Experts in Networks

Transco Holdings plc
Annual Report and Accounts 2004/05

Transco

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The Group's adjusted operating profit* was down by £179 million to £930 million compared to last year. This was due, as expected, to a decline in formula income, exacerbated by a very mild winter, and to the planned increased investment in our mains replacement programme. However, whilst managing the highly complex process of selling four regional gas distribution networks, controllable costs were reducing by another 3% in real terms.

Progress

Our most significant move was the sale, on 1 June 2005, of four of our gas distribution networks for cash proceeds of £5.8 billion, a considerable premium to the regulatory value at 31 March 2005. Following completion, we still own the largest gas distribution network in the country, but with a new unified structure which will enable us to place an increased emphasis on safety, and efficiency and the sharing of best practice.

Our safety performance has continued to improve through the implementation of best practice, with a further 18% reduction in lost time injuries. In addition, we once again exceeded all our safety related standards of service.

* Excludes impact of exceptional items.

Investment

UK continental shelf gas reserves are decreasing and we estimate that around half of the UK's gas supply will be imported by the end of the decade. Changing patterns of gas supply will provide the opportunity for us to make significant investment in the NTS, with new LNG importation facilities and interconnectors planned to come on-stream over the next three years.

Outlook

Transco's priority remains to create value for shareholders through the delivery of its regulatory contract, while maintaining the drive for continuous improvement in safety, reliability, and service standards.

Steve Holliday
Director

Operating Review

Introduction

Overview of Transco Holdings

Transco Holdings is a part of National Grid Transco, an international network utility, and is the holding company for the Transco business.

At 31 March 2005, Transco owned, operated and developed Britain's natural gas transmission and distribution systems, which deliver gas to around 21 million consumers.

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 plc, 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. In October 2002, as part of the merger with National Grid Group, a further 'ring-fence' was placed around Transco Holdings to align financial and organisational structures.

In August 2004, we agreed the sales of four of our UK gas distribution networks. These sales were completed on 1 June 2005, after which we still own the largest gas distribution network in the UK. Further details of these sales are included on page 5.

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.

Business segments

Our continuing 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 four 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.

Discontinued operations

The four regional gas distribution networks sold on 1 June 2005 are reported as discontinued operations. They were formerly reported as part of our UK gas distribution segment.

Financial performance

This Operating Review focuses on the performance of individual business segments, including a consideration of the business environment within which each of our business segments operates and the operational and financial performance of each business segment. The Operating Review contains a discussion of changes in segmental financial results during the years under review.

The Financial Review beginning on page 9 primarily focuses on the financial impact of matters that do not arise from operating performance or are better discussed in the wider Group context rather than on a segment by segment basis. Consequently, it comments on consolidated turnover, adjusted operating profit, operating profit, interest, taxation, exceptional items and 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 presented in the financial statements.

Adjusted profit measures

We 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. The Directors believe that excluding exceptional items removes their distorting impact in order to provide a clearer comparison from year to year. These measures are the primary financial performance measures used by the Directors to evaluate our operations.

Other performance measures

The Group uses a number of measures of operational and financial performance relating to its various businesses. As the Group's businesses are regulated utilities, many of our targets are determined by the relevant regulators. Much of the Group's performance depends on meeting and exceeding those regulatory targets. Measures of operational performance include: Lost Time Injuries (LTIs); the management of controllable costs; reliability of our pipeline networks; and other service quality measures.

The Directors believe that safety is paramount and, as a fundamental part of this, that all work-related injuries and illnesses are preventable. Consequently, we measure the level of LTIs as a key operational performance indicator for the Group. LTIs are injuries that arise from a person's employment and cause that person to be unable to attend the workplace and perform his or her duties for one or more shifts or working days. All our businesses are required to report on LTIs suffered by their respective employees and any contractors.

The level of controllable costs is another critical performance measure. Our ability to make a profit depends largely on our ability to manage those of our costs that we can control. Controllable costs include employment costs (excluding pension fund deficits) and other costs incurred in operating and maintaining transmission and distribution systems. In the event that the definition of controllable costs is changed for any reason, comparatives are amended so that year-on-year changes are not distorted. Ofgem monitors our performance in a number of areas and our ability to reduce controllable costs is important to this process.

Certain costs, of course, cannot be controlled and hence are not included within the definition of controllable costs. Some are fixed or semi-fixed and generally cannot be altered by management in the ordinary course. These costs include depreciation charges, replacement expenditure, and certain pension and pension deficit related costs. Those commodity and other costs incurred by Group businesses that are passed through to our customers in turnover or such commodity costs that change as a result of movements in market prices over which we have no control are therefore also excluded from the definition of controllable costs.

Operational reliability is a core measure of our success, and it is fundamental to our relationships with our regulators and the public. We monitor reliability using various methods, relevant to each particular network. We also measure service quality in each of those businesses, with various methods relevant to each particular network, to assess the performance of our management and staff in serving our customers.

Summary results

The following tables summarise the turnover, adjusted operating profit and operating profit of the Group by business segment. Comparative figures for the year ended 31 March 2004 have been restated to reflect changes in accounting policies as described in note 1 to the accounts on page 24.

Years ended 31 March	2005	2004 (restated)
Turnover	**£m**	£m
UK gas distribution	**1,113**	1,130
UK gas transmission	**561**	560
Other activities	**397**	425
Sales between businesses	**(75)**	(62)
Continuing operations	**1,996**	2,053
Discontinued operations	**1,102**	1,115
Sales between businesses	**(53)**	(46)
Group turnover	**3,045**	3,122

Years ended 31 March	2005	2004 (restated)
Adjusted operating profit	**£m**	£m
UK gas distribution	**225**	309
UK gas transmission	**271**	281
Other activities	**89**	112
Continuing operations	**585**	702
Discontinued operations	**345**	407
Total adjusted operating profit	**930**	1,109

Exceptional items, which are not included in the adjusted operating profit and other adjusted measures, are defined as material items arising from the ordinary activities of the Group, requiring 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 and environmental costs. Page 9 contains a discussion of the nature of these exceptional items for each year.

Years ended 31 March	2005	2004 (restated)
Operating profit	**£m**	£m
UK gas distribution	**119**	289
UK gas transmission	**268**	275
Other activities	**89**	117
Continuing operations	**476**	681
Discontinued operations	**271**	338
Total operating profit	**747**	1,019

Turnover and operating profit

Movements from year to year in turnover do not necessarily have an impact on the financial condition of the Group as the amounts we charge to customers can vary depending on our costs. In particular, we can pass through certain elements of our costs to customers, and these, therefore, do not have a significant impact on adjusted operating profit and operating profit.

In addition, there can be timing differences in our regulated gas distribution and transmission businesses between when costs are incurred and when these can be recovered from customers. In these cases, turnover, operating costs, adjusted operating profit and operating profit will vary from year to year.

Cash flows from operating activities

The Group generated positive operating cash flows before exceptional items of £1,301 million in 2004/05, compared with £1,623 million in 2003/04. After exceptional items, operating cash inflows were £1,175 million and £1,474 million in 2004/05 and 2003/04 respectively.

Cash flows from our operations are largely stable over a period of years, but they do depend on the timing of customer payments. The Group's gas distribution and transmission operations are subject to multi-year price control agreements with regulators, resulting in essentially stable cash flows. However, weather conditions can affect cash flows, with abnormally mild or extreme weather driving volumes down or up respectively.

UK gas distribution

Background information

At 31 March 2005, our UK gas distribution business comprised almost all of Britain's gas distribution system and consisted of approximately 170,000 miles of distribution pipelines. Gas was transported on behalf of approximately 70 active gas shippers from the NTS through the eight regional distribution networks to around 21 million consumers.

Following the sale of four of our regional gas distribution networks (Scotland, South of England, Wales and West and North of England), which was completed on 1 June 2005, our retained gas distribution system consists of approximately 82,000 miles of distribution pipeline.

We are and will continue to be responsible for the safety, development, maintenance and daily operation of our UK gas distribution system.

Following completion of the network sales, the national emergency number 0800 111 999 remains the same, which we continue to manage on behalf of all gas transporters.

Regulation

Our UK gas distribution business is operated under the terms of our distribution gas transporter licence. We are subject to revenue restrictions known as price controls.

The price control that applies to our UK gas distribution business takes into account Ofgem's estimates of operating expenditure, capital expenditure, replacement expenditure and allowed rate of return on our regulatory value, which is currently set at a real pre-tax rate of 6.25%. As at 31 March 2005, our regulatory value was estimated as approximately £11 billion, of which £5.2 billion related to the four sold networks.

On 1 April 2002, the activities of the UK gas distribution business, including the four sold networks, became subject to a separate five-year price control formula ('distribution price control formula'), as distinct from the gas transmission price control. 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 gas distribution networks.

The 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 a 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 was allocated a regulatory value associated with its distribution assets using an estimate of the UK gas distribution business's 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%.

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 underperforms. In 2004/05, it is estimated that we earned a small additional return from the operation of the incentive mechanism for mains replacement, which was lower than the previous year. The lower return is primarily due to a reduction in Ofgem allowances compared to the previous year, together with inflationary pressures acting on our labour and contract costs.

Ofgem has indicated that it will extend the existing five year gas distribution price control for a further year, with a mini price control review taking place to set revenue for 2007/08, followed by a full price control review for the next five year price control period starting 1 April 2008.

New incentive schemes are being designed which will apply to both the sold networks and our retained networks.

With effect from 1 May 2005, our UK gas distribution business, each of the four sold networks and our UK gas transmission business each hold a gas transporter licence. These licences are derived from the original integrated transmission and distribution licence, but have been substantially amended in order to distinguish between the separate activities of transmission and distribution gas transportation, and to facilitate a post sales environment with multiple gas distribution transporters.

Safety

UK gas distribution has continued to make progress towards National Grid Transco's goal of zero injuries and work related ill-health. Over the last year we have achieved an 18% reduction in LTIs to our employees from 119 in 2003/04 to 97 in 2004/05 (including the four sold networks).

We continue to make progress in our management of occupational illness with a comprehensive health surveillance programme for our industrial employees monitoring issues such as Hand Arm Vibration Syndrome.

Operating performance

Gas demand for our continuing operations was 344 TWh in 2004/05, compared with 351 TWh in 2003/04, while gas demand for our discontinued operations was 353 TWh in 2004/05 compared with 355 TWh in 2003/04. The decrease was due to the very mild weather experienced. If the weather had corresponded to seasonal normal temperatures, it is estimated that gas demand would have been 362 TWh in 2004/05 for our continuing operations, compared with 365 TWh in 2003/04, while gas demand for our discontinued operations was 367 TWh in 2004/05 compared with 367 TWh in 2003/04.

While there has been underlying growth of 0.4% in demand from small users (2003/04 1.9% demand growth), 2004/05 saw a 2.6% reduction in underlying demand from business and other large users (2003/04 3.5% reduction), which can be attributed to higher gas prices.

We 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.

Over the year, we have seen a significant improvement in performance against all of our connections-related standards of service, meeting all but two of our performance targets. Low levels of performance in the early part of the year against these two standards adversely affected our overall performance for the year. Ofgem is currently investigating our performance in relation to standards of service associated with connections activities for 2003/04.

We have been working with Ofgem and the wider industry to develop new connections-related standards of service which came into effect on 1 May 2005. These standards better reflect the current connections market and provide more comprehensive protection to consumers requiring a gas connection service.

Furthermore, it has become increasingly apparent that the prospects for competition in the domestic connections market are limited. Therefore, we have decided to deliver this element of the service from within our UK gas distribution business to improve service to domestic customers further.

Financial performance – continuing operations

The results of the continuing operations of the UK gas distribution segment for the years ended 31 March 2005 and 2004 were as follows.

Years ended 31 March **UK gas distribution – continuing operations**	**2005** **£m**	2004 (restated) £m
Turnover	**1,113**	1,130
Operating costs excluding exceptional items	**(888)**	(821)
Adjusted operating profit	**225**	309
Exceptional items	**(106)**	(20)
Operating profit	**119**	289

The £17 million reduction in turnover, comparing 2004/05 to 2003/04, was primarily due to a £25 million reduction in revenue recovered under the distribution price control formula. This arose from a 3.5% price cut implemented in April 2004, which reduced income by £21 million, and a £7 million reduction because of the relatively mild weather, partially offset by a £3 million increase from growth in underlying volumes. This net reduction in income was partially offset by a £7 million increase in work undertaken by Transco's workforce on behalf of National Grid Transco's regulated and non-regulated metering businesses.

The £67 million increase in operating costs, excluding exceptional items, comparing 2004/05 with 2003/04, was principally because of a planned £52 million increase in expenditure associated with the iron mains replacement programme. The other main factors behind the increase were higher controllable costs (£20 million, discussed below) and increased work for the Group's other businesses (£12 million), partly offset by a lower charge for UK gas distribution's share of the Lattice pension deficit (£17 million).

Further cost efficiencies have been achieved across continuing and discontinued operations against the backdrop of substantial organisational change and the significant volume of work required to design and implement a new industry structure as a result of the network sales. Controllable costs, excluding increases in ongoing pension costs and gas commodity prices, decreased by 3% in real terms during the year and have now decreased by 23% in real terms since March 2002.

The £52 million increase in replacement expenditure comparing 2004/05 to 2003/04 was in line with the planned increase in the iron mains replacement programme agreed with the Health and Safety Executive (HSE).

The £84 million reduction in UK gas distribution adjusted operating profit comparing 2004/05 to 2003/04 was the result of the factors referred to above, with the increased replacement expenditure and lower price controlled income being the two main factors.

Exceptional items explains the difference between adjusted operating profit and operating profit. Exceptional charges in 2004/05 comprised £102 million in respect of internal restructuring initiatives and a £4 million charge reflecting a revised estimate of environmental liabilities.

Financial performance – discontinued operations
The results of discontinued operations for the years ended 31 March 2005 and 2004 were as follows.

Years ended 31 March **UK gas distribution – discontinued operations**	**2005** **£m**	2004 (restated) £m
Turnover	**1,102**	1,115
Operating costs excluding exceptional items	**(757)**	(708)
Adjusted operating profit	**345**	407
Exceptional items	**(74)**	(69)
Operating profit	**271**	338

The £13 million reduction in turnover, comparing 2004/05 to 2003/04, was primarily due to a £28 million reduction in revenue recovered under the distribution price control formula. This arose from a 3.5% price cut implemented in April 2004, which reduced income by £22 million, and a £7 million reduction because of the relatively mild weather, partially offset by a £1 million increase from growth in underlying volumes. This net reduction in income was partially offset by a £10 million increase in work undertaken by Transco's workforce on behalf of National Grid Transco's regulated and non-regulated metering businesses.

The £49 million increase in operating costs, excluding exceptional items, comparing 2004/05 with 2003/04, was principally because of a planned £34 million increase in expenditure associated with the iron mains replacement programme. The other main factor behind the increase was increased work for the Group's other businesses (£17 million).

The £34 million increase in replacement expenditure comparing 2004/05 to 2003/04 was in line with the planned increase in the iron mains replacement programme agreed with the Health and Safety Executive (HSE).

The £62 million reduction in adjusted operating profit comparing 2004/05 to 2003/04 was the result of the factors referred to above, with the increased replacement expenditure and lower price controlled income being the two main factors.

Exceptional items explains the difference between adjusted operating profit and operating profit. Exceptional charges in 2004/05 comprised £62 million in connection with the network sales process, £7 million in respect of internal restructuring initiatives and a £5 million charge reflecting a revised estimate of environmental liabilities.

Investment in the networks
Growth capital expenditure in the reinforcement and extension of the gas distribution network was £120 million in 2004/05, compared with £125 million in 2003/04, in respect of continuing operations, and £152 million in 2004/05 compared with £168 million in 2003/04 in respect of discontinued operations.

During the year ended 31 March 2005, we made around 120,000 new connections to our networks.

The reduction in capital expenditure comparing 2003/04 to 2004/05 is because of a lower level of investment in high pressure pipeline projects, such projects being dependent on forecasts of future demand.

During 2004/05 we spent £239 million on replacement expenditure for our continuing operations and £235 million for our discontinued operations. Ofgem treats 50% of projected replacement expenditure as recoverable during the price control period and 50% as recoverable over future years, as another form of capital investment in the network.

Network sales
The process to implement the sales of four of our eight gas distribution networks (Scotland, Wales and West, North of England and South of England), announced in August 2004, was completed on 1 June 2005.

In January this year, Ofgem gave its conditional approval to the sale of the four gas distribution networks. This was followed by Department of Trade and Industry consent later that month. Since then, we have developed a network code with the industry that will be suitable for us and independent distribution gas transporters. This revised code has become the Uniform Network Code.

A Joint Office of Gas Transporters (an unincorporated association) has been established in order to administer and coordinate certain functions that result from common licence obligations imposed on both transmission and distribution gas transporters. The role of the Joint Office includes, for example, the coordination of transportation charge changes and the administration of the Uniform Network Code modification procedures.

We have established xoserve limited, a separate legal entity, which commenced operating from 1 May 2005 and acts as the common service provider ('agency') envisaged by the licences of transmission and distribution gas transporters. The role of the agency is to act as a sub-contractor to relevant NTS and distribution network gas transporters and, as such, provide services (which includes the provision of information, data processing, invoicing and supply point administration services) and systems (the scope of which is set out in the Uniform Network Code) on a common basis to such gas transporters. The key objective of xoserve is to minimise the changes shippers will experience post network sales by providing a common interface between shippers and multiple distribution gas transporters.

Ofgem has also completed a number of public consultations concerning the establishment of the appropriate industry frameworks. Ofgem's impact assessments and detailed cost benefit analysis concluded that the sales will potentially generate around £225 million benefit to customers.

On 1 May, having received Ofgem approval, we transferred the four sold networks into four new wholly-owned subsidiaries of Transco. On the same day, the Uniform Network Code became effective and the Joint Office and xoserve commenced operations.

We received the HSE's acceptance of the safety cases for the new independent gas networks on 20 May 2005. The safety case is a document setting out our arrangements for the safe flow of gas, investigations of gas escapes, fires, explosions and gas quality. It must be accepted by the HSE in order for a gas transporter to transport gas.

Ofgem's final consent to allow the sales to complete on 1 June was received on 25 May 2005.

With cash proceeds of £5.8 billion, the sales represent a major step in value creation.

We remain committed to operating a substantial gas distribution business in Great Britain and we will continue to be the largest operator of gas distribution assets in the country. The retained system consists of approximately 82,000 miles of distribution pipelines, distributing gas to around 11 million consumers.

The 'Way Ahead' for our retained distribution networks

The 'Way Ahead' restructuring programme in the West Midlands, London, North West and East of England networks (the networks that we retain) is advanced. A number of offices have closed and more are set to close over the coming months as we move to a new unified structure which is supported by two key centres, one in Hinckley and the other at our new office in Northampton. This will enable us to place increased emphasis on safety and efficiency, and share best practice across the organisation.

It should also enable the delivery of further reductions in controllable costs. This is particularly focused on bringing overheads into line with the smaller size of the retained business. In addition, we have entered into eight-year alliances with key contractors to ensure the safe, efficient and sustainable delivery of the iron mains replacement programme.

UK gas transmission

Background information

Our UK gas transmission business comprises the ownership and operation of the gas National Transmission System (NTS) in Great Britain.

The NTS comprises approximately 4,300 miles of high pressure pipe and 25 compressor stations, connecting to eight distribution networks and to third party independent systems for onward transportation of gas to end consumers. Day-to-day operation of the NTS includes balancing supply with demand, maintaining satisfactory system pressures and ensuring gas quality standards are met.

Our UK gas transmission business has two separately regulated activities:

- transmission owner, and
- system operator.

As gas transmission owner, we own and maintain the physical assets, develop the network to accommodate new connections and disconnections, and manage a programme of asset replacement and investment to ensure the long-term reliability of the system.

As gas system operator, we undertake 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. The gas system operator is subject to a regulatory incentive scheme.

Regulation

Our UK gas transmission operations are undertaken under the terms of the NTS gas transporter licence. We are subject to separate revenue restrictions, known as price controls, in respect of gas transmission owner and gas system operator activities which will both last until 31 March 2007.

We are preparing for discussions with Ofgem regarding the next five-year price control commencing on 1 April 2007.

Under the terms of the NTS gas transporter licence, we receive 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 Ofgem's estimate of operating expenditure, capital expenditure and allowed rate of return on the regulatory value, which for the current price control is set at a real pre-tax rate of 6.25%. Our regulatory value is estimated as approximately £2.5 billion at 31 March 2005.

System operator

The system operator price control includes incentive arrangements such that if performance exceeds the targets set in the price control, we retain 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. Our gas transporter licence may also, in certain circumstances, allow the recovery of significant and unforeseen increases in efficiently incurred costs.

Further detailed arrangements for the industry are provided through the Network Code, which defines the obligations, responsibilities and roles of the industry participants.

During 2004, the Health and Safety Executive (HSE) and Ofgem accepted our proposal to remove the ‘Top-up’ arrangements from the Transco Safety Case and the Network Code. Previously under the Network Code, our UK gas transmission business undertook the role of ‘Top-up Manager’. This required the setting, monitoring and preservation of storage levels to protect gas stocks under prolonged and severe winter conditions. This could entail the purchase of gas from the open market to maintain the prescribed levels of gas storage stocks. In turn, this could have led to the business and the wider industry incurring significant costs, if there was a shortage of gas available to the market.

Under the revised arrangements, Top-up storage monitors have been replaced by a set of ‘safety monitors’. These ensure that sufficient gas is kept in the various storage facilities throughout the winter to underpin the safe operation of the network. A potential breach of a safety monitor could lead to Transco declaring a network gas supply emergency and using the established emergency procedures to avoid the breach occurring. The new framework more clearly distinguishes between our role in ensuring safety, and the market’s role in delivering a secure supply.

On 20 January 2005, the Gas and Electricity Markets Authority granted its conditional consent to our application to dispose of four of our eight distribution networks. In conjunction with this, we have undertaken to use our best endeavours to implement enduring exit arrangements for the NTS by 1 September 2005, including the design of incentive schemes to support the exit arrangements.

The incentive schemes are being designed to ensure, among other things, that the NTS is incentivised, through an efficient balance of risk and reward, to release for sale the maximum capacity of the network in response to demand.

Final proposals on the enduring incentive arrangements are anticipated to be published by Ofgem in summer 2005.

In November 2004, we opened the new Gas National Control Centre (GNCC) in Warwick. The centre represents an investment of £3.3 million, and is equipped with the latest technology to cope with the increasing network and commercial complexity.

Operating performance
2004/05 saw a maximum demand for gas of 418 mcm on 28 February 2005. This was a decrease from the previous year’s peak of 444 mcm recorded on 28 January 2004.

The ability of the gas transmission system to transport the available gas is dependent on the performance of our compressor fleet. The compressors are used to manage the pressure at key points on the gas transmission system. The performance of the fleet is measured by the average time elapsed between breakdowns; a longer time indicates better performance. Over 2004/05, the performance improved with the average time between compressor failures at 24% above our five-year average, compared with 11% above the five-year average in 2003/04.

Financial performance
UK gas transmission results for the years ended 31 March 2005 and 2004 were as follows.

Years ended 31 March **UK gas transmission**	**2005** **£m**	2004 (restated) £m
Turnover	**561**	560
Operating costs excluding exceptional items	**(290)**	(279)
Adjusted operating profit	**271**	281
Exceptional items	**(3)**	(6)
Operating profit	**268**	275

The £10 million decrease in adjusted operating profit in 2004/05 was mainly a result of an increase in shrinkage gas costs in 2004/05.

Investment in the network
Capital investment in the replacement, reinforcement and extension of the UK gas national transmission system in 2004/05 was £118 million, compared with £159 million in 2003/04. This decrease was largely due to completion of major projects.

Investment in gas transmission systems is by its nature variable, and is largely driven by changing sources of supply and asset replacement requirements. The gas transporter licence obliges us to provide connections and capacity upon request for users wishing to use the networks.

The UK is entering a period of changing supply patterns for gas. The sources of gas are shifting, with the decline in UK continental shelf gas reserves. We also continue to see a trend towards greater use of gas in power generation with the UK moving towards a low carbon economy.

Due to the decline in gas production from the UK continental shelf, our latest forecast is that the UK will import in the region of 50% of its gas requirements by the end of the decade. We have therefore seen increasing activity in providing the necessary import capability. This involves gas interconnectors and liquefied natural gas (LNG) importation facilities, such as the Norwegian interconnector, the LNG facility at Milford Haven and the LNG facility on the Isle of Grain which National Grid Transco is developing, and which will come on stream this year. It is anticipated that additional Norwegian gas supplies will be delivered at the Easington terminal, and so will require further gas transportation construction from Pannal to Nether Kellett for 2007/08. The Milford Haven importation facility is also due to be connected for the 2007/08 gas supply year and will require the reinforcement of the existing gas transportation network with approximately 170 miles of pipeline in South Wales and Gloucestershire to cater for the increase in flow. The projects to meet the changing supply sources will amount to a total of £750 million in capital expenditure on the gas transmission system over the next five years.

In addition, parts of the gas transmission network, such as compressor stations, control systems and valves, are reaching the end of their lives. This, together with work required to meet changing supply sources, means that the UK gas transmission business will be embarking on a significant increase in investment and asset renewal.

Other businesses
Metering
Other business activities mainly comprise our UK metering business. This provides services on behalf of Transco for an asset base of around

20 million domestic, industrial and commercial gas meters. On 12 July 2004, the UK gas metering industry successfully implemented a suite of new contracts, information systems and business processes to deliver the recommendations of Ofgem's Review of Gas Metering Arrangements. Our metering business played a major role in the four-year industry-wide project.

During 2005/06, it is our intention to bring together our metering business with National Grid Transco's unregulated metering business, Onstream, under a single legal entity, held by National Grid Transco.

Financial performance
The results of other activities for the years ended 31 March 2005 and 2004 were as follows.

Years ended 31 March Other businesses	**2005** **£m**	2004 (restated) £m
Turnover	**397**	425
Operating costs excluding exceptional items	**(308)**	(313)
Adjusted operating profit	**89**	112
Exceptional items	**–**	5
Operating profit	**89**	117

The reduction in adjusted operating profit was principally due to the decrease in turnover of the UK metering business, reflecting lower prices offered in commercial contracts signed in March 2004.

Employee policy
Safety
We believe safety is a core business value and recognise the responsibility each of us has to ensure our own safety and the safety of the colleagues with whom we work.

Our approach to safety management is set out in National Grid Transco's Vision for Safety and its Group Safety and Occupational Health policy. Over the last year, our priority areas for employee safety have remained culture change through introducing behavioural-based safety leadership and improving our approach to risk assessment and the integration of the results into job briefings.

During 2004/05, we included for the first time directly supervised contractors in our employee safety statistics for UK gas distribution, as this more accurately recognises the day-to-day management of their safety performance.

For a second year, our UK gas distribution business has shown a significant improvement in contractor LTIs, with a 42% reduction compared to 2003/04.

Valuing people through inclusion
We are committed to developing and operating our business in a way that results in a more inclusive culture.

We believe that fostering diversity is everyone's responsibility and that open, honest and respectful communication is the cornerstone of good business.

In January, National Grid Transco launched its Group-wide Vision statement for Inclusion and Diversity by sending an information pack to every employee and it has established Group-wide steering groups to develop and execute action plans. We will establish a set of measures against which to track our progress and we will continue to encourage regular feedback from our internal and external stakeholders. Fundamentally, we believe that a positive approach to Inclusion and Diversity is not a 'nice to have' but is essential for us to attract and retain the best people, improve our effectiveness, deliver superior performance and enhance the success of our company.

Inclusion and Diversity vision of the National Grid Transco Group
We will strive to develop and operate our business in a way that results in a more inclusive and diverse culture. This will enable us to attract and retain the best people, improve our effectiveness, deliver superior performance and enhance the success of the company.

We will ensure all employees, regardless of race, gender, nationality, age, disability, sexual orientation, religion and background, have the opportunity to develop to their full potential. We will prevent artificial or prejudicial barriers from getting in the way of their development.

- We believe that fostering diversity is everyone's responsibility.
- We believe that open, honest and respectful communication is the cornerstone of good business.
- We believe that a positive approach to Inclusion and Diversity is not a 'nice to have' but is fundamentally the right thing to do for us as a business.

Employee engagement
The 2004 National Grid Transco employee survey demonstrated a positive response concerning employee engagement. Our employees tell us that they are proud to work for us, are personally motivated to help us be successful and are willing to put in increased efforts to help the Group succeed. However, we have recognised that there are a number of areas still to be worked on and, as a result, we have identified a number of Group-wide priorities, which we are now addressing across each of the businesses. These include the need to improve communications, ensuring that our Group strategy is clearly explained and understood, and managing change processes in a better way. We will continue to progress with these over the coming year.

The survey also highlighted the need to reinforce our performance management and development planning process.

We are creating opportunities to involve employees to a greater degree and the employee opinion survey, focus groups, and project specific steering groups have enabled to us to promote two way feedback.

We believe that our approach to employee reward and the continued encouragement of share ownership amongst our employees helps to promote the links between employee and shareholder objectives.
Total reward statements were produced for all UK employees during 2004. These were well received and it is our intention to repeat this on an annual basis.

Financial Review

Basis of accounting

The accounts on pages 19 to 38 present our results for the years ended 31 March 2005 and 2004 and our financial position as at 31 March 2005 and 2004. They have been prepared using the accounting policies shown on pages 19 and 20, in accordance with generally accepted accounting principles in the United Kingdom (UK GAAP).

This is expected to be the last annual report in which we will be presenting consolidated financial statements under UK GAAP, as we intend to apply International Financial Reporting Standards (IFRS) starting with our annual report for the year ending 31 March 2006.

Further discussion on the performance of the Group on a segment by segment basis is included in the Operating Review on pages 2 to 8.

Financial performance

Year ended 31 March Group	**2005** **£m**	2004 (restated) £m
Turnover	**3,045**	3,122
Operating costs excluding exceptional items	**(2,115)**	(2,013)
Adjusted operating profit	**930**	1,109
Operating exceptional items	**(183)**	(90)
Total operating profit	**747**	1,019
Net interest payable	**(431)**	(397)
Profit before taxation	**316**	622
Taxation	**(92)**	(153)
Profit for the year	**224**	469

The following discussion compares the results for the year ended 31 March 2005 (2004/05) with those of the year ended 31 March 2004 (2003/04).

Changes in accounting policies

The Group adopted FRS 20 ‘Share-based Payment’ on 1 April 2004. The standard requires the Group to record a charge in its profit and loss account reflecting the value of grants of shares or rights to shares to third parties, including employees. A charge is recognised in the profit and loss account based on the fair value of the shares at the date the grant of shares or right to shares is made. The charge incurred in 2004/05 was £3 million.

As a consequence of this change in accounting policy, the financial statements for 2003/04 have been restated, with adjusted operating profit and operating profit reduced by £15 million. Net liabilities at 31 March 2004 were restated from £1,811 million to £1,807 million.

Group turnover

Group turnover reduced by £77 million from £3,122 million in 2003/04 to £3,045 million in 2004/05 principally due to reduced UK gas distribution turnover.

Group operating costs

Group operating costs, excluding exceptional items, increased by £102 million from £2,013 million in 2003/04 to £2,115 million in 2004/05. This was principally due to an £86 million planned increase in replacement expenditure.

Adjusted operating profit

Adjusted operating profit at £930 million in 2004/05 was £179 million lower than 2003/04, primarily as a result of a £84 million reduction in the adjusted operating profits of UK gas distribution, and a £62 million reduction for discontinued operations. The contribution from other activities was also £23 million lower.

Operating exceptional items

Net operating exceptional items included within total operating profit increased by £93 million from a net charge of £90 million in 2003/04 to a net charge of £183 million in 2004/05. The exceptional operating items for 2004/05 related to:

- £62 million of restructuring costs related to our disposal of four distribution networks;
- £112 million of other restructuring costs, primarily relating to planned cost reduction programmes, of which £102 million relates to UK gas distribution and £7 million to discontinued operations; and
- £9 million of increases in provisions for environmental costs, based on higher cost estimates from the continued evaluation of new environmental legislation and the impact of changes in the timing of expenditure.

Net operating exceptional items in 2003/04 comprised £103 million of other restructuring costs, of which £40 million was for UK gas distribution and £63 million for discontinued operations, and a release of £13 million of environmental costs following the completion of site investigations.

Group operating profit

Group total operating profit fell by £272 million from 2003/04 to 2004/05, resulting from a £179 million reduction in adjusted operating profit and a £93 million increase in net operating exceptional items.

Interest

Net interest rose by £34 million from £397 million in 2003/04 to £431 million in 2004/05. This was due to an increase in the level of net debt and interest rates, partly offset by a £15 million reduction in pensions interest.

Taxation

The net tax charge fell from £153 million in 2003/04 to £92 million in 2004/05. The net tax charge includes exceptional tax credits in respect of exceptional items of £44 million in 2004/05 and £28 million in 2003/04. The effective tax rate increased from 24.6% in 2003/04 to 28.7% in 2004/05.

Excluding the effects of exceptional tax credits and tax adjustments in respect of prior years, the effective tax rate for 2004/05 was 31.1% compared with 31.2% for 2003/04 and compared with a standard UK corporation tax rate of 30% for both years.

Note 9 to the accounts on page 30 shows a reconciliation of the main components giving rise to the difference between the relevant effective rate and the UK standard corporation tax rate.

Pensions costs

Pensions costs calculated in accordance with Statement of Standard Accounting Practice 24 (SSAP 24) were £93 million in 2004/05, with £82 million charged to operating costs and £11 million to interest expense. This was £26 million lower than the charge in 2003/04 of £119 million. This resulted from the spreading of a lower pension deficit in the Lattice Scheme.

The Group does not account for pension costs under FRS 17, 'Retirement benefits', but has provided the required additional disclosures as shown in note 7 to the accounts on page 29.

Segmental reporting

The presentation of segment information is based on the management responsibilities that existed at 31 March 2005. The segments at 31 March 2005 comprised UK gas distribution, UK gas transmission and other activities. The four regional gas distribution networks sold on 1 June 2005 are reported as discontinued operations. They were previously a part of UK gas distribution.

A review of the operating and financial performance of the reporting segments is contained on pages 2 to 8, together with additional financial and performance information relating to the segments, including a discussion of changes in turnover, adjusted operating profit and operating profit.

Liquidity resources and capital expenditure

Cash flow

Net cash inflow from operations before exceptional items was £1,301 million in 2004/05, compared with £1,623 million in 2003/04. The reduced cash flow from operations before exceptional items was principally due to the decrease in adjusted operating profit.

Exceptional cash flows in 2004/05 and 2003/04 of £126 million and £149 million relate to cash flows arising from restructuring costs and environmental expenditure. Taking these into account, net cash inflow from operations was £1,175 million in 2004/05 compared with £1,474 million in 2003/04.

Net payments of interest totalled £384 million in the 2004/05, compared with £334 million in 2003/04. This increase was due to higher levels of net debt and an increase in interest rates.

Net corporation tax payments amounted to £160 million in 2004/05, compared with £59 million in 2003/04.

Net purchases of tangible fixed assets absorbed cash of £472 million in 2004/05, compared with £493 million in 2003/04. The reduction in net cash outflow in the 12 months ended 31 March 2005 reflects a lower level of investment across all businesses.

Equity shareholders' funds

Equity shareholders' funds at 31 March 2004 have been restated from the amounts reported in last year's Group accounts as a consequence of implementing FRS 20 'Share-based Payment'. The deficit on equity shareholders' funds at 31 March 2004 of £1,811 million was restated to £1,807 million.

The deficit on equity shareholders' funds increased from £1,807 million (restated) at 31 March 2004 to £4,031 million at 31 March 2005. This decrease is primarily explained by the dividends paid or proposed of £2,450 million exceeding retained profits for the year of £224 million.

Capital expenditure

Capital expenditure was £463 million in 2004/5, compared with £535 million in 2003/04. The reduction in capital expenditure reflects a lower level of investment across all businesses.

The Operating Review on pages 2 to 8 contains a discussion of any significant variances between years for capital expenditure by reporting segment and provides details of any material capital expenditure programmes.

Net debt and gearing

Net debt rose from £5,974 million at 31 March 2004 to £6,528 million at 31 March 2005. Gearing at 31 March 2005, calculated as net debt at that date expressed as a percentage of net debt plus net assets shown by the balance sheet plus proposed dividends (£2,000 million at 31 March 2005: £nil at 31 March 2004), amounted to 145% up from 143% (restated) 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 52% at 31 March 2005 up from 51% (restated) 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/(liabilities)	**2005** **£m**	2004 (restated) £m
Net (liabilities) per balance sheet	**(4,031)**	(1,807)
Adjustment for increase in estimated regulatory values	**8,020**	7,510
Adjusted net assets	**3,989**	5,703

An analysis of debt is provided in note 17 to the accounts on page 33, and a reconciliation of the movement in net debt from 1 April 2004 to 31 March 2005 is provided in note 23(c) to the accounts on page 37.

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

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

At 31 March 2005, Transco had a US$1.25 billion Euro Commercial Paper Programme (US$0.1 billion unutilised); a US$2.5 billion US Commercial Paper Programme (US$1.5 billion unutilised); and Transco plc and Transco Holdings plc had a joint Euro Medium Term Note Programme of €7 billion (€3.3 billion unissued).

At 31 March 2005, Transco had £1.5 billion of short-term (364 day) 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 Holdings. All significant issues in relation to the funding of Transco Holdings are approved by the Finance Committees of both National Grid Transco and Transco Holdings.

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 2005 are shown in note 18 to the accounts on pages 33 to 35.

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 2005 are shown in note 18 to the accounts on page 34.

Transco Holdings plc has a credit rating of A3/A-/A-, and Transco plc, its wholly owned subsidiary undertaking, has a credit rating of A2/A/A, provided by Moody's, Standard & Poor's and Fitch respectively. It is a condition of the regulatory ring-fence around Transco Holdings and Transco that they use reasonable endeavours to maintain an investment grade credit rating. These ratings mean that Transco Holdings and 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 a minimum of 75% of such transactions expected to occur up to six months in advance and of 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 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

Commitments and contingencies

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

	2005 £m	2004 £m
Future capital expenditure contracted for but not provided	**313**	76
Total operating lease commitments	**110**	149
Third party contingencies	**13**	13
Other commitments and contingencies	**127**	69

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 are shown in note 25 to the accounts on pages 37 and 38.

Details of material litigation to which the Group was a party as at 31 March 2005

Transco plc, a subsidiary undertaking of Transco Holdings, has been charged with breaches of the Health and Safety at Work Act 1974 following the fatal accidents at Larkhall, Lanarkshire, in December 1999, and Cavendish Mill, Lancashire, in November 2001.In each case the maximum penalty for such breaches is an unlimited fine.

Retirement arrangements

The substantial majority of the Group'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 was carried out at 31 March 2003. This valuation was completed during the year ended 31 March 2004. It 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. An assessment of the Scheme was conducted at 31 March 2004. This assessment indicated that the deficit has decreased in the defined benefit section on the basis of the funding assumptions adopted by the actuary. The next full valuation will be conducted at 31 March 2006.

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, National Grid Transco will pay the gross amount of any deficit up to a maximum amount of £520 million (£364 million net of tax) into the Scheme. Transco's share of these payments is £468 million (£328 million net of tax). Until the 31 March 2007 actuarial valuation has been 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 National Grid Transco failing to make agreed payments into the fund. Employer cash contributions for the ongoing cost of the Lattice Scheme are currently being made at a rate of 23.3% of pensionable payroll for the year to 31 March 2006.

Critical accounting policies

The financial statements are prepared using the Group's accounting policies as described on pages 19 and 20, in accordance with UK GAAP.

The application of accounting principles requires us to make estimates, judgements and assumptions that may affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities in the accounts. On an ongoing basis, we evaluate our estimates using historical experience, consultation with experts and other methods that we consider reasonable in the particular circumstances to ensure compliance with UK GAAP. Actual results may differ significantly from our estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known.

Certain of the Group's UK GAAP accounting policies have been identified as critical accounting policies, as these policies involve particularly complex or subjective decisions or assessments. The discussion of critical accounting policies below should be read in conjunction with the description of the Group's accounting policies set out on pages 19 and 20.

Estimated asset economic lives

Determining the particular asset economic lives in respect of tangible fixed assets involves the exercise of judgement and 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'. For the year ended 31 March 2005, the Group profit and loss account reflected depreciation of tangible fixed assets amounting to £404 million (2003/04: £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; 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.

At 31 March 2005, we carried out reviews for impairment of our LNG storage assets. At 31 March 2004, we carried out reviews for impairment of our metering and LNG storage assets.

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 2005 was £474 million (2003/04: £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.

In the UK gas distribution and UK gas transmission segments, turnover in respect of transportation services supplied includes an estimate for transportation services supplied but not yet invoiced, which substantially represent the transportation services supplied in respect of the last month of the year. The estimate of unbilled turnover is determined as the total of commodity services supplied, less amounts already billed during the year. Total commodity services supplied is calculated from the actual volume of gas transported at estimated weighted average prices, based on recent history and the value of contracted capacity services supplied. Our estimate of unbilled revenues for these segments amounted to £304 million, 10% of total annual segmental revenues, at 31 March 2005 (£319 million, 10%, at 31 March 2004).

Under UK GAAP, the Group is not permitted to recognise 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 for accounting periods commencing on or after 1 January 2005. 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.

For the year ended 31 March 2005, the Group recognised a charge excluding exceptional items for pensions of £93 million (2003/04: £119 million).

Note 7 to the accounts on page 29 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. The assumptions adopted are based on prior experience, market conditions and the advice of plan actuaries.

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 items. Restructuring costs recognised by the Group are referred to in 'Exceptional items' for each year and are discussed earlier in this Financial Review.

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 18 to the accounts on pages 33 to 35 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 as described in note 19 to the accounts on page 35. 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.

At 31 March 2005, we have recorded provisions for environmental liabilities totalling £89 million (31 March 2004: £85 million). A range of recorded provision balances was possible if different assumptions had been used as to the amount of future expenditure or its timing. The amount of the provision can also be affected by changes in the discount rate used.

Taxation

The group's tax charge is based on the profit for the year and tax rates in effect. The determination of appropriate provisions for taxation requires us to take into account anticipated decisions of tax authorities and estimate our ability to utilise tax benefits through future earnings and tax planning. Our estimates and assumptions may differ from future events.

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 2005 have been noted in this Annual Report and Accounts.

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.

Board of Directors

Colin Buck (55)
Appointed a Director of the Company in June 2003 and is also Finance Director of Transco responsible for all financial aspects and Corporate Governance issues. 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.

Malcolm Cooper (46)
Appointed a Director of the Company in October 2000 and is also Group Treasurer of National Grid Transco. He joined British Gas plc in 1991, having previously worked for Andersen Consulting, and was appointed Director of Corporate Finance in October 1998. He is a Fellow of the Chartered Association of Certified Accountants and the Association of Corporate Treasurers.

Mark Fairbairn (46)
Appointed a Director of the Company in June 2003 and is also a Director and Chief Operating Officer of Transco. 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).

Steve Holliday (48)
Appointed a Director of the Company in June 2003 and is also Chief Executive of Transco. 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. Steve is also a Non-executive Director of Marks and Spencer Group plc.

Steve Lucas (51)
Appointed a Director of the Company in October 2000 and is also Group Finance Director of National Grid Transco and a Director of 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. Steve is also a Non-executive Director of Compass Group plc.

Helen Mahy
Company Secretary
Appointed March 2002. She is a Barrister and an Associate of the Chartered Insurance Institute, and was previously Group General Counsel and Company Secretary at Babcock International Group plc. She was appointed a Non-Executive Director of AGA Foodservice Group plc in March 2003.

General Information

Incorporation
Transco Holdings 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 Holdings plc is a wholly owned subsidiary undertaking of Lattice Group plc. The ultimate parent company of Transco Holdings plc is National Grid Transco plc.

Employee policy
Information on Transco's employee policies is included on page 8.

The Group uses multiple channels to communicate with its staff. These include email, Group intranets, cascade briefings, employee telephone information lines and in-house magazines. Additionally, regular consultation with employees and their trade unions takes place using both formal and informal mechanisms.

The Group facilitates share ownership amongst its employees by the operation of both sharesave and share incentive plans.

Directors' remuneration
Details of Directors' remuneration are shown in note 6, page 29.

Transco Holdings does not have a Remuneration Committee, Transco Holdings' 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
Steve Holliday and Steve Lucas 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.

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.

Dividends
An interim dividend of £450 million was paid during the year and a further dividend of £2,000 million was proposed (2003/04: £301 million paid).

Donations
Charitable donations of £243,000 were made in 2004/05 in support of community initiatives and relationships in the UK (2003/04: £560,000). 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 Holdings' ultimate parent company, National Grid Transco, is a signatory to the Better Payment Practice Code, details of which can be found at www.payontime.co.uk.

Directors' beneficial interests

	At 1 April 2004	At 31 March 2005(i)
Colin Buck	13,429	20,657
Malcolm Cooper	49,252	49,576
Mark Fairbairn	9,699	13,236

All interests are in shares in National Grid Transco plc, Transco Holdings' ultimate parent undertaking. Interests exclude shares acquired pursuant to the National Grid Share Matching Scheme (see below under Directors' interests in share options note (i)).

(i) Interests include shares acquired pursuant to the National Grid Transco Share Incentive Plan.

Performance Share Plan interests

	Beneficial holding at 1 April 2004	Awarded in year	Beneficial holding at 31 March 2005	Release dates
Colin Buck	18,507	22,241	40,748	June 2007 to June 2008
Malcolm Cooper	29,611	39,917	69,528	June 2007 to June 2008
Mark Fairbairn	29,611	47,072	76,683	June 2007 to June 2008

All interests are 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 2004	Lapsed	Granted	Exercised	Beneficial holding at 31 March 2005	Weighted average exercise price per share (pence)	Normal exercise period
Colin Buck	55,576	–	2,588	3,004	55,160	477.7p	Jun 2003 – Jun 2012
Malcolm Cooper	22,863	–	–	–	22,863	406.18p	Dec 2005 – Dec 2012
Mark Fairbairn	101,721	–	862	1,001	101,582	503.7p	Jun 2001 – Jun 2012

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

In addition to the interests shown above, these Directors 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 2002	733	478.25	1,223
Colin Buck	June 2003	1,129	402.75	1,940
Colin Buck	May 2004	1,528	431.25	2,626
Malcolm Cooper	May 2004	2,071	431.25	3,560
Mark Fairbairn	June 2002	1,176	478.25	1,960
Mark Fairbairn	June 2003	1,419	402.75	2,437
Mark Fairbairn	May 2004	2,850	431.25	4,897

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

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

The average creditor payment period at 31 March 2005 was 29 days (32 days at 31 March 2004).

Research and development

Expenditure on research and development was £4 million in 2004/05 (2003/04: £4 million).

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: Accounting Policies, Accounts and Notes to the Accounts) 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.

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 Accounts, 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

Notice of the Transco Holdings plc Annual General Meeting for 2005 will be issued separately to shareholders.

On behalf of the Board

Helen Mahy
Company Secretary
28 June 2005
Registered Office:
1-3 Strand, London WC2N 5EH
Registered in England and Wales No. 3675375

Independent Auditors' Report to the Members of Transco Holdings 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 Introductory 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 2005 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 28 June 2005

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.

The Group has adopted Financial Reporting Standard 20 'Share-based Payment' during the year. The impact of adoption is shown in note 1.

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.

The Group's principal subsidiary, 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. These restrictions are not sufficiently onerous to prevent Group management from exercising control of the business or rights over the subsidiary undertaking's assets and management and hence Transco's results have been consolidated.

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, apart from certain meters which are depreciated on a sum-of-the-digits 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 18
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 items. Impairment reversals are recognised when, in management's opinion, the reversal is permanent.

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) Operating 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.

o) Share-based payments
Equity-settled share-based payments are made to employees of the Group. These are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest.

p) Investments
Investments in subsidiary companies are included in the balance sheet at cost adjusted by any provision required for impairment in value.

Group Profit and Loss Account for the years ended 31 March

	Notes	**2005** **£m**	2004 (restated) (i) £m
Group turnover – continuing operations		**1,996**	2,053
Group turnover – discontinued operations		**1,049**	1,069
Group turnover	2(a)	**3,045**	3,122
Operating costs	3	**(2,298)**	(2,103)
Operating profit – continuing operations	2(b)	**476**	668
Operating profit – discontinued operations	2(b)	**271**	351
Operating profit			
– Before exceptional items	2(b)	**930**	1,109
– Exceptional items – continuing operations	4(a)	**(109)**	(34)
– Exceptional items – discontinued operations	4(a)	**(74)**	(56)
Total operating profit	2(b)	**747**	1,019
Net interest	8	**(431)**	(397)
Profit on ordinary activities before taxation		**316**	622
Taxation			
– Excluding exceptional items	9	**(136)**	(181)
– Exceptional items	9	**44**	28
Total taxation	9	**(92)**	(153)
Profit for the year			
– Before exceptional items		**363**	531
– Exceptional items – operating		**(139)**	(62)
Profit for the year		**224**	469
Dividends	10	**(2,450)**	(301)
(Loss)/profit transferred (from)/to profit and loss account reserve	21	**(2,226)**	168

(i) During the year ended 31 March 2005, the Group adopted Financial Reporting Standard (FRS) 20 'Share-based Payment' – see note 1.

The notes on pages 24 to 38 form part of the Accounts.

Balance Sheets at 31 March

	Notes	Group 2005 £m	Group 2004 (restated)(i) £m	Company 2005 £m	Company 2004 (restated)(i) £m
Fixed assets					
Tangible assets	11	**7,935**	7,876	**–**	–
Investments	12	**–**	–	**7,118**	7,118
		7,935	7,876	**7,118**	7,118
Current assets					
Stocks	13	**30**	32	**–**	–
Debtors (amounts falling due within one year)	14	**509**	381	**154**	150
Debtors (amounts falling due after more than one year)	14	**4**	–	**–**	–
Current asset investments		**13**	75	**242**	490
Cash at bank and in hand		**3**	–	**–**	–
		559	488	**396**	640
Creditors (amounts falling due within one year)					
Borrowings		**(1,764)**	(988)	**(126)**	(173)
Other creditors		**(3,430)**	(1,741)	**(2,217)**	(445)
	15	**(5,194)**	(2,729)	**(2,343)**	(618)
Net current (liabilities)/assets		**(4,635)**	(2,241)	**(1,947)**	22
Total assets less current liabilities		**3,300**	5,635	**5,171**	7,140
Creditors (amounts falling due after more than one year)					
Borrowings		**(4,780)**	(5,061)	**(1,384)**	(1,425)
Other creditors		**(1,101)**	(1,027)	**(2,644)**	(2,544)
	16	**(5,881)**	(6,088)	**(4,028)**	(3,969)
Provisions for liabilities and charges	19	**(1,450)**	(1,354)	**(2)**	(2)
Net (liabilities)/assets		**(4,031)**	(1,807)	**1,141**	3,169
Capital and reserves					
Called up share capital	20	**147**	147	**147**	147
Other reserves	21	**(5,537)**	(5,537)	**–**	–
Profit and loss account	21	**1,359**	3,583	**994**	3,022
Equity shareholders' (deficits)/funds	22	**(4,031)**	(1,807)	**1,141**	3,169

(i) During the year ended 31 March 2005, the Group adopted Financial Reporting Standard (FRS) 20 'Share-based Payment' – see note 1.

Commitments and contingencies are shown in note 25, pages 37 and 38.

The notes on pages 24 to 38 form part of the Accounts.

The Accounts on pages 19 to 38 inclusive were approved by the Board on 28 June 2005 and were signed on its behalf by:

Steve Holliday

Colin Buck

Group Cash Flow Statement for the years ended 31 March

	Notes	2005 £m	2004 £m
Net cash inflow from operating activities before exceptional items	23(a)	**1,301**	1,623
Expenditure relating to exceptional items		**(126)**	(149)
Net cash inflow from operating activities		**1,175**	1,474
Returns on investments and servicing of finance			
Interest received and similar income		**32**	55
Interest paid and similar charges		**(416)**	(389)
Net cash outflow for returns on investments and servicing of finance		**(384)**	(334)
Taxation			
Corporation tax paid		**(160)**	(59)
Capital expenditure			
Payments to acquire tangible fixed assets		**(472)**	(513)
Receipts from disposal of tangible fixed assets		**–**	20
Net cash outflow for capital expenditure		**(472)**	(493)
Equity dividends paid		**(450)**	(301)
Net cash (outflow)/inflow before management of liquid resources and financing		**(291)**	287
Management of liquid resources (i)			
Decrease/(increase) in short–term deposits		**62**	(68)
Net cash inflow/(outflow) from the management of liquid resources	23(b)(c)	**62**	(68)
Financing			
Increase/(decrease) in borrowings	23(b)(c)	**492**	(335)
(Decrease)/increase in loans from fellow subsidiary undertaking		**(254)**	108
Other funding movement		**–**	15
Net cash inflow/(outflow) from financing		**238**	(212)
Net increase in cash and overdrafts	23(b)(c)	**9**	7

(i) Liquid resources comprise money market deposits, equities and gilts.

Group Statement of Total Recognised Gains and Losses for the years ended 31 March

	2005 £m	2004 (restated) (i) £m
Profit for the year	**224**	469
Total recognised gains and losses relating to the year	**224**	469
Prior year adjustment (i)	**4**	
Total recognised gains and losses since last annual report	**228**	

(i) During the year ended 31 March 2005, the Group adopted Financial Reporting Standard (FRS) 20 'Share-based Payment' – see note 1.

The notes on pages 24 to 38 form part of the Accounts.

Five Year Financial Record (unaudited)

Profit and loss account

	12 months ended 31 Mar 2005 £m	12 months ended 31 Mar 2004 (restated) £m	12 months ended 31 Mar 2003 (restated) £m	15 months ended 31 Mar 2002 (restated) £m	12 months ended 31 Dec 2000 (restated) £m
Group turnover	**3,045**	3,122	3,037	3,922	2,975
Operating costs	**(2,298)**	(2,103)	(2,255)	(2,631)	(1,902)
Operating profit	**747**	1,019	782	1,291	1,073
Operating profit before exceptional items	**930**	1,109	928	1,391	1,114
Exceptional items	**(183)**	(90)	(146)	(100)	(41)
Operating profit	**747**	1,019	782	1,291	1,073
Non-operating exceptional costs	**–**	–	(8)	–	–
Profit on disposal of fixed asset investments	**–**	–	4	–	4
(Loss)/profit on disposal of tangible fixed assets	**–**	–	(6)	10	(19)
Net interest	**(431)**	(397)	(415)	(502)	(444)
Profit on ordinary activities before taxation	**316**	622	357	799	614
Taxation					
– excluding exceptional items	**(136)**	(181)	(161)	(275)	(202)
– exceptional items	**44**	28	41	32	8
Profit for the period	**224**	469	237	556	420

Balance sheet

	31 Mar 2005 £m	31 Mar 2004 (restated) £m	31 Mar 2003 (restated) £m	31 Mar 2002 (restated) £m	31 Dec 2000 (restated) £m
Fixed assets	**7,935**	7,876	7,783	7,540	7,122
Current assets	**559**	488	416	534	614
Creditors: amounts falling due within one year	**(5,194)**	(2,729)	(2,271)	(1,923)	(2,751)
Net current liabilities	**(4,635)**	(2,241)	(1,855)	(1,389)	(2,137)
Total assets less current liabilities	**3,300**	5,635	5,928	6,151	4,985
Creditors: amounts falling due after more than one year	**(5,881)**	(6,088)	(6,470)	(6,620)	(5,757)
Provisions for liabilities and charges	**(1,450)**	(1,354)	(1,448)	(1,409)	(1,385)
Net liabilities	**(4,031)**	(1,807)	(1,990)	(1,878)	(2,157)
Total shareholders' funds (deficits)	**(4,031)**	(1,807)	(1,990)	(1,878)	(2,157)

Cash flow statement

	12 months ended 31 Mar 2005 £m	12 months ended 31 Mar 2004 £m	12 months ended 31 Mar 2003 (restated) £m	15 months ended 31 Mar 2002 (restated) £m	12 months ended 31 Dec 2000 (restated) £m
Operating cash inflow before exceptional items	**1,301**	1,623	1,454	2,366	1,479
Net expenditure relating to exceptional items	**(126)**	(149)	(135)	(12)	(4)
Net cash inflow from operating activities	**1,175**	1,474	1,319	2,354	1,475
Net cash outflow from returns on investments and servicing of financing	**(384)**	(334)	(391)	(424)	(454)
Net cash outflow from taxation	**(160)**	(59)	(85)	(240)	(191)
Net cash outflow from capital expenditure and financial investment	**(472)**	(493)	(605)	(909)	(606)
Net cash flow from acquisitions and disposals	**–**	–	1	13	6
Equity dividends paid	**(450)**	(301)	(550)	(160)	(379)
Net cash (outflow)/inflow before management of liquid resources	**(291)**	287	(311)	634	(149)
Net cash inflow/(outflow) from management of liquid resources	**62**	(68)	15	36	210
Net cash inflow/(outflow) from financing activities	**238**	(212)	318	(698)	(55)
Net increase/(decrease) in cash in period	**9**	7	22	(28)	6

Definitions

Company
Transco Holdings plc.

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

GAAP
Generally accepted accounting principals.

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

HSE
Health and Safety Executive.

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

LNG
Liquefied natural gas.

LTI
Lost time injury. A work-related injury that causes a person to be away from work for at least one normal shift after the shift on which the injury occurs, because the person is unfit to perform his or her duties.

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.

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

NTS
Transco's UK gas national transmission system.

Ofgem
The Office of Gas and Electricity Markets.

Ordinary shares
Ordinary shares of £1 each in the capital of Transco Holdings.

TWh
Terawatt hours. 10^9 kWh (Kilowatt hours)

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

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

1. Adoption of Financial Reporting Standard (FRS) 20

During the year, the Group adopted FRS 20 'Shared-based Payment'. The adoption of this standard constitutes a change in accounting policy. Therefore, the impact has been reflected as a prior year adjustment in accordance with FRS 3.

The standard requires that where shares or rights to shares are granted to third parties, including employees, a charge should be recognised in the profit and loss account based on the fair value of the shares at the date the grant of shares or right to shares is made.

For the year ended 31 March 2005, the adoption of FRS 20 has reduced both basic and adjusted operating profit by £7m, reduced basic and adjusted profit for the year by £3m, and increased net assets employed by £10m.

The effect of the adoption of FRS 20 on prior year comparatives is as follows:

	Year ended 31 March 2004		
	As previously reported £m	Impact of FRS 20 £m	As restated £m
Operating profit			
– Before exceptional items	1,124	(15)	1,109
– After exceptional items	1,034	(15)	1,019
Profit for the year			
– Before exceptional items	546	(15)	531
– After exceptional items	484	(15)	469
Net liabilities			
– At 31 March 2004	(1,811)	4	(1,807)
– At 1 April 2003	(1,994)	4	(1,990)

The corresponding entry to the pre-tax FRS 20 charge for the year ended 31 March 2004 was recorded through the profit and loss account reserve. Therefore, the impact of restatements for FRS 20 on the profit and loss account reserve at 31 March 2004 represents only the deferred tax credit of £4m.

The adoption of FRS 20 has had no impact on the profit and loss account or net assets of the Company.

2. Segmental analysis

Segmental information is presented in accordance with the management responsibilities and economic characteristics of the Group's business activities. Discontinued operations comprise the four gas distribution networks which the Group sold on 1 June 2005.

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

a) Turnover

	Total sales 2005 £m	**Sales between businesses 2005 £m**	**Sales to third parties 2005 £m**	Total sales 2004 (restated) £m	Sales between businesses 2004 (restated) £m	Sales to third parties 2004 (restated) £m
Continuing operations						
UK gas distribution	**1,113**	**47**	**1,066**	1,130	41	1,089
UK gas transmission	**561**	**3**	**558**	560	2	558
Other activities	**397**	**25**	**372**	425	19	406
	2,071	**75**	**1,996**	2,115	62	2,053
Discontinued operations	**1,102**	**53**	**1,049**	1,115	46	1,069
	3,173	**128**	**3,045**	3,230	108	3,122

b) Operating profit

	Before exceptional items		After exceptional items	
	2005 £m	2004 (restated) £m	**2005 £m**	2004 (restated) £m
Continuing operations				
UK gas distribution	**225**	309	**119**	289
UK gas transmission	**271**	281	**268**	275
Other activities	**89**	112	**89**	117
	585	702	**476**	681
Discontinued operations	**345**	407	**271**	338
	930	1,109	**747**	1,019

2. Segmental analysis (continued)

c) Total and net assets/(liabilities)

at 31 March	Total assets 2005 £m	Total assets 2004 (restated) £m	Net assets/(liabilities) 2005 £m	Net assets/(liabilities) 2004 (restated) £m
Continuing operations				
UK gas distribution	**2,280**	2,221	**1,484**	1,500
UK gas transmission	**2,080**	2,166	**1,831**	1,889
Other activities	**995**	1,054	**884**	923
	5,355	5,441	**4,199**	4,312
Discontinued operations	**2,888**	2,707	**2,075**	1,903
	8,243	8,148	**6,274**	6,215
Unallocated	**251**	216	**(10,305)**	(8,022)
	8,494	8,364	**(4,031)**	(1,807)

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, cash, 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 2005 £m	Capital expenditure 2004 (restated) £m	Depreciation 2005 £m	Depreciation 2004 (restated) £m
Continuing operations				
UK gas distribution	**120**	125	**94**	97
UK gas transmission	**118**	159	**76**	75
Other activities	**73**	83	**137**	153
	311	367	**307**	325
Discontinued operations	**152**	168	**97**	98
	463	535	**404**	423

Capital expenditure comprises additions to tangible fixed assets.

3. Operating costs

	Continuing operations 2005 £m	Continuing operations 2004 (restated) £m	Discontinued operations 2005 £m	Discontinued operations 2004 (restated) £m	Total 2005 £m	Total 2004 (restated) £m
Total operating costs	**1,520**	1,385	**831**	764	**2,351**	2,149
Charged from discontinued operations	**(53)**	(46)	**–**	–	**(53)**	(46)
External operating costs	**1,467**	1,339	**831**	764	**2,298**	2,103
Depreciation	**307**	325	**97**	98	**404**	423
Payroll costs (note 5(a))	**269**	277	**132**	133	**401**	410
Other operating charges						
– Purchases of gas	**85**	66	**28**	20	**113**	86
– Rates and property taxes	**159**	158	**84**	82	**243**	240
– Replacement expenditure	**239**	187	**235**	201	**474**	388
– Exceptional operating items	**109**	34	**74**	56	**183**	90
– Other non-exceptional operating charges	**299**	292	**181**	174	**480**	466
	891	737	**602**	533	**1,493**	1,270
	1,467	1,339	**831**	764	**2,298**	2,103
Operating costs include:						
Research and development costs					**4**	4
Operating lease rentals:						
– Plant and machinery					**11**	11
– Other					**18**	15
Auditors' remuneration:						
Statutory audit services						
– Annual audit (Company: £21,000; 2004: £13,000)					**0.4**	0.4
– Regulatory reporting					**0.2**	0.2
Further audit related services					**0.3**	0.3

4. 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.

a) Operating exceptional items

	2005 £m	2004 (restated) £m
Continuing operations		
Restructuring costs (i)	**105**	40
Environmental provision (iii)	**4**	(6)
	109	34
Discontinued operations		
Restructuring costs (ii)	**69**	63
Environmental provision (iii)	**5**	(7)
	74	56
Total operating exceptional items	**183**	90

(i) The restructuring costs in respect of continuing operations for 2005 and for 2004 primarily relate to cost reduction programmes (2005: £72m after tax; 2004: £28m after tax).

(ii) The restructuring costs in respect of discontinued operations for 2005 consist of £62m (2004: £24m) costs associated with the disposal of distribution networks and other charges of £7m (2004: £90m). The other charges primarily relate to cost reduction programmes. (2005: £56m after tax, 2004: £47m after tax).

(iii) During the year ended 31 March 2005, a review of the environmental provision was undertaken to take into account the impact of recent changes to the regulations on waste disposal. This review, together with related revisions to the expected expenditure profile, has resulted in a charge in 2005 of £9m (£6m after tax). The credit of £13m in 2004 arises from an adjustment to carrying values following the completion of site investigations.

b) Taxation

The exceptional tax credit of £44m in 2005 is net of a £5m charge relating to the settlement of the liabilities arising from the operation of the Group's Qualifying Employee Share Ownership Trust. The remainder of the exceptional tax credit for 2005 and all of the exceptional tax credit for 2004 relates to exceptional operating items.

5. Payroll costs and employees

a) Payroll costs

	2005 £m	2004 (restated) £m
Wages and salaries	**374**	365
Social security costs	**32**	31
Pension costs (note 7)	**82**	93
	488	489
Less: Amounts capitalised	**(10)**	(14)
Payroll costs included in replacement expenditure	**(69)**	(59)
Payroll costs included in exceptional operating items	**(8)**	(6)
	401	410

In addition to the payroll costs above, there were severance costs of £70m (2004: £62m) included within other operating charges – exceptional items.

b) Number of employees

	2005 Average Number	2004 Average Number
United Kingdom	**11,159**	11,792

	31 Mar 2005 Number	31 Mar 2004 Number
United Kingdom	**11,063**	11,341

5. Payroll costs and employees (continued)

c) Share option and award schemes

National Grid Transco operates two principal forms of share option scheme in which the Group's employees and Directors participate. They are an employee sharesave scheme and an Executive