170,000 miles of distribution pipelines and is the largest gas distribution system in Europe. Gas is transported on behalf of approximately 70 active gas shippers from the NTS through the distribution system to around 21 million consumers.

As well as gas transportation, Transco is responsible for the safety, development and maintenance of the transportation system and operates the national gas emergency service.

Regulation

On 1 April 2002, the activities of Transco's distribution business became subject to a separate five-year price control formula ('distribution price control formula'). With effect from 1 April 2004, this single price control formula was disaggregated into eight separate price control formulae ('networks price control formulae') to cover the activities of the eight regional distribution networks.

The new networks price control formulae take the same form as the distribution price control formula, with a maximum allowed revenue assigned to each network. Each formula retains the 65% fixed, 35% variable revenue associated with transportation volume changes, a mains replacement incentive mechanism and the pass through of prescribed rates and gas transporter licence fees.

Each network has been allocated a regulatory value associated with its distribution assets, using an estimate of Transco's distribution business regulatory value as at 1 April 2002. The allocation was done in a manner to minimise unnecessary regional differentials in transportation charges. The networks price control formulae also incorporate the same cost of capital assumptions at a real pre-tax rate of 6.25%.

To set the new networks price control formulae it was also necessary to allocate allowances for operating costs, capital expenditure, replacement expenditure, regulatory depreciation and transportation volumes. Projected replacement expenditure continues to be divided 50:50 between regulatory capital and regulatory operating expenditure, thereby ensuring that the cost of the iron mains replacement programme does not fall wholly on today's customers, but is shared with future customers. The regulatory treatment of replacement expenditure contrasts with the accounting treatment where all such costs are expensed (see critical accounting policies – replacement expenditure on page 10).

Each network is subject to its own mains replacement incentive mechanism and retains 33% of any outperformance against Ofgem's annual cost targets as additional profit, or alternatively, bears 50% of any overspend if it under-performs.

In 2003/04, operating under the distribution price control formula, Transco made an estimated £10 million of additional profit from this mechanism.

Financial performance

UK gas distribution turnover for the year ended 31 March 2004 was £2,245 million, compared with £2,089 million in 2002/03.

Principal factors behind the £156 million increase in turnover comparing 2003/04 to 2002/03 were:

- an increase in revenue recovered under the distribution price control formula of £84 million, primarily because of a 5% price increase implemented in October 2003 which added £79 million, combined with an increase in underlying volumes which added £21 million, but offset by an £11 million reduction because of relatively mild weather; and
- a £72 million increase in other, relatively low margin income, primarily because of increased work for National Grid Transco's other businesses, such as increased workload undertaken by Transco's emergency service on behalf of National Grid Transco's regulated and non-regulated metering businesses.

UK gas distribution adjusted operating profit for the year ended 31 March 2004 was £729 million, compared with £554 million in 2002/03.

UK gas distribution operating profit for the year ended 31 March 2004 was £653 million, compared with £443 million in 2002/03.

Exceptional charges which explain the difference between adjusted operating profit and operating profit are discussed in the context of all exceptional items of the Group on page 7.

The £175 million increase in adjusted operating profit comparing 2003/04 to 2002/03 was mainly a result of an £84 million increase in formula income, a £103 million reduction in controllable operating costs and a £17 million reduction in replacement expenditure. This was offset by a net increase in depreciation and amortisation of capital contributions of £11 million and a £23 million charge for UK gas distribution's share of the Lattice pensions deficit.

UK gas distribution's replacement expenditure (repex) for the year ended 31 March 2004 was £388 million compared with £405 million in 2002/03. The £17 million reduction comparing 2003/04 to 2002/03 was associated with the start of the iron mains replacement programme with 2003/04 representing the lowest year of expenditure planned until 2007.

UK gas distribution's controllable costs in 2003/04 were £103 million lower than 2002/03 and 7% lower than the 2003/04 allowance projected by Ofgem as part of the five-year distribution price control formula which commenced in April 2002. The reduction was a direct result of the implementation of restructuring plans announced in September 2002, coupled with continued investment in technology, and the centralisation of activities, aided by synergies from the Merger of National Grid and Lattice.

Operating performance

Gas throughput was 706 TWh in 2003/04 compared to 708 TWh in 2002/03. If the weather had corresponded to seasonal normal temperatures, it is estimated that gas throughput would have been 731 TWh in 2003/04 compared to 730 TWh in 2002/03.

While there has been underlying growth of 1.9% in demand from small users (2002/03 2.0% demand growth), 2003/04 saw a 3.5% reduction in underlying demand from business and other large users (2002/03 1.6% reduction). This is attributed to higher gas prices, power stations being off-line and recession in a number of manufacturing sectors.

Standards of service
Over the past few months we have been working with Ofgem and the wider industry to implement plans to improve the standards of service provided by Transco in relation to its connections activities. While Ofgem has recognised that the performance of the connection service provided by Transco has improved, in May 2004 it confirmed a financial penalty of £1 million in relation to earlier performance problems. It was also made clear that we were not found to be in breach of any safety regulations. The problems we have had with our connections operations has adversely impacted our overall standards of service performance and as a result there is some room for improvement. Despite this, we have once again exceeded our safety related standards of service targets with more than 98% of 'uncontrolled' gas escapes (where the gas leak cannot be controlled by turning the gas supply off at the meter) attended within one hour, and more than 99% of 'controlled' gas escapes (where the gas leak can be controlled at the meter) attended within two hours.

Investment in the network
Capital expenditure on the reinforcement and extension of the gas distribution network was £293 million in 2003/04 compared with £380 million in 2002/03. The reduction in capital expenditure comparing 2003/04 to 2002/03 was principally due to the fact that investment in the high pressure pipelines in the distribution networks incorporates a number of very large projects and is dependent on forecasts of future demand. The profile of expenditure over time is stepped with the commencement and completion of projects to expand the network. As a result of the completion of projects commenced mainly in 2001/02, expenditure fell by £87 million in 2003/04 compared to 2002/03.

During the year ended 31 March 2004, Transco made over 100,000 new connections to its network. The total number of new connections to Britain's network, taking into account other connections made by third parties, is estimated to be in excess of 200,000.

Network sales
Plans for the possible sale of up to four of Transco's eight distribution networks, announced May 2003, have progressed steadily over the past year. A large number of indicative bids for the five networks potentially identified for sale (Scotland, North of England, North West, Wales and West and South of England) have been received and discussions have continued with a number of parties. It is expected that the results of the sales process will be announced this summer with any sales due for completion in early 2005.

National Grid Transco has been discussing its plans with Ofgem and the wider industry through industry workstreams. In April 2004, Ofgem gave approval for the next phase of work to consider the implications of the proposed network sales on the basis that it is in consumers' interests. Completion of this phase of work is expected by the end of July and Ofgem's final consent to specific sales is expected in the second half of 2004.

The HSE has been kept appraised of all developments, and will need to approve new safety cases and any changes proposed by National Grid Transco before the sales can complete. The 0800 111 999 national gas emergency service number will remain the same and will continue to be managed by National Grid Transco. The emergency engineers that are currently dispatched to attend public reported gas escapes and gas emergencies within each network will be included as part of any network sale.

Although we may sell up to four networks, if this maximises shareholder value, we remain committed to a substantial gas distribution business in Britain and we will continue to be the largest operator of gas distribution assets in the country.

The 'Way Ahead' for our retained distribution networks
We have begun our 'Way Ahead' restructuring programme in the networks that we will retain. This involves a move to a more centralised structure that will enable us to place increased emphasis on safety and efficiency, the deployment of best practice across the organisation, and facilitate our aim to be the best in the world at balancing cost, performance and risk. Any network that is currently part of the sale process, but which is not subsequently sold, will be incorporated into the Way Ahead programme later this year. This will enable us to deliver major reductions in controllable operating expenditure.

UK gas transmission

Background information
Through the UK gas transmission business, we own and operate the NTS comprising approximately 4,200 miles of high pressure pipeline, and 24 compressor stations, connecting to Transco's eight distribution networks and third party independent systems for onward transportation of gas to consumers. Day-to-day operation of the NTS includes balancing supply with demand, maintaining satisfactory system pressures and ensuring gas quality standards are met.

The UK gas transmission business comprises two separately regulated activities: Transmission Owner and System Operator.

The Transmission Owner (TO) activity owns and maintains the physical assets, develops the system to accommodate growth and changes in gas loads and manages a programme of investment to ensure the long-term reliability of the system.

The System Operator (SO) undertakes a range of activities necessary for the successful delivery in real time of secure, reliable and efficient energy and the balancing of supply and demand.

Regulation
The UK gas transmission business is undertaken under the terms of Transco's gas transporter licence and is subject to separate price controls in respect of its Transmission Owner and System Operator activities which will both last until March 2007.

Under the terms of the gas transporter licence, Transco receives income through charges to shippers for entry and exit capacity (Transmission Owner activity) and commodity charges (System Operator activity). The system entry capacity charges are set via auctions. The exit capacity charges and the entry capacity auction proceeds together recover the allowed revenue under the Transmission Owner price control in respect of the provision of the transmission assets.

Transmission Owner
The Transmission Owner price control takes into account, among other factors, operating expenditure, capital expenditure and cost of capital, which for the current price control is set at a real pre-tax rate of 6.25%. In addition, cost

pass-through is provided in respect of prescribed rates and Ofgem's licence fees attributable to the gas transmission activity.

System Operator
The System Operator price control includes incentive arrangements such that if performance exceeds the targets set in the price control, Transco retains a share of the benefits, and vice versa. The incentives cover the costs of investment for additional capacity, managing capacity constraints, the costs of purchasing shrinkage gas (gas that is either used in operating the system or lost from the system during transportation) and other System Operator costs.

Further detailed arrangements for the industry are provided through the Network Code. Under the Network Code, our UK Transmission business undertakes the role of 'Top-up' manager. This requires the setting, monitoring and then the preservation of storage levels to protect gas stocks under prolonged and severe winter conditions. Under severe winter conditions this may entail the purchase of gas from the open market to maintain the prescribed levels of gas storage stocks. Where there is a shortage of gas available to the market this may lead the business to incur significant costs.

Our gas transporter licence has an Income Adjusting Event provision that currently allows changes to our income to allow the recovery of significant increases in efficiently incurred costs.

Financial performance
UK gas transmission turnover for the year ended 31 March 2004 was £560 million, compared with £552 million in 2002/03.

UK gas transmission adjusted operating profit for 2003/04 was £283 million, compared with £269 million in 2002/03.

The £14 million increase in adjusted operating profit in 2003/04 was mainly a result of the following:

- a £9 million one-off benefit to shrinkage costs; and
- a 9% reduction in TO controllable costs.

Operating performance
The winter of 2003/04 saw a maximum demand for gas of 440 mcm on 28 January 2004. This compared with the record peak on 7 January 2003 of 450 mcm.

Investment in the network
Capital investment on the reinforcement and extension of the NTS in 2003/04 was £159 million, compared with £177 million in 2002/03.

Other businesses

Financial performance
The adjusted operating profit for the year ended 31 March 2004 was £112 million, compared with £113 million in 2002/03.

Metering
Our UK Metering business owns and operates Transco's 21 million gas meters, providing installation and maintenance services to gas shippers. It also provides meter reading services to Transco's UK gas distribution business and to some gas shippers.

During 2003/04 we have continued to focus on the challenges and opportunities of competition, which Ofgem is introducing in the UK metering market. The priority of the metering business continues to be the provision of services for our currently installed base of gas meters. In the last quarter of 2003/04, we successfully secured long-term usage contracts, including a new pricing structure, with gas suppliers, covering substantially all of our meters, to secure a long-term revenue stream for current, new and replacement meters.

Directors' Report and Operating and Financial Review

Board of Directors

Roger Urwin (58)
Chairman
Appointed a Director of the Company in October 2002 and is also Group Chief Executive of National Grid Transco. He was previously Chief Executive of London Electricity plc and prior to this he held a number of appointments within the Central Electricity Generating Board before joining the Midlands Electricity Board as Director of Engineering. He is a Non-executive Director of The Special Utilities Investment Trust PLC and is a Fellow of the Royal Academy of Engineering.

Steve Holliday (47)
Chief Executive
Appointed a Director of the Company in October 2002 and Chief Executive in April 2003. He is also Executive Director of National Grid Transco responsible for UK Gas Distribution and Business Services. He was formerly an Executive Director of British Borneo Oil and Gas. Previously, he spent 19 years with the Exxon group, where he held senior positions in the international gas business and operational areas such as refining and shipping. His international experience includes a four-year spell in the US. He also worked developing business opportunities in countries as diverse as China, Australia, Japan, Brazil and the former Soviet Union.

Mark Fairbairn (45)
Chief Operating Officer
Appointed a Director of the Company in June 2003. He joined National Grid in 1989 from BNFL. Within National Grid he held a variety of roles in Asset Management, Systems Operation and, most recently, as Director of Engineering Services. He was instrumental in achieving significant improvements on Safety and Environmental issues within National Grid and was awarded the OBE in 2002 for his services to the Electrical industry in respect of his leadership of the fundamental changes implemented for the introduction of the New Electricity Trading Arrangements (NETA).

Colin Buck (54)
Finance Director
Appointed a Director of Transco in October 2002 and is responsible for all financial aspects and Corporate Governance issues within Transco. He joined National Grid in 1990 and held a number of posts in finance. He was appointed Finance Director of National Grid Company plc in January 2001 before moving to his current position.

Steve Lucas (50)
Executive Director
Appointed a Director of the Company in December 1999 and is also Group Finance Director of National Grid Transco. Previously he had been Executive Director, Finance of Lattice Group since its demerger from BG Group in 2000. Prior to this, he was Treasurer of BG Group having joined British Gas plc in 1994. A Chartered Accountant, he worked in private practice in the City of London until 1983. He then joined Shell International petroleum Company, occupying a number of finance management roles, including seven years in Africa and the Far East.

Jim O'Sullivan (44)
Engineering and Safety Director
Appointed a Director of the Company in October 2002 he has over 15 years experience in safety sensitive roles in the aviation industry with particular knowledge of engineering governance, design processes, project control and quality assurance. He joined Transco in September 2002 from British Airways where his latter roles included Technical and Quality Director, Maintenance and Engineering Manager for Concorde and leading the Boeing 777 project in the USA.

Nick Winser (43)
Executive Director
Appointed a Director of the Company in July 2003. He is also Executive Director of National Grid Transco responsible for UK and US Transmission operations. He was previously Chief Operating Officer of US Transmission for National Grid Transco. He joined National Grid Company in 1993, becoming Director of Engineering in 2001. Prior to this he had been with PowerGen since 1991 as principal negotiator on commercial matters having joined the Central Electricity Generating Board in 1983 where he served in a variety of technical engineering roles.

During the period under review the following resigned as Directors of the Company: Rob Verrion (on 1 June 2003) and Tony Wray (on 6 June 2003).

Alison Kay
Company Secretary
Alison Kay was appointed Company Secretary on 21 October 2002. She is also Company Secretary of National Grid Company plc.

Directors' Report and Operating and Financial Review

Financial Review

Segmental reporting
The presentation of segment information is based on the management responsibilities that existed at 31 March 2004. Minor changes to the definition of segments have been made during 2003/04, the principal effect of which was to reclassify the results of the LNG Storage business from 'UK gas transmission' to 'Other activities'. As a result, comparative figures for 2002/03 have been restated resulting in a reclassification of operating profit from 'UK gas transmission' to 'Other activities' amounting to £5 million.

A review of the operating and financial performance of the reporting segments is contained on pages 3 to 5, together with additional financial and performance information relating to the segments.

The segments at 31 March 2004 comprised UK gas distribution, UK gas transmission and other activities.

12 months ended 31 March 2004 (2003/04) compared with the 12 months ended 31 March 2003 (2002/03)

Group turnover
Group turnover increased by £85 million from £3,037 million in 2002/03 to £3,122 million in 2003/04 due to increased UK gas distribution turnover.

Group total operating profit
Group total operating profit increased by £257 million to £1,047 million, reflecting an increase in adjusted operating profit of £188 million and a reduction in net exceptional charges of £69 million. The primary reason for the increase in adjusted operating profit is a result of the strong performance of UK gas distribution. Pages 3 to 5 contain a commentary that explains this improvement in adjusted operating profit performance and also explains the movements for the other businesses.

Exceptional items
The results for the 12 months ended 31 March 2004 include total net exceptional pre-tax charges of £77 million (£53 million post tax). Pre-tax charges are made up of £77 million of operating exceptional costs and comprise:

- Restructuring costs, principally arising from business related efficiency programmes, amounting to £90 million (£66 million post tax); and
- A release of part of the environmental costs provision of £13 million before taxation (£13 million post tax). Following the completion of an investigative site survey, the estimate of environmental liabilities has been reduced to reflect the best estimate of these liabilities having regard to relevant legislation.

Interest
Net interest fell by £16 million from £322 million in 2002/03 to £306 million in 2003/04. This was mainly due to a £12 million increase in capitalisation of finance costs together with a fall in short-term interest rates and a reduction in the level of net debt.

Taxation
The net tax charge rose from £148 million in 2002/03 to £183 million in 2003/04. The tax charge for 2003/04 of £183 million includes a net credit relating to exceptional items amounting to £24 million. Excluding the exceptional tax items and tax adjustments for prior years from the tax charge, the effective tax rate for the 12 months ended 31 March 2004 based on profit before taxation and exceptional items was 30.3% compared with the standard corporation tax rate in the UK of 30%. The effective tax rate after taking account of exceptional items was 24.7%. Note 8 to the accounts on page 24 shows a reconciliation of the main components giving rise to the difference between the relevant effective rate and the UK standard corporation tax rate.

Retirement arrangements
The substantial majority of Transco's employees are members of the Lattice Group Pension Scheme (the Scheme). The Scheme has a defined benefit section, which is effectively closed to new entrants, and a defined contribution section. There are no current plans to merge the Scheme with that of National Grid.

An actuarial valuation of the Scheme as at 31 March 2003 was carried out. This has revealed that the pre-tax deficit was £879 million (£615 million net of tax) in the defined benefit section on the basis of the funding assumptions adopted by the actuary. It is intended that there will be annual assessments of the Scheme with the first assessment being conducted as at 31 March 2004. This assessment is still in the process of being carried out and therefore the outcome is currently unknown.

It has been agreed that no funding of the deficit identified in the 2003 actuarial valuation will need to be provided to the Scheme until the outcome of the actuarial valuation at 31 March 2007 is known. At that point, the Group will pay a share of the gross amount of any deficit up to a maximum

Summary of results

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Group turnover	**3,122**	3,037
Total operating profit before exceptional items	**1,124**	936
Exceptional operating items	**(77)**	(146)
Total operating profit	**1,047**	790
Exceptional non-operating items	**–**	(13)
Net interest	**(306)**	(322)
Profit before tax	**741**	455
Tax – excluding exceptional items	**(207)**	(189)
Tax – exceptional items	**24**	41
Profit for the financial year	**558**	307

amount of £468 million (£328 million net of tax) into the Scheme. Until the 31 March 2007 valuation is completed, National Grid Transco has arranged for banks to provide the trustees of the Scheme with letters of credit. The main conditions under which these letters of credit could be drawn relate to events which would imperil the interests of the Scheme, such as Transco plc becoming insolvent or the National Grid Transco group failing to make agreed payments into the fund. Cash contributions for the ongoing cost of the Scheme are currently being made at a rate of 22.3% of pensionable payroll.

Pension accounting

The Group continues to account for pensions under UK GAAP in accordance with Statement of Standard Accounting Practice 24 (SSAP 24). Consistent with that statement, the pension costs charged to the Group by Lattice included an amount for amortisation of pension surpluses. During 2002/03, in the light of the performance of the world's stock markets, the Group took the decision to suspend the recognition of any further pension surplus.

During 2003/04, the actuarial funding and SSAP 24 valuations of the Scheme undertaken at 31 March 2003 were completed. The charge for 2003/04 under SSAP 24 in respect of the Scheme amounted to £119 million compared with £72 million for 2002/03. Of this total charge, £65 million relates to the ongoing cost (£79 million 2002/03), £28 million relates to the spreading of the deficit (£8 million credit 2002/03), and £26 million to the net interest charge (£1 million 2002/03). The ongoing SSAP 24 charge represents 22.8% (21.4% excluding administration costs) of pensionable payroll.

The Group does not account for pension costs under Financial Reporting Standard 17 'Retirement benefits' (FRS 17), but has provided the required transitional disclosures as shown in note 6 to the accounts on page 23.

Liquidity resources and capital expenditure

Cash flow

Net cash inflow from operations was £1,487 million in 2003/04, compared with £1,319 million in 2002/03. Included within net cash inflow from operations were exceptional cash outflows of £136 million in 2003/04, compared with £135 million in 2002/03.

Net cash inflow from operations before exceptional items was £1,623 million in 2003/04, compared with £1,454 million in 2002/03. The increased cash flow from operations before exceptional items was mainly due to the increase in adjusted operating profit.

Exceptional cash flows in 2003/04 and 2002/03 relate to cash flows arising from restructuring initiatives, Merger related costs and environmental expenditure.

Net payments of interest totalled £258 million in the 2003/04, compared with £309 million in 2002/03.

Net corporation tax payments amounted to £59 million in 2003/04, compared with £62 million in 2002/03.

Net purchases of tangible fixed assets absorbed cash of £493 million in 2003/04, compared with £605 million in 2002/03. The reduction in net cash outflow in the 12 months ended 31 March 2004 reflects a lower level of investment across all businesses.

Equity shareholders' funds

Equity shareholders' funds increased from £1,649 million at 31 March 2003 to £2,137 million at 31 March 2004. This increase is explained by retained profits for the year amounting to £488 million.

Capital expenditure

Capital expenditure was £535 million in 2003/4, compared with £646 million in 2002/03. The reduction in capital expenditure reflects a lower level of investment across all businesses. An analysis of capital expenditure by segment is contained in note 1 on page 20.

At 31 March 2004, future capital expenditure contracted for but not provided in the accounts amounted to £76 million. It is expected that this capital expenditure commitment will be financed from the Group's operational cash flow and credit facilities as required.

Net debt and gearing

Net debt fell from £5,164 million at 31 March 2003 to £4,866 million at 31 March 2004. Gearing at 31 March 2004, calculated as net debt at that date expressed as a percentage of net debt plus net assets shown by the balance sheet, amounted to 69% down from 76% at the start of the year. By comparison, the gearing ratio adjusted for the inclusion of the businesses at their estimated regulatory values ('adjusted gearing ratio'), amounted to 34% at 31 March 2004 down from 37% at the start of the year.

The Group believes that this adjusted ratio is a more relevant measure of 'gearing' than one based on book values alone, as the book values do not reflect the economic value of the regulated business assets.

A reconciliation of the adjustments necessary to calculate adjusted net assets is shown in the table below:

Adjustments to net assets	**2004 £m**	2003 £m
Net assets per balance sheet	**2,137**	1,649
Adjustment for increase in regulatory values	**7,510**	7,060
Adjusted net assets	**9,647**	8,709

An analysis of debt is provided in note 16 to the accounts on page 27, and a reconciliation of the movement in net debt from 1 April 2003 to 31 March 2004 is provided in note 22(c) to the accounts on page 32.

Cash forecasting

Both short and long-term cash flow forecasts are produced frequently to assist in identifying the liquidity requirements of the Group. These are supplemented by a financial headroom position that is supplied to the Finance Committee of the National Grid Transco Board regularly to demonstrate funding adequacy for at least a 12-month period. The Group also maintains a minimum level of committed facilities in support of that objective.

Credit facilities and unutilised Commercial Paper and Medium Term Note Programmes

The Group has both committed and uncommitted facilities that are available for general corporate purposes.

At 31 March 2004, Transco had a US$1.25 billion Euro Commercial Paper Programme (US$0.90 billion unutilised); a US$2.5 billion US Commercial Paper Programme (unutilised); and Transco plc and Transco Holdings plc had a joint Euro Medium Term Note Programme of €7.0 billion (€2.6 billion unissued).

At 31 March 2004, Transco had £0.76 billion of short-term (364 day) committed facilities (undrawn), £0.58 billion of long term committed facilities (undrawn); and £0.9 billion (undrawn) of uncommitted borrowing facilities.

Treasury policy

The funding and treasury risk management of the Group is carried out on its behalf by a central department operating under policies and guidelines approved by the Board of National Grid Transco. The Finance Committee, a committee of the Board of National Grid Transco, is responsible for regular review and monitoring of treasury activity and for approval of specific transactions, the authority for which may be delegated. The National Grid Transco group has a Treasury function that raises all of the funding for the National Grid Transco group and manages interest rate and foreign exchange rate risk.

There is a separate financing programme for Transco. All significant issues in relation to the funding of Transco are approved by the Finance Committees of both National Grid Transco and Transco.

The Treasury function is not operated as a profit centre. Debt and treasury positions are managed in a non-speculative manner, such that all transactions in financial instruments or products are matched to an underlying current or anticipated business requirement. The use of derivative financial instruments is controlled by policy guidelines set by the Board of National Grid Transco. Derivatives entered into in respect of gas commodities are used in support of the business operational requirements and the policy regarding their use is explained below.

Details of the maturity, currency and interest rate profile of the Group's borrowings as at 31 March 2004 are shown in note 17 to the accounts on pages 28 to 30.

The Group's financial position enables it to borrow on the wholesale capital and money markets and most of its borrowings are through public bonds and commercial paper. These borrowings contain no restrictive covenants.

The Group places surplus funds on the money markets usually in the form of short term fixed deposits which are invested with approved banks and counterparties. Details of the Group's short term investments as at 31 March 2004 are shown in note 17 to the accounts on page 29. Transco plc has a credit rating of A2/A. It is a condition of the regulatory ring-fence around Transco plc that it uses reasonable endeavours to maintain an investment grade credit rating. This rating means that Transco should have ready access to the capital and money markets for future funding when necessary.

The main risks arising from the Group's financing activities are set out below. The Board of National Grid Transco and the Finance Committee of that Board reviews and agrees policies for managing each risk and they are summarised below.

Refinancing risk management

The Board of National Grid Transco mainly controls refinancing risk by limiting the amount of financing obligations (both principal and interest) arising on borrowings in any 12-month and 36-month period. This policy restricts the Group from having an excessively large amount of debt to refinance in a given time-frame. During the year, a mixture of short term debt and long term debt was issued.

Interest rate risk management

The interest rate exposure of the Group arising from its borrowings and deposits is managed by the use of fixed and floating rate debt, interest rate swaps, swaptions and forward rate agreements. The Group's interest rate risk management policy is to seek to minimise total financing costs (ie interest costs and changes in the market value of debt) subject to constraints so that even with large movements in interest rates, neither the interest cost nor the total financing cost can exceed pre-set limits.

The performance of the Treasury function in interest rate risk management is measured by comparing the actual total financing costs of its debt with those of a passively-managed benchmark portfolio.

Foreign exchange risk management

The Group has a policy of hedging certain contractually committed foreign exchange transactions over a prescribed minimum size. It covers 75% of such transactions expected to occur up to six months in advance and 50% of transactions in the 6 to 12 month period in advance. Cover generally takes the form of forward sale or purchase of foreign currencies and must always relate to underlying operational cash flows.

Counterparty risk management

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Finance Committee of the Board of National Grid Transco has agreed a policy for managing such risk, which is controlled through credit limits, approvals and monitoring procedures.

Derivative financial instruments held for purposes other than trading

As part of its business operations, the Group is exposed to risks arising from fluctuations in interest rates and exchange rates. The Group uses off-balance sheet derivative financial instruments (derivatives) to manage exposures of this type and, as such, they are a useful tool in reducing risk. The Group's policy is not to use derivatives for trading purposes. Derivative transactions can, to varying degrees, carry both counterparty and market risk.

The Group enters into interest rate swaps to manage the composition of floating and fixed rate debt, and so hedge the exposure of borrowings to interest rate movements. In addition the Group enters into bought and written option contracts on interest rate swaps. These transactions are known as swaptions. The Group also enters into foreign currency swaps to manage the currency composition of borrowings and so hedge the exposure to exchange rate movements. Certain agreements are combined foreign currency and interest rate swap transactions. Such agreements are known as cross-currency swaps.

The Group enters into forward rate agreements to hedge interest rate risk on short-term debt and money market investments. Forward rate agreements are commitments to fix an interest rate that is to be paid or received on a notional deposit of specified maturity, commencing at a future specified date.

Valuation and sensitivity analysis

The Group calculates the fair value of debt and derivative instruments by discounting all future cash flows by the market yield curve at the balance sheet date. The market yield curve for each currency is obtained from the Reuters or Bloomberg screen notes for interest and foreign exchange rates. In the case of instruments with optionality, the Black's variation of the Black-Scholes model is used to calculate fair value. For debt and derivative instruments held, the Group utilises a sensitivity analysis technique to evaluate the effect that changes in relevant rates or prices will have on the market value of such instruments.

Commodity price hedging
In the normal course of business the Group is party to commodity derivatives. These include gas futures, gas options and gas forwards that are used to manage commodity prices and system capacity associated with its natural gas transportation operations. This includes the buying back of capacity rights already sold in accordance with the Group's UK gas transporter licence and Network Code obligations.

These financial exposures are monitored and managed as an integral part of the Group's financial risk-management policy. At the core of this policy is a condition that the Group will engage in activities at risk only to the extent that those activities fall within commodities and financial markets to which it has a physical market exposure in terms and volumes consistent with its core business. The Group does not issue or intend to hold derivative instruments for trading purposes, and only holds such instruments consistent with its licence and regulatory obligations in the UK.

UK gas transmission is obliged to sell, through a series of auctions (both short and long term), a pre-determined quantity of transmission system entry capacity for every day in the year at pre-defined locations. Where system constraints on a day reduce available capacity to below the level of gas to be flowed, UK gas transmission is required to buy back system entry capacity. Forward and option contracts are used to reduce the risk and exposure to on the day entry capacity prices.

Commitments, contingencies and litigation
The Group's commitments and contingencies outstanding at 31 March are summarised in the table below:

	2004 £m	2003 £m
Future capital expenditure contracted for but not provided	**76**	148
Total operating lease commitments	**149**	174
Third party contingencies	**13**	13
Other commitments and contingencies	**69**	73

It is proposed to meet these commitments from the operating cash flows and from existing credit facilities, as necessary. Details of the nature of the commitments and contingencies, including an analysis of the ageing of commitments, are shown in note 24 to the accounts on page 33.

Pages 7 and 8 give information regarding the Group's obligations in respect of pensions, and other post retirement benefits.

Details of material litigation to which the Group was a party as at 31 March 2004
As a result of a fatal accident at Larkhall, Lanarkshire in December 1999 in which four people died, the Company has been served with proceedings alleging breach of sections 3 and 33 of the Health and Safety at Work Act 1974. The case is currently listed for trial in Edinburgh commencing on 27 September 2004. The maximum penalty for breach of either of the above sections is an unlimited fine.

Critical accounting policies
The Group accounts are prepared in accordance with UK GAAP. The Group's accounting policies are described on pages 15 and 16 of the accounts. Management is required to make estimates and assumptions that may affect the reported amounts of assets, liabilities, revenue, expenses and the disclosure of contingent assets and liabilities in the accounts. The following matters are considered to have a critical impact on the accounting policies adopted by the Group.

Estimated asset economic lives
The adoption of particular asset economic lives in respect of tangible fixed assets can materially affect the reported amounts for depreciation of tangible fixed assets.

The economic lives of tangible fixed assets are disclosed in 'Accounting policies – d) tangible fixed assets and depreciation'. The adoption of particular economic lives involves the exercise of judgement, and can materially impact the profit and loss account. For the year ended 31 March 2004, the Group profit and loss account reflected depreciation of tangible fixed assets amounting to £423 million.

Impairment of fixed assets
Fixed asset investments and tangible fixed assets are reviewed for impairment in accordance with UK GAAP. Future events could cause these assets to be impaired, resulting in an adverse effect on the future results of the Group. Reviews for impairments are carried out under UK GAAP in the event that circumstances or events indicate the carrying value of fixed assets may not be recoverable. Examples of circumstances or events that might indicate that impairment had occurred include: a pattern of losses involving the fixed asset; a decline in the market value for a particular fixed asset; and an adverse change in the business or market in which the fixed asset is involved.

When a review for impairment is carried out under UK GAAP, the carrying value of the asset, or group of assets if it is not reasonably practicable to identify cash flows arising from an individual fixed asset, is compared to the recoverable amount of that asset or group of assets. The recoverable amount is determined as being the higher of the expected net realisable value or the present value of the expected cash flows attributable to that asset or assets. The discount rate used to determine the present value is an estimate of the rate the market would expect on an equally risky investment, and is calculated on a pre-tax basis. Estimates of future cash flows relating to particular assets or groups of assets involve exercising a significant amount of judgement.

Replacement expenditure
This expenditure represents the cost of planned maintenance on mains and services assets, the vast majority relating to the Group's UK gas distribution business. This expenditure is principally undertaken to maintain the safety of the gas network and is written off to the profit and loss account as incurred, because such expenditure does not enhance the economic performance of those assets. If such expenditure in the future were considered to enhance these assets, it would be capitalised and treated as an addition to tangible fixed assets, thereby significantly affecting the reporting of future results.

The total amount charged to the profit and loss account in respect of replacement expenditure during the year ended 31 March 2004 was £388 million. This accounting policy only materially affects the results of the UK gas distribution segment.

Turnover
Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year-end. Changes to the estimate of the transportation services supplied during this period would have an impact on the reported results of the Group.

Turnover in respect of transportation services supplied comprises amounts invoiced to shippers plus an estimate for transportation services supplied but not yet invoiced, which substantially represents the transportation services supplied in respect of the last month of the financial year. The estimated element of turnover is determined as the total of commodity services supplied, calculated from the actual volume of gas transported at estimated weighted average prices, based on recent history and the value of capacity services supplied, which are contracted amounts. This estimate affects the UK gas distribution and UK gas transmission segments.

Under UK GAAP, the Group is not permitted to and has not recognised any liability for amounts received or receivable from customers in excess of the maximum amount allowed for the year under regulatory agreements that will result in an adjustment to future prices.

Pensions
The substantial majority of the Group's employees are members of the Lattice Group Pension Scheme (the Scheme). The Group recognises pension costs in its profit and loss account as they are charged to the Group by Lattice. The charge from Lattice comprises the regular pension cost of the Group's employees and variations from the regular pension cost in respect of the effect of any surplus or deficit attributable to the Group.

A new UK accounting standard (FRS 17) will replace existing GAAP. As the Group's share of the assets and liabilities of the Scheme cannot be reasonably identified, the Scheme will be treated as a defined contributions scheme for the purposes of FRS 17. However, FRS 17 may significantly change the amount of pension costs charged to the Group by Lattice.

Pensions are inherently long term, and future experience may differ from the actuarial assumptions used to determine the net charge for pensions.

Note 6 to the accounts on page 23 describes the principal assumptions that have been used to determine the pension charges in accordance with current UK GAAP. The calculation of any charge relating to pensions is clearly dependent on the assumptions used, which reflects the exercise of judgement. Management exercises that judgement having regard to independent actuarial advice.

Restructuring costs
The application of UK GAAP measurement principles results in the recognition of restructuring costs, mainly redundancy related, when the Group is irrevocably committed to the expenditure, with the main features of any restructuring plan being communicated to affected employees. If material, these costs are recognised as exceptional. Restructuring costs recognised by the Group are referred to in 'Exceptional items'.

Derivative financial instruments
Derivatives are used by the Group to manage its interest rate and foreign currency risks. All such transactions are undertaken to provide a commercial hedge of risks entered into by the Group.

With the exception of indexed linked swap contracts, UK GAAP applies a 'historical cost' and 'hedge accounting' model to these 'derivatives'. Substantially, this model results in gains and losses arising on derivatives being recognised in the profit and loss account or statement of total recognised gains and losses at the same time as the gain or loss on the item being hedged is recognised.

The application of a 'fair value' model would result in derivatives being marked to market. Gains or losses relating to these derivatives may or may not be recognised in the profit and loss account or statement of total recognised gains and losses at the same time as any related gains or losses on underlying economic exposures, depending upon whether the derivatives are deemed to have a hedging relationship.

Note 17 to the accounts on pages 28 to 30 gives a significant amount of detail relating to the Group's financial instruments. This includes the identification of the difference between the 'carrying value' and 'fair value' of the Group's financial instruments, including 'derivatives'.

Environmental liabilities
Provision is made for liabilities arising from statutory decontamination costs of old gas manufacturing sites owned by the Group. The calculation of this provision is based on estimated cash flows relating to those costs discounted at an appropriate discount rate where the impact of discounting is material. The total costs and the timing of cash flows relating to environmental liabilities are based on management estimates, supported by the use of external consultants. There may be variances from these amounts that could materially affect future results.

Related party transactions
The Group provides services to and receives services from its related parties. As a wholly owned subsidiary undertaking of National Grid Transco, which consolidates Transco within its publicly available financial statements, Transco is exempt from disclosing transactions with other members of National Grid Transco group. There were no other material related party transactions.

Changes and developments
Any significant changes and developments that have occurred since 31 March 2004 have been noted in this Annual Report and Accounts. Otherwise, there have been no significant changes or developments since 31 March 2004.

Going concern
Having made enquiries, the Directors consider that the Company and the Group have adequate resources to continue in business for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing the accounts.

Directors' Report and Operating and Financial Review

General Information

Incorporation
Transco plc is incorporated in England and Wales with its registered office at 1-3 Strand London WC2N 5EH (telephone +44 (0) 20 7004 3000).

Material interests
At no time during the year has any Director had any material interest in a contract within the Group, being a contract of any significance in relation to the Group's business.

Substantial shareholders
Transco plc is a wholly owned subsidiary of Transco Holdings plc. The ultimate parent company of Transco is National Grid Transco plc.

Employee policy
The Group is committed to ensuring that the environment within which employees work fosters development and growth, recognises and rewards individual efforts, and enables all employees to reach their full potential.

We have established, through e-mails, intranet, cascade briefings and in-house magazines, effective methods for communicating with employees on matters concerning them. Regular consultation with employees and their trade unions takes place using both formal and informal mechanisms.

We have continued the merger and integration programmes and restructuring of our transmission and distribution businesses. Throughout this process we have consulted with trade union representatives and our employees and aim wherever possible to achieve headcount reductions either through early retirement or voluntary redundancy.

Our family friendly policies aim to open up wider opportunities to working parents and create greater flexibility in the way we operate. Our new performance management frameworks have created greater focus on an individual's contribution to the overall business goals.

We are committed to a culture that encourages the inclusion and diversity of all our employees through respecting and appreciating their differences and supporting all employees in reaching their full potential. To reinforce this commitment, National Grid Transco has set up an Inclusion and Diversity Steering Group, chaired by Steve Holliday, and has established champions across all the businesses to promote and progress work in this area.

Directors' remuneration
Details of Directors' remuneration are shown in note 5, page 22.

Transco does not have a Remuneration Committee, Transco's Directors being remunerated in line with the policy developed by The National Grid Transco Remuneration Committee, details of which may be found in that company's Annual Report and Accounts.

Directors' interests
Roger Urwin, Steve Holliday, Steve Lucas and Nick Winser are also Directors of National Grid Transco plc and details of their interests in the shares of National Grid Transco plc appear in that company's annual report and accounts. Interests of the other directors are set out below.

Directors' beneficial interests

	At 1 April 2003 or on appointment	At 31 March 2004 (ii)
Colin Buck	11,972	13,429
Jim O'Sullivan	–	357
Mark Fairbairn	6,479(i)	9,699

All interests are in shares in National Grid Transco plc, Transco's ultimate parent undertaking.

(i) As at date of appointment.
(ii) Interests include shares acquired pursuant to the National Grid Transco Share Incentive Plan.
(iii) Interests exclude shares acquired pursuant to the National Grid Share Matching Scheme (see below under Directors' interests in share options note (ii)).

Performance Share Plan interests

	Beneficial holding at 1 April 2003 or on appointment	Awarded in year	Beneficial holding at 31 March 2004	Release date
Colin Buck	0	18,507	18,507	June 2007
Jim O'Sullivan	0	20,333	20,333	June 2007
Mark Fairbairn	0(i)	29,611	29,611	June 2007

(i) As at appointment date.
(ii) All interests held in accordance with the National Grid Transco Performance Share Plan details of which are given in the annual report and accounts of that company.

Directors' interests in share options

	Beneficial holding at 1 April 2003 or on appointment	Lapsed	Granted	Exercised	Beneficial holding at 31 March 2004	Weighted average exercise price per share (pence)	Normal exercise period
Colin Buck (ii)	55,702	–	1,200	1,326	55,576	474.53	Jun 2003 – Jun 2012
Jim O'Sullivan	16,358	–	–	–	16,358	425.91	Dec 2005 – Dec 2012
Mark Fairbairn (ii)	101,721(i)	–	–	–	101,721	503.13	Jun 2001 – Jun 2012

All interests are in options over shares in National Grid Transco plc, Transco's ultimate parent undertaking.

(i) As at appointment date.
(ii) In addition to the interests shown above Colin Buck and Mark Fairbairn hold interests in the National Grid Share Matching Scheme as follows:-

	Date of grant	No of shares	Purchase price (pence)	Matching option*
Colin Buck	June 2001	980	579.50	1,634
Colin Buck	June 2002	733	478.25	1,223
Colin Buck	June 2003	1,129	402.75	1,940
Mark Fairbairn	June 2001	1,117	579.50	1,862
Mark Fairbairn	June 2002	1,176	478.25	1,960
Mark Fairbairn	June 2003	1,419	402.75	2,437

* The Matching Option is exercisable at £1.00 per option, between three and ten years from the date of grant.

(iii) Options were given under the Executive Share Option Schemes, Sharesave Schemes and Share Matching Scheme operated by ultimate parent undertaking and details of each scheme are given in the annual report and accounts of that company.

None of the Directors (nor any person connected with them) has a beneficial interest or non-beneficial interest in the share capital of the Company. None of the Directors (nor any person connected with them) holds any interest in any other securities, including options over the Company's shares, of the Company.

Donations

Charitable donations of £560,000 were made in 2003/04. In addition to these contributions, Transco provides financial and in-kind support to many other organisations through its community involvement programme.

No donations were made in the UK and EU for the purposes of the Political Parties, Elections and Referendums Act 2000.

Payment to suppliers

Transco's ultimate parent company, National Grid Transco, is a signatory to the Confederation of British Industry (CBI) Prompt Payment Code and has procedures to ensure the payment of invoices in accordance with contract terms. Copies of the CBI Prompt Payment Code may be obtained from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU.

The average creditor payment period at 31 March 2004 was 32 days.

Research and development

Expenditure on research and development was £4 million in 2003/04 compared with £8 million in 2002/03.

Auditors

PricewaterhouseCoopers LLP have indicated their willingness to be re-appointed auditors of the Group.

Statement of Directors' responsibilities for preparing 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 and of the Group as at the end of the financial year and of the profit or loss of the Group for the financial year.

The Directors consider that in preparing the financial statements detailed in the following sections, the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates and all applicable accounting standards have been followed: Accounting Policies, Accounts, Notes to the Accounts and Operating and Financial Review. The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and of the Group and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and to detect fraud and other irregularities.

The Directors, having prepared the financial statements, have requested the Auditors to take whatever steps and to undertake whatever inspections they consider appropriate for the purposes of enabling them to give their audit report.

Annual General Meeting

The Annual General Meeting will be held at 10am on 19 July 2004 at NGT House, Warwick Technology Park, Gallows Hill, Warwick CV34 6DA.

On behalf of the Board

Alison Kay
Company Secretary
26 May 2004
Registered Office:
1-3 Strand, London WC2N 5EH
Registered in England and Wales No. 2006000

Independent Auditors' Report to the Members of Transco plc

We have audited the financial statements which comprise the Group Profit and Loss Account, the Group and Company Balance Sheet, the Group Cash Flow Statement and the related Notes to the Accounts.

Respective responsibilities of directors and auditors
The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members 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 consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the United Kingdom Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Chairman's Statement, the Directors' Report and the Operating and Financial Review.

Basis of audit opinion
We conducted our audit in accordance with Auditing Standards 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 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.

Audit opinion
In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 March 2004 and the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham 26 May 2004

Accounting Policies

a) Basis of preparation of accounts

The accounts are prepared under the historical cost convention and in accordance with applicable UK accounting and financial reporting standards.

The preparation of accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

b) Basis of consolidation

The Group accounts include the accounts of the Company and all its subsidiary undertakings, ('Group undertakings').

The results of newly acquired Group undertakings are included in the Group accounts from the date the Group acquires control. The results of Group undertakings are included in the Group accounts up to the date that control is relinquished.

Transco plc has been ring-fenced for regulatory purposes. The ring-fence requires Transco to meet a number of regulatory conditions including restrictions on fund raising, business activities, dividend payments and granting of guarantees.

Earnings per share information has not been presented in these accounts as the Company, being an indirectly held wholly owned subsidiary undertaking of National Grid Transco plc, does not have publicly traded equity.

c) Foreign currencies

Assets and liabilities in foreign currencies are generally translated at the rates of exchange ruling at the balance sheet date. In respect of certain assets or liabilities that are matched by an exact and directly related forward exchange derivative, then the relevant asset or liability is translated at the rate of exchange under the related derivative.

d) Tangible fixed assets and depreciation

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

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

Additions represent the purchase or construction of new assets, extensions to, or significant increases in, the capacity of tangible fixed assets.

Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the life of the assets.

No depreciation is provided on freehold land and assets in the course of construction. Other tangible fixed assets are depreciated on a straight-line basis at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful 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, as shown below.

	Years
Freehold and leasehold buildings	up to 50
Plant and machinery:	
Mains and services	55 to 65
Regulating equipment	30 to 50
Gas storage	40
Meters	10 to 15
Motor vehicles and office equipment	3 to 10

e) 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 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 amount that can be generated through the sale of assets. Value in use represents the present value of expected future cash flows 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 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.

f) 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 to 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.

g) Deferred taxation

Deferred taxation is provided in full on all material timing differences, with certain exceptions. No provision for deferred taxation is made for any timing differences on non-monetary assets arising from fair value adjustments, except where there is a binding agreement to sell the assets concerned. However, no provision is made where it is more likely than not that any taxable gain will be rolled over into replacement assets.

Deferred tax balances have not been discounted.

h) Stocks

Stocks are stated at cost less provision for deterioration and obsolescence.

i) Environmental costs

Environmental costs, based on discounted future estimated expenditures expected to be incurred, are provided for in full. The unwinding of the discount is included within the profit and loss account as a financing charge.

j) Turnover

Turnover primarily represents the amounts derived from the 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, excludes inter-business and inter-company transactions, and is stated net of value added tax. Where revenues received or receivable exceed the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, no liability is recognised.

k) Pensions

The substantial majority of the Group's employees are members of the Lattice Group Pension Scheme (the Scheme). The Group recognises pension costs in its profit and loss account as they are charged to the Group by Lattice. The charge from Lattice comprises the regular pension cost of the Group's employees and variations from the regular pension cost in respect of any surplus or deficit attributable to the Group. The interest element of any surplus or deficit attributable to the Group is included within the profit and loss account as a financing charge.

l) Leases

Operating lease payments are charged to the profit and loss account on a straight-line basis over the term of the lease.

m) Financial instruments

Derivative financial instruments ('derivatives') are used by the Group mainly for the management of its interest rate and foreign currency exposures. The principal derivatives used include interest rate swaps, currency swaps, forward foreign currency agreements and interest rate swaptions.

All transactions are undertaken or maintained to provide a commercial hedge of the interest or currency risks associated with the Group'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.

Termination payments made or received in respect of derivatives are spread over the shorter of the life of the original instrument or the life of the underlying exposure in cases where the underlying exposure continues to exist. Where the underlying exposure ceases to exist, any termination payments are taken to the profit and loss account.

Those derivatives, relating both to interest rates and/or currency exchange, that are directly associated with a specific transaction and exactly match the underlying cash flows relating to the transaction are accounted for on the basis of the combined economic result of the transaction including the related derivative.

n) Restructuring costs

Costs arising from the Group's restructuring programmes primarily relate to redundancy costs. Redundancy costs are charged to the profit and loss account in the period in which the Group becomes irrevocably committed to incurring the costs and the main features of the restructuring plan have been announced to affected employees. Redundancy costs are classified as part of other operating charges as these costs do not relate to services provided by the employees for the year.

Group Profit and Loss Account

	Notes	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Group turnover	1(a)	**3,122**	3,037
Operating costs	2	**(2,075)**	(2,247)
Operating profit			
– Before exceptional items	1(b)	**1,124**	936
– Exceptional items	3(a)	**(77)**	(146)
Total operating profit	1(b)	**1,047**	790
Merger costs	3(b)	**–**	(8)
Profit on disposal of fixed asset investments	3(b)	**–**	1
Loss on disposal of tangible fixed assets	3(b)	**–**	(6)
Net interest	7	**(306)**	(322)
Profit on ordinary activities before taxation		**741**	455
Taxation			
– Excluding exceptional items	8	**(207)**	(189)
– Exceptional items	8	**24**	41
Total taxation	8	**(183)**	(148)
Profit for the year		**558**	307
Dividends	9	**(70)**	(244)
Profit transferred to profit and loss account reserve	20	**488**	63

The Group has no recognised gains and losses other than those included in the profit and loss account.

All operations are continuing operations.

Balance Sheets at 31 March

	Notes	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Fixed assets					
Tangible assets	10	**7,876**	7,783	**7,880**	7,785
Investments	11	**–**	–	**16**	16
		7,876	7,783	**7,896**	7,801
Current assets					
Stocks	12	**32**	31	**32**	31
Debtors (amounts falling due within one year)	13	**294**	305	**292**	298
Debtors (amounts falling due after more than one year)	13, 17	**2,544**	2,241	**2,544**	2,241
Current asset investments	17	**75**	7	**264**	206
		2,945	2,584	**3,132**	2,776
Creditors (amounts falling due within one year)					
Borrowings	16, 17	**(1,305)**	(1,089)	**(861)**	(580)
Other creditors	14	**(1,360)**	(1,120)	**(1,801)**	(1,633)
		(2,665)	(2,209)	**(2,662)**	(2,213)
Net current assets		**280**	375	**470**	563
Total assets less current liabilities		**8,156**	8,158	**8,366**	8,364
Creditors (amounts falling due after more than one year)					
Borrowings	16, 17	**(3,636)**	(4,082)	**(2,768)**	(2,838)
Other creditors	15	**(1,027)**	(977)	**(2,111)**	(2,424)
		(4,663)	(5,059)	**(4,879)**	(5,262)
Provisions for liabilities and charges	18	**(1,356)**	(1,450)	**(1,356)**	(1,450)
Net assets employed		**2,137**	1,649	**2,131**	1,652
Capital and reserves					
Called up share capital	19	**45**	45	**45**	45
Share premium account	20	**204**	204	**204**	204
Capital redemption reserve	20	**1,332**	1,332	**1,332**	1,332
Profit and loss account	20	**556**	68	**550**	71
Equity shareholders' funds	21	**2,137**	1,649	**2,131**	1,652

Commitments and contingencies are shown in note 24, page 33.

The accounts on pages 15 to 33 inclusive were approved by the Board on 26 May 2004 and were signed on its behalf by:

Steve Holliday Chief Executive

Colin Buck Finance Director

Group Cash Flow Statement

	Notes	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Net cash inflow from operating activities before exceptional items	22(a)	**1,623**	1,454
Expenditure relating to exceptional items		**(136)**	(135)
Net cash inflow from operating activities		**1,487**	1,319
Returns on investments and servicing of finance			
Interest received and similar income		**55**	17
Interest paid and similar charges		**(313)**	(326)
Net cash outflow for returns on investments and servicing of finance		**(258)**	(309)
Taxation			
Corporation tax paid		**(59)**	(62)
Capital expenditure			
Payments to acquire tangible fixed assets		**(513)**	(617)
Receipts from disposal of tangible fixed assets		**20**	12
Net cash outflow for capital expenditure		**(493)**	(605)
Acquisitions and disposals			
Receipts from disposal of investments		**–**	1
Equity dividends paid		**(70)**	(337)
Net cash inflow before management of liquid resources and financing		**607**	7
Management of liquid resources			
Increase in short–term deposits		**(68)**	(4)
Net cash outflow from management of liquid resources	22(b)(c)	**(68)**	(4)
Financing			
Decrease in borrowings	22(b)(c)	**(229)**	(8)
Loan to parent undertaking		**(303)**	(165)
Funding of special pension contribution		**–**	193
Net cash (outflow)/inflow from financing		**(532)**	20
Net increase in cash and overdrafts	23(b)(c)	**7**	23

Notes to the Accounts

1. Segmental analysis

Segmental information is presented in accordance with the management responsibilities and economic characteristics of the Group's business activities. Management responsibilities changed during the year ended 31 March 2004. Segmental reporting has been aligned to reflect the changes in responsibilities, resulting in a restatement of segmental results for the 12 months ended 31 March 2003. The principal effect of this is to reclassify the results of the LNG Storage business from 'UK gas transmission' to 'Other activities'.

A geographical analysis of results and assets is not provided as Transco's operations are all undertaken in the UK for UK customers.

a) Turnover

	12 months ended 31 March 2004			12 months ended 31 March 2003 Restated		
	Total sales £m	**Sales between businesses £m**	**Sales to third parties £m**	Total sales £m	Sales between businesses £m	Sales to third parties £m
UK gas distribution	**2,245**	**87**	**2,158**	2,089	47	2,042
UK gas transmission	**560**	**2**	**558**	552	–	552
Other activities	**425**	**19**	**406**	461	18	443
Group turnover	**3,230**	**108**	**3,122**	3,102	65	3,037

b) Operating profit

	Before exceptional items		After exceptional items	
	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 Restated £m	**12 months ended 31 Mar 2004 £m**	12 months ended 31 Mar 2003 Restated £m
UK gas distribution	**729**	554	**653**	443
UK gas transmission	**283**	269	**277**	250
Other	**112**	113	**117**	97
	1,124	936	**1,047**	790

c) Total and net assets

	Total assets		Net assets	
at 31 March	**2004 £m**	2003 Restated £m	**2004 £m**	2003 Restated £m
UK gas distribution	**4,928**	4,998	**3,403**	3,480
UK gas transmission	**2,166**	1,883	**1,889**	1,571
Other	**1,054**	1,144	**923**	1,064
	8,148	8,025	**6,215**	6,115
Unallocated	**2,673**	2,342	**(4,078)**	(4,466)
	10,821	10,367	**2,137**	1,649

The analysis of total assets and net assets by business segment excludes inter-business balances. Unallocated total assets include amounts owed by fellow subsidiary undertakings, prepaid financing charges and current asset investments. Unallocated net liabilities include net amounts owed by fellow subsidiary undertakings, net borrowings, taxation, interest and dividends.

d) Other segmental information

	Capital expenditure		Depreciation	
	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 Restated £m	**12 months ended 31 Mar 2004 £m**	12 months ended 31 Mar 2003 Restated £m
UK gas distribution	**293**	380	**195**	185
UK gas transmission	**159**	177	**75**	64
Other	**83**	89	**153**	136
	535	646	**423**	385

Capital expenditure comprises additions to tangible fixed assets.

2. Operating costs

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Depreciation	**423**	385
Payroll costs (note 4(a))	**395**	439
Other operating charges		
– Purchases of gas	**86**	108
– Rates	**240**	235
– Replacement expenditure	**388**	405
– Exceptional operating items (note 3)	**77**	146
– Other non-exceptional operating charges	**466**	529
	1,257	1,423
	2,075	2,247
Operating costs include:		
Research and development costs	**4**	8
Operating lease rentals:		
– Plant and machinery	**11**	15
– Other	**15**	14
Auditors' remuneration:		
Statutory audit services		
– Annual audit (i)	**0.4**	0.4
– Regulatory reporting	**0.2**	0.2
Further audit related services	**0.3**	–
Other non-audit services (ii)	**–**	3.1

(i) The audit fee for the Group and the Company are not materially different.
(ii) Other non-audit services for 2002/03 includes £2.2m paid to the former consulting business of PricewaterhouseCoopers which was sold to IBM United Kingdom Limited on 30 September 2002.

3. Exceptional items

The Group has categorised the following items as exceptional items under UK GAAP because, by either their size, incidence or because they are specifically prescribed, they need to be separately disclosed for the accounts to show a true and fair view.

Paragraph 20 of Financial Reporting Standard (FRS) 3 'Reporting Financial Performance', requires that certain items be disclosed after operating profit and these are shown below as 'non-operating exceptional items'. These items comprise: a) costs associated with a fundamental reorganisation which in the case of the Group, relate to the transaction costs of the Merger; and b) profit on disposal of fixed assets (including the gain on sale of other fixed asset investments).

Other exceptional items are shown below as 'operating exceptional items' and the Directors believe require separate disclosure, as permitted by FRS 3, within operating profit to show a true and fair view. These items include: Restructuring costs; Merger costs arising from the recognition of employee and property costs arising as a direct result of the Merger; and environmental provision which are all disclosed by virtue of their size.

a) Operating

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Restructuring costs (i)	**90**	100
Merger costs (ii)	**–**	46
Environmental provision (iii)	**(13)**	–
	77	146

(i) The restructuring costs for the 12 months ended 31 March 2004 consist of £11m costs associated with the proposed disposal of distribution networks and other charges of £79m. The other charges, and the charges for the 12 months ended 31 March 2003, primarily relate to planned cost reduction programmes. (12 months ended 31 March 2004: £66m after tax, 12 months ended 31 March 2003: £70m after tax).
(ii) The Merger costs for the 12 months ended 31 March 2003 represents employee and property costs associated with the Merger of National Grid and Lattice (£39m after tax).
(iii) Following the completion of site investigations, the environmental obligations in respect of those sites have been reduced by £13m (£13m after tax).

b) Non-operating

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Merger costs (iv)	**–**	8
Profit on disposal of investments (v)	**–**	(1)
Loss on disposal of tangible fixed assets (vi)	**–**	6
	–	13

(iv) The after tax cost of the Merger in the 12 months ended 31 March 2003 was £6m.
(v) The after tax profit on disposal of fixed asset investments in the 12 months ended 31 March 2003 was £1m.
(vi) The after tax loss on disposal of tangible fixed assets in the12 months ended 31 March 2003 was £4m.

4. Payroll costs and employees

a) Payroll costs

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Wages and salaries	**350**	402
Social security costs	**31**	31
Pension costs	**93**	71
	474	504
Less: Amounts capitalised	**(14)**	(9)
Payroll costs included in replacement expenditure	**(59)**	(56)
Payroll costs included in exceptional operating items	**(6)**	–
	395	439

b) Number of employees

	12 months ended 31 Mar 2004 Average Number	12 months ended 31 Mar 2003 Average Number
United Kingdom	**11,792**	13,489

	31 Mar 2004 Number	31 Mar 2003 Number
United Kingdom	**11,341**	12,397

In addition to the payroll costs above, there were severance costs of £62m (12 months ended 31 March 2003: £104m) included within other operating charges – exceptional items.

5. Directors' emoluments

The aggregate amount of emoluments paid to Directors in respect of qualifying services for the 12 months ended 31 March 2004 was £2,040,131 (12 months ended 31 March 2003: £2,015,408). The amount paid in respect of compensation for loss of office in the 12 months ended 31 March 2004 was £599,011 (in the 12 months ended 31 March 2003: £nil). Directors' emoluments include amounts in respect of accrued bonus which had not yet been approved at the date of these accounts.

A number of the current Directors are also directors and employees of National Grid Transco plc or a subsidiary undertaking of that company and are paid by these companies.

As at 31 March 2004, retirement benefits were accruing to 6 Directors under a defined benefit scheme and one Director under a defined contribution scheme. The aggregate emoluments for the highest paid Director were £492,004 for the 12 months ended 31 March 2004 (12 months ended 31 March 2003: £332,241); and total accrued annual pension at 31 March 2004 for the highest paid Director was £188,600 (31 March 2003: £91,700). The amount of contributions paid in respect of defined contribution pension schemes was £19,800 (12 months ended 31 March 2003: £12,960).

Details of Directors' interests in shares are contained on pages 12 and 13.

6. Pensions

Pension cost

Transco participates in the Lattice Group Pension Scheme (the Scheme). Lattice Group plc charges its subsidiary undertakings with an allocation of the total Scheme cost. The costs in respect of the Scheme are set out below:

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Charged against operating profit	**93**	71
Charged within net interest	**26**	1
Total cost	**119**	72

There were no outstanding or prepaid pension contributions at 31 March 2004 (31 March 2003: £nil).

Pension Scheme

Substantially all of the Group's employees are members of the Scheme. The Scheme provides final salary defined benefits for employees who joined the Lattice Group up to 31 March 2002. A defined contribution section was added to the Scheme from 1 April 2002 for employees joining the Lattice Group from that date.

The Scheme is funded with assets held in a separate trustee administered fund. It is subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employer's contributions 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 of the Scheme was carried out by Watson Wyatt LLP at 31 March 2003. The projected unit method was used and the principal actuarial assumptions adopted were that the annual rate of inflation would be 2.5% and that future real increases in pensionable earnings would be 1.5%. Investments held in respect of pensions before they become payable would average 4.9% real annual rate of return, and investments held in respect of pensions after they become payable would average 2.6% real annual rate of return and that pensions would increase at a real annual rate of 0.05%. The aggregate market value of the Scheme's assets was £10,141m and the value of the assets represented approximately 92% of the actuarial value of benefits due to members calculated on the basis of pensionable earnings and service at 31 March 2003 on an ongoing basis and allowing for projected increases in pensionable earnings and pensions.

The results of the actuarial valuation carried out at 31 March 2003 showed that based on long-term financial assumptions the contribution rate required to meet the future benefit accrual was 23.7% of pensionable earnings (20.7% employer's and 3% employees'). Employer's contributions were increased from 8.5% to 20.7% with effect from 1 April 2003. This contribution rate will be reviewed when the next independent actuarial valuation is carried out, which will be no later than 31 March 2006. The ongoing contribution rate does not include an allowance for administration expenses. These contributions are reviewed annually. From 1 April 2003 the rate used for the recovery of administration costs was 1.4% of salary, from 1 April 2004 the rate was 1.6% of salary. Employers are currently, therefore, paying a total contribution rate of 22.3%. The actuarial valuation revealed a deficit of £879m gross (£615m net of tax) in the defined benefit section on the basis of the assumptions adopted by the actuary. It has been agreed that no funding of the deficit identified in the 2003 actuarial valuation will need to be provided to the scheme until the outcome of the actuarial valuation at 31 March 2007 is known. At that point, the National Grid Transco group will pay the gross amount of any deficit up to a maximum amount of £520m (£364m net of tax) into the scheme. Transco's share of these payments is £468m (£328m net of tax). For the period prior to these lump sum deficiency contributions being paid, the National Grid Transco group has arranged for banks to provide the trustees of the Scheme with letters of credit. The main conditions under which these letters of credit could be drawn relate to events which would imperil the interests of the scheme, such as Transco plc becoming insolvent or the National Grid Transco group failing to make agreed payments into the fund.

A further valuation was carried out at 31 March 2003, to calculate the charge in accordance with Statement of Standard Accounting Practice 24. The principal assumptions adopted were price inflation of 2.5%; pension increases in payment of 2.55%; general pensionable pay escalation of 3.5%; and a discount rate of 6%. The principal results of this valuation were the need to recognise a regular cost based on 21.4% of salary (excluding administration costs) and a deficit of £468m, which is being spread over the average expected future service lives of employees in the Scheme amounting to 14.1 years.

FRS 17, Retirement Benefits

In November 2000, the Accounting Standards Board introduced a new accounting standard FRS 17 'Retirement Benefits', replacing SSAP 24 'Accounting for Pension Costs'. FRS 17 is fully effective for periods beginning on or after 1 January 2005, though disclosures are required in the financial years prior to its full implementation. As Transco's share of the underlying assets and liabilities of the Scheme cannot be identified separately, Transco would account for pensions under FRS 17 as if the Scheme were a defined contributions scheme and is not required to make the full disclosures under FRS 17. The pension charge which Transco would have incurred in the 12 months ended 31 March 2004 amounted to £161m (12 months ended 31 March 2003: £115m) of which £42m (12 months ended 31 March 2003: £43m) related to redundancies. Lattice has not yet determined the methodology which it would use to charge pensions costs to its subsidiary undertakings following the full adoption of FRS 17.

7. Net interest

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Bank loans and overdrafts	**9**	5
Other	**305**	331
	314	336
Unwinding of discount on provisions	**6**	6
Interest capitalised	**(12)**	–
Interest payable and similar charges net of interest capitalised	**308**	342
Interest receivable and similar income	**(2)**	(20)
	306	322

Loss incurred on the repurchase of debt during the 12 months ended 31 March 2004 included in interest payable and similar charges was £nil (12 months ended 31 March 2003: £7m).

Interest on the funding attributable to assets in the course of construction was capitalised at a rate of 5.7%.

No interest was capitalised in prior years as the amounts were not material.

8. Taxation

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
United Kingdom current tax		
– Corporation tax at 30%	**238**	135
– Adjustment in respect of prior years	**(14)**	(5)
Deferred tax		
– Current period	**(14)**	18
– Adjustment in respect of prior years	**(27)**	–
Taxation	**183**	148
Comprising:		
Taxation – excluding exceptional items	**207**	189
Taxation – exceptional items	**(24)**	(41)
	183	148

A reconciliation of the UK corporation tax rate to the effective tax rate of the Group is as follows:

	% of profit before taxation	
	12 months ended 31 Mar 2004	12 months ended 31 Mar 2003
UK corporation tax rate	**30.0**	30.0
Effect on tax charge of:		
Origination and reversal of timing differences	**1.7**	(3.1)
Permanent differences	**0.3**	1.6
Current tax charge	**32.0**	28.5
Deferred taxation	**(1.7)**	3.1
Effective tax rate before tax adjustments in respect of prior years and exceptional items	**30.3**	31.6
Tax adjustments in respect of prior years	**(5.0)**	(0.8)
Effective tax rate before exceptional items	**25.3**	30.8
Exceptional items	**(0.6)**	1.7
Effective tax rate after exceptional items	**24.7**	32.5

Factors that may affect future tax charges
Transco has brought forward non-trading debits of £75m (31 March 2003: £75m) which may reduce tax payments in future years.

No provision has been made for deferred tax on gains recognised on the sale of properties where potentially taxable gains have been rolled over into replacement assets. Such tax would become payable only if the replacement asset were sold without it being possible to claim roll-over relief. The total amount not provided for is £46m (31 March 2003: £46m). At present, it is not envisaged that any tax on amounts rolled over will become payable in the foreseeable future.

9. Dividends

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Ordinary shares:		
Interim dividend	**70**	244

Transco plc is prohibited from declaring a dividend or other distribution unless it has certified to Ofgem that it is in compliance in all material respects with certain regulatory obligations, including a requirement to ensure it has sufficient financial resources and facilities to enable it to carry on its business and a requirement to use all reasonable endeavours to maintain an investment grade rating.

10. Tangible fixed assets

The Group

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2003	75	10,503	237	624	11,439
Additions	2	326	132	75	535
Disposals	(1)	(102)	(1)	(89)	(193)
Reclassifications	–	121	(209)	88	–
Cost at 31 March 2004	76	10,848	159	698	11,781
Depreciation at 1 April 2003	(20)	(3,209)	–	(427)	(3,656)
Charge for the year	(3)	(338)	–	(82)	(423)
Disposals	–	89	–	85	174
Depreciation at 31 March 2004	(23)	(3,458)	–	(424)	(3,905)
Net book value at 31 March 2004	**53**	**7,390**	**159**	**274**	**7,876**
Net book value at 31 March 2003	55	7,294	237	197	7,783

The Company

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2003	75	10,506	237	623	11,441
Additions	2	328	132	75	537
Disposals	(1)	(102)	(1)	(89)	(193)
Reclassifications	–	121	(209)	88	–
Cost at 31 March 2004	76	10,853	159	697	11,785
Depreciation at 1 April 2003	(20)	(3,209)	–	(427)	(3,656)
Charge for the year	(3)	(338)	–	(82)	(423)
Disposals	–	89	–	85	174
Depreciation at 31 March 2004	(23)	(3,458)	–	(424)	(3,905)
Net book value at 31 March 2004	**53**	**7,395**	**159**	**273**	**7,880**
Net book value at 31 March 2003	55	7,297	237	196	7,785

The net book value of land and buildings comprises:

At 31 March	2004 £m	2003 £m
Freehold	**48**	51
Long leasehold	**1**	2
Short leasehold	**4**	2
	53	55

The cost of tangible fixed assets at 31 March 2004 includes £12m (2003: £nil) relating to interest capitalised.

Included in creditors (amounts falling due within one year) and creditors (amounts falling due after more than one year) are contributions to the cost of tangible fixed assets amounting to £34m (2003: £32m) and £1,000m (2003: £956m) respectively.

11. Fixed asset investments

The Group

The Group has £nil fixed asset investments as at 31 March 2004 (2003: £nil).

The Company

	Shares in subsidiary undertakings £m
Cost at 1 April 2003 and 31 March 2004	**16**

The names of the principal Group undertakings are included in note 26.

12. Stocks

The Group and the Company

At 31 March	**2004 £m**	2003 £m
Raw materials and consumables	**32**	31

13. Debtors

	The Group		The Company	
At 31 March	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Amounts falling due within one year				
Trade debtors	**16**	27	**16**	27
Amounts owed by fellow subsidiary undertakings	**23**	11	**22**	4
Other debtors	**31**	24	**31**	24
Prepayments and accrued income	**224**	243	**223**	243
	294	305	**292**	298
Amounts falling due after more than one year				
Amounts owed by parent undertaking	**2,544**	2,241	**2,544**	2,241
Total debtors	**2,838**	2,546	**2,836**	2,539

14. Creditors (amounts falling due within one year)

	The Group		The Company	
At 31 March	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Borrowings (note 16)	**1,305**	1,089	**861**	580
Trade creditors and accruals	**362**	310	**362**	310
Amounts owed to Group undertakings	**–**	–	**461**	544
Amounts owed to fellow subsidiary undertakings	**290**	252	**289**	252
Corporation tax	**173**	–	**176**	–
Social security and other taxes	**164**	165	**164**	165
Other creditors	**172**	193	**150**	162
Deferred income	**199**	200	**199**	200
	2,665	2,209	**2,662**	2,213

Other creditors include interest payable of £113m (2003: £118m).

15. **Creditors** (amounts falling due after more than one year)

	The Group		The Company	
At 31 March	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Borrowings (note 16)	**3,636**	4,082	**2,768**	2,838
Amounts owed to Group undertakings	**–**	–	**1,084**	1,447
Deferred income	**1,027**	977	**1,027**	977
	4,663	5,059	**4,879**	5,262

Deferred income mainly comprises contributions to capital projects.

16. Borrowings

The following table analyses the Group's total borrowings after taking account of currency and interest rate swaps.

	The Group		The Company	
At 31 March	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Amounts falling due within one year:				
Bank loans and overdrafts	**100**	189	**100**	189
Commercial paper	**202**	–	**202**	–
Bonds	**494**	515	**50**	36
Borrowings from fellow subsidiary undertakings	**490**	349	**490**	349
Other loans	**19**	36	**19**	6
	1,305	1,089	**861**	580
Amounts falling due after more than one year:				
Bonds	**3,616**	4,030	**2,748**	2,786
Other loans	**20**	52	**20**	52
	3,636	4,082	**2,768**	2,838
Total borrowings	**4,941**	5,171	**3,629**	3,418

Total borrowings are repayable as follows:

In one year or less	**1,305**	1,089	**861**	580
More than one year, but not more than two years	**257**	643	**102**	193
More than two years, but not more than three years	**887**	199	**677**	45
More than three years, but not more than four years	**293**	888	**285**	677
More than four years, but not more than five years	**457**	236	**412**	228
More than five years – other than by instalments	**1,742**	2,116	**1,292**	1,695
	4,941	5,171	**3,629**	3,418

None of the Group's borrowings are secured by charges over the assets of the Group.

Bonds falling due after more than one year also include the amount of £73m (2003: £65m), including accretion of interest to 31 March 2004, in respect of a zero coupon bond due 2021, which had a market value of £287m (2003: £290m).

17. Financial instruments

The Group's treasury policy, including details of the nature, terms and credit risk associated with financial instruments with off-balance sheet risk is described on pages 9 and 10.

The Group's counterparty exposure under foreign currency swaps and foreign exchange contracts was £146m (31 March 2003: £320m) and interest rate swaps £25m (31 March 2003: £71m).

The Group has no significant exposure to either individual counterparties or geographical groups of counterparties.

Short-term debtors and creditors, where permitted by the financial reporting standard on derivatives and other financial instruments (FRS 13), have been excluded from the following disclosures. It is assumed that because of short maturities, the fair value of short-term debtors and creditors approximates to their book values.

Currency and interest rate composition of financial liabilities

The currency and interest rate composition of the Group's financial liabilities are shown in the table below after taking into account currency and interest rate swaps.

			Fixed rate liabilities		
At 31 March 2004	**Total £m**	**Variable rate £m**	**Fixed rate £m**	**Weighted average interest rate %**	**Weighted average period for which rate is fixed Years**
Sterling					
Borrowings	4,941	2,854	2,087	6.1	6
Other financial liabilities	3	3	–	–	–
	4,944	2,857	2,087	6.1	6
At 31 March 2003					
Sterling					
Borrowings	5,171	2,488	2,683	6.1	5
Other financial liabilities	20	20	–	–	–
	5,191	2,508	2,683	6.1	5

At 31 March 2004 the weighted average interest rate on short-term borrowings of £1,305m (2003: £1,089m) was 4.6% (2003: 7.4%).

Substantially all of the variable rate borrowings are subject to interest rates which fluctuate with LIBOR (London Interbank Offered Rate).

In calculating the weighted average number of years for which interest rates are fixed, swaps which are cancellable at the option of the swap provider are taken to have a life based on the earliest date at which they can be cancelled.

17. Financial instruments (continued)

Currency and interest rate composition of financial assets

The currency and interest rate composition of the Group's financial assets are shown in the table below after taking account of currency and interest rate swaps.

At 31 March 2004	Total £m	Non-interest bearing £m	Fixed rate assets: Fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Sterling	72	–	72	3.7	0
US dollars	2	–	2	1.1	0
Other currencies	1	–	1	2.0	0
Cash and investments	75	–	75	–	–
Other financial assets (sterling)	2,544	2,544	–	–	–
	2,619	2,544	75	–	–
At 31 March 2003					
Sterling	3	–	3	4.0	0
US dollars	2	–	2	1.1	0
Other currencies	2	–	2	2.5	0
Cash and investments	7	–	7	–	–
Other financial assets (sterling)	2,241	2,241	–	–	–
	2,248	2,241	7	–	–

Other financial assets comprises amounts owed by Transco's immediate parent company, Transco Holdings plc.

The maturity profile of the Group's financial liabilities and assets are shown in the tables below after taking into account currency and interest rate swaps.

Maturity of financial liabilities at 31 March	2004 £m	2003 £m
In one year or less	**1,305**	1,093
More than one year, but not more than two years	**260**	647
More than two years, but not more than three years	**887**	203
More than three years, but not more than four years	**293**	892
More than four years, but not more than five years	**457**	240
More than five years	**1,742**	2,116
	4,944	5,191

Maturity of financial assets at 31 March	2004 £m	2003 £m
In one year or less	**75**	7
No maturity date	**2,544**	2,241
	2,619	2,248

Financial assets with no maturity date comprise amounts owed by Transco's immediate parent company, Transco Holdings plc.

Fair values of financial instruments at 31 March	2004		2003	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Financial instruments held or issued to finance the Group's operations:				
Short-term borrowings	**(1,305)**	**(1,267)**	(1,089)	(1,093)
Long-term borrowings	**(3,578)**	**(4,079)**	(4,174)	(4,677)
Financial assets	**2,619**	**2,619**	2,248	2,248
Financial instruments held to manage the interest rate and currency profile:				
Interest rate swaps	**–**	**14**	–	62
Forward foreign currency contracts and cross currency swaps	**(58)**	**90**	92	313

Market values, where available, have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting future cash flows at prevailing interest rates.

17. Financial instruments (continued)

The notional principal amounts relating to financial instruments held to manage interest rate and currency profile for interest rate swaps and forward rate agreements, foreign currency contracts and cross-currency swaps, amounted to £6,282m (2003: £3,846m) and £3,028m (2003: £3,428m) respectively.

	Unrecognised gains £m	Unrecognised losses £m	Unrecognised net gain £m	Deferred gains £m	Deferred losses £m	Deferred net gain £m
Gains and (losses) on hedges at 1 April 2003	346	(63)	283	34	(84)	(50)
(Gains)/losses arising in previous years recognised in the year	(62)	6	(56)	(7)	12	5
Gains/(losses) arising in previous years not recognised in the year	284	(57)	227	27	(72)	(45)
Gains/(losses) arising in the year	(31)	(34)	(65)	61	(8)	53
Gains and (losses) on hedges at 31 March 2004	**253**	**(91)**	**162**	**88**	**(80)**	**8**
Of which:						
Gains and (losses) expected to be recognised within one year	3	(6)	(3)	11	(12)	(1)
Gains and (losses) expected to be recognised after one year	250	(85)	165	77	(68)	9

Borrowing facilities

At 31 March 2004, the Group had undrawn committed borrowing facilities as shown below:

	2004 £m	2003 £m
In one year or less	**758**	622
More than one year, but not more than two years	**575**	–
More than two years, but not more than three years	**–**	600
	1,333	1,222

18. Provisions for liabilities and charges

The Group and the Company

	Environmental £m	Deferred taxation £m	Restructuring £m	Total £m
At 31 March 2003	98	1,276	76	1,450
Charged/(released) to profit and loss account	(13)	(41)	79	25
Utilised	(6)	–	(119)	(125)
Unwinding of discount	6	–	–	6
At 31 March 2004	**85**	**1,235**	**36**	**1,356**

The environmental provision represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by the Group.

At 31 March 2004, the environmental provision represented the net present value of the estimated statutory decontamination costs of old gas manufacturing sites (discounted using a nominal rate of 5.25%). The anticipated timing of the cash flows for statutory decontamination cannot be predicted with certainty, but it is expected to be incurred over the period 2005 to 2057. During the year ended 31 March 2004, a project to survey all contaminated old gas manufacturing sites was completed. This resulted in a re-evaluation of the provision and a reduction in the amount of provision made, reflected as an exceptional credit of £13m in the profit and loss account – see note 3(a).

There are a number of uncertainties that affect the calculation of the provision for gas site decontamination, including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. The Group has made its best estimate of the financial effect of these uncertainties in the calculation of the provision, but future material changes in any of the assumptions could materially impact on the calculation of the provision and hence the profit and loss account.

The undiscounted amount of the provision at 31 March 2004 relating to gas site decontamination was £127m, being the undiscounted best estimate of the liability having regard to the uncertainties referred to above (excluding the impact of changes in discount rate). The Group believes that the best estimate of this liability lies in a range of between £100m and £160m.

At 31 March 2004, £3m of the total restructuring provision (2003: £20m) consisted of provisions for costs in respect of surplus leasehold properties. The expected payment dates for property restructuring costs remain uncertain. The remainder of the restructuring provision relates to business reorganisation costs.

Deferred taxation comprises:

	Provided	
At 31 March	**2004 £m**	2003 £m
Accelerated capital allowances	**1,248**	1,277
Other timing differences	**(13)**	(1)
	1,235	1,276

19. Share capital

At 31 March	**Number of shares 2004 millions**	Number of shares 2003 millions	**2004 £m**	2003 £m
Authorised				
Ordinary shares of 1⅔₁₅p each	**6,052**	6,052	**69**	69
Allotted and fully paid				
Ordinary shares of 1⅔₁₅p each	**3,944**	3,944	**45**	45

Transco plc is a wholly owned subsidiary undertaking of Transco Holdings plc.

20. Reserves

	The Group			The Company		
	Share premium account £m	Capital redemption reserve £m	Profit and loss account reserve £m	Share premium account £m	Capital redemption reserve £m	Profit and loss account reserve £m
At 31 March 2003	204	1,332	68	204	1,332	71
Retained profit for the year			488			479
At 31 March 2004	**204**	**1,332**	**556**	**204**	**1,332**	**550**

Transco is prohibited from declaring a dividend or other distribution unless it has certified that it is in compliance in all material respects with certain regulatory obligations, including a requirement to ensure it has sufficient financial resources and facilities to enable it to carry on its business and a requirement to use all reasonable endeavours to maintain an investment grade credit rating.

The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. Of the Group profit after taxation, £549m (12 months ended 31 March 2003: £312m) is attributable to the Company.

21. Reconciliation of movement in equity shareholders' funds

The Group	**12 months ended 31 Mar 2004 £m**	12 months ended 31 Mar 2003 £m
Profit for the year	**558**	307
Dividends	**(70)**	(244)
Net increase in equity shareholders' funds	**488**	63
Equity shareholders' funds at the start of the year	**1,649**	1,586
Equity shareholders' funds at the end of the year	**2,137**	1,649

22. Group cash flow statement

a) Reconciliation of operating profit to net cash inflow from operating activities before exceptional items

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Total operating profit	**1,047**	790
Exceptional operating items	**77**	146
Depreciation	**423**	385
(Increase)/decrease in stocks	**(1)**	3
Increase in debtors	**(60)**	(31)
Increase in creditors	**137**	161
Cash inflow from operating activities before exceptional items	**1,623**	1,454

b) Reconciliation of net cash flow to movement in net debt

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m
Movement in cash and overdrafts	**7**	23
Net cash outflow from the management of liquid resources	**68**	4
Decrease in borrowings	**229**	8
Decrease in net debt resulting from cash flows	**304**	35
Other non-cash movements	**(6)**	(22)
Decrease in net debt in the year	**298**	13
Net debt at the start of the year	**(5,164)**	(5,177)
Net debt at the end of the year	**(4,866)**	(5,164)

c) Analysis of changes in net debt

	At 1 Apr 2002 £m	Cash Flow £m	Non-cash Movements £m	Other Movements £m	At 31 Mar 2003 £m
Cash at bank and in hand	–	–	–	–	–
Bank overdrafts	(36)	23	–	–	(13)
		23			
Current asset investments	3	4	–	–	7
Borrowings due within one year	(916)	395	(543)	(12)	(1,076)
Borrowings due after one year	(4,228)	(387)	543	(10)	(4,082)
		8			
	(5,177)	35	–	(22)	(5,164)

	At 1 Apr 2003 £m	Cash Flow £m	Non-cash Movements £m	Other Movements £m	**At 31 Mar 2004 £m**
Cash at bank and in hand	–	–	–	–	**–**
Bank overdrafts	(13)	7	–	–	**(6)**
		7			
Current asset investments	7	68	–	–	**75**
Borrowings due within one year	(1,076)	365	(588)	–	**(1,299)**
Borrowings due after one year	(4,082)	(136)	588	(6)	**(3,636)**
		229			
	(5,164)	304	–	(6)	**(4,866)**

23. Related party transactions

Transco is a wholly owned subsidiary undertaking of National Grid Transco, which consolidates Transco within its publicly available financial statements. Transco is therefore exempt from disclosing transactions with other members of National Grid Transco group. There were no other material related party transactions (12 months ended 2003: £nil).

Amounts owed by other National Grid Transco group undertakings are shown in note 13 and amounts owed to other National Grid Transco group undertakings are shown in notes 14, 15 and 16.

24. Commitments and contingencies

a) Future capital expenditure

As at 31 March 2004, the Group had placed contracts for capital expenditure (tangible fixed assets) amounting to £76m (2003: £148m).

b) Lease commitments

At 31 March 2004, the Group's operating lease commitments for the financial year ending 31 March 2005 amounted to £21m (2003 commitments for 2004: £27m) and are analysed by lease expiry date as follows:

	Land and buildings		Other		Total	
At 31 March	**2004 £m**	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Expiring:						
In one year or less	**1**	2	**2**	5	**3**	7
In more than one year, but not more than five years	**2**	–	**4**	7	**6**	7
In more than five years	**12**	13	**–**	–	**12**	13
	15	15	**6**	12	**21**	27

Total commitments under non-cancellable operating leases were as follows:

At 31 March	**2004 £m**	2003 £m
Amounts due:		
In one year or less	**21**	27
In more than one year, but not more than two years	**17**	20
In more than two years, but not more than three years	**15**	14
In more than three years, but not more than four years	**12**	13
In more than four years, but not more than five years	**12**	13
In more than five years	**72**	87
	149	174

c) Third party contingencies

Transco has outstanding BG Group related commitments and contingencies amounting to £13m at 31 March 2004 (2003: £13m), arising from the restructuring of BG Group in 1999. BG Group has been working with the Group since early 1999 to remove all the relevant guarantees or to find an alternative guarantor which is not part of the Group. For any guarantees that have not been replaced, the Group will continue to provide such guarantees on an arm's length basis until they are removed or replaced.

d) Other commitments and contingencies

The value of other Group commitments and contingencies at 31 March 2004 amounted to £69m (2003: £73m), including a performance guarantee of £24m (2003: £24m) relating to certain property obligations of a National Grid Transco Group undertaking.

e) Parent company loan guarantees on behalf of Group undertakings

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its financial subsidiary undertakings to third parties. At 31 March 2004, the sterling equivalent amounted to £1,222m (2003: £1,816m).

f) Larkhall prosecution

As a result of a fatal accident at Larkhall, Lanarkshire in December 1999 in which four people died, the Company faces charges alleging breaches of sections 3 and 33 of the Health and Safety at Work Act 1974. The case is currently listed for trial in Edinburgh commencing on 27 September 2004. The maximum penalty for breach of either of the above sections is an unlimited fine.

25. Ultimate parent company

Transco plc's immediate parent company is Transco Holdings plc. The ultimate parent company, and controlling party, is National Grid Transco plc, which is registered in England and Wales. Both Transco Holdings plc and National Grid Transco plc consolidate the accounts of Transco plc. Copies of the consolidated accounts of Transco Holdings plc and copies of the consolidated accounts of National Grid Transco plc may be obtained from the Company Secretary, 1-3 Strand, London WC2N 5EH.

26. Principal subsidiary undertakings

The principal subsidiary undertakings included in the Group accounts at 31 March 2004 are listed below. These undertakings are wholly-owned.

as at 31 March 2004	Country of operation and incorporation	Principal activity
Transco Metering Services Limited	UK	Gas metering services
British Transco International Finance B.V.	The Netherlands	Financing
British Transco Finance Inc.	USA	Financing
British Transco Capital Inc.	USA	Financing

A full list of all Group and associated undertakings will be attached to the Company's Annual Return to be filed with the Registrar of Companies.

Five Year Financial Record (unaudited)

Profit and loss account

		12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m	15 months ended 31 Mar 2002 Restated £m	12 months ended 31 Dec 2000 Restated £m	12 months ended 31 Dec 1999 Restated £m
Turnover, including share of joint ventures		**3,122**	3,037	3,922	2,975	4,671
Less: share of joint ventures turnover	– discontinued operations	**–**	–	–	–	(63)
Group turnover	– continuing operations	**3,122**	3,037	3,922	2,975	3,058
Group turnover	– discontinued operations	**–**	–	–	–	1,550
Group turnover		**3,122**	3,037	3,922	2,975	4,608
Operating costs	– continuing operations	**(2,075)**	(2,247)	(2,631)	(1,902)	(1,769)
	– discontinued operations	**–**	–	–	–	(1,277)
		(2,075)	(2,247)	(2,631)	(1,902)	(3,046)
Operating profit of Group undertakings	– continuing operations	**1,047**	790	1,291	1,073	1,289
Operating profit of Group undertakings	– discontinued operations	**–**	–	–	–	273
		1,047	790	1,291	1,073	1,562
Share of joint ventures' operating profits	– discontinued operations	**–**	–	–	–	94
Operating profit						
– before exceptional items – continuing operations		**1,124**	936	1,391	1,114	1,309
– before exceptional items – discontinued operations		**–**	–	–	–	367
– exceptional items – continuing operations		**(77)**	(146)	(100)	(41)	(20)
Total operating profit		**1,047**	790	1,291	1,073	1,656
Non–operating exceptional costs – continuing operations		**–**	(8)	–	–	–
Profit/(loss) on disposal of fixed asset investments – continuing operations		**–**	1	–	4	(669)
Profit/(loss) on disposal of tangible fixed assets – continuing operations		**–**	(6)	10	(19)	36
Share of profit on disposals in joint ventures – discontinued operations		**–**	–	–	–	1
Net interest		**(306)**	(322)	(418)	(360)	(418)
Profit on ordinary activities before taxation		**741**	455	883	698	606
Taxation						
– excluding exceptional items		**(207)**	(189)	(300)	(228)	(374)
– exceptional items		**24**	41	32	8	–
Profit on ordinary activities after taxation		**558**	307	615	478	232
Minority interest		**–**	–	–	–	(14)
Profit for the period		**558**	307	615	478	218

Balance sheet

	31 Mar 2004 £m	31 Mar 2003 £m	31 Mar 2002 Restated £m	31 Dec 2000 Restated £m	31 Dec 1999 Restated £m
Fixed assets	**7,876**	7,783	7,540	7,121	6,820
Current assets	**2,945**	2,584	2,578	2,681	2,878
Creditors: amounts falling due within one year	**(2,665)**	(2,209)	(1,969)	(2,752)	(2,520)
Net current assets/(liabilities)	**280**	375	609	(71)	358
Total assets less current liabilities	**8,156**	8,158	8,149	7,050	7,178
Creditors: amounts falling due after more than one year	**(4,663)**	(5,059)	(5,156)	(4,240)	(4,525)
Provisions for liabilities and charges	**(1,356)**	(1,450)	(1,407)	(1,385)	(1,392)
Net assets	**2,137**	1,649	1,586	1,425	1,261
Transco shareholders' funds	**2,137**	1,649	1,586	1,425	1,261
Minority interest	**–**	–	–	–	–
Total shareholders' funds	**2,137**	1,649	1,586	1,425	1,261

Five Year Financial Record (unaudited)

Cash flow statement

	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 £m	15 months ended 31 Mar 2002 Restated £m	12 months ended 31 Dec 2000 Restated £m	12 months ended 31 Dec 1999 Restated £m
Operating cash inflow before exceptional items	**1,623**	1,454	2,353	1,468	1,562
Net expenditure relating to exceptional items	**(136)**	(135)	(12)	(4)	(31)
Net cash inflow from operating activities	**1,487**	1,319	2,341	1,464	1,531
Dividends from joint ventures and associates	**–**	–	–	–	3
Net cash outflow from returns on investments and servicing of financing	**(258)**	(309)	(364)	(383)	(381)
Net cash outflow from taxation	**(59)**	(62)	(240)	(191)	(373)
Net cash outflow from capital expenditure and financial investment	**(493)**	(605)	(909)	(606)	(828)
Net cash flow from acquisitions and disposals	**–**	1	13	7	(667)
Equity dividends paid	**(70)**	(337)	(432)	(400)	(348)
Net cash inflow/(outflow) before management of liquid resources	**607**	7	409	(109)	(1,063)
Net cash inflow/(outflow) from management of liquid resources	**(68)**	(4)	55	210	9
Net cash inflow/(outflow) from financing activities	**(532)**	20	(493)	(95)	1,093
Net increase/(decrease) in cash in period	**7**	23	(29)	6	39

Definitions

Company
Transco plc.

Demerger
The demerger of Lattice Group plc from BG Group plc which became effective on 23 October 2000.

Group
Transco and/or its subsidiary undertakings or any of them as the context requires.

GWh
Gigawatt hours. 10^6 kWh.

HSE
Health and Safety Executive.

kWh
Kilowatt hours.

Lattice or Lattice Group
Lattice Group plc and/or its subsidiary undertakings or any of them as the context requires immediately prior to the completion of the Merger.

Licence
The Gas Transporter Licence treated as granted under section 7 of the Gas Act 1986, as amended, to Transco by which Transco is authorised to transport gas.

LNG
Liquefied natural gas.

m
Million

mcm
Million cubic metres.

Merger
The merger of National Grid and Lattice which became effective on 21 October 2002.

National Grid or National Grid Group
National Grid Group plc and/or its subsidiary undertakings or any of them as the context requires immediately prior to the completion of the Merger.

National Grid Transco
National Grid Transco plc and/or its subsidiary undertakings or any of them as the context requires.

NTS
Transco's UK national gas transmission system.

Ofgem
The Office of Gas and Electricity Markets.

Ordinary shares
Ordinary shares of $1\frac{2}{15}$ pence each in the capital of Transco.

TWh
Terawatt hours. 10^9 kWh.

Transco
Transco plc and/or its subsidiary undertakings or any of them as the context requires.

Transco plc

1-3 Strand
London WC2N 5EH
United Kingdom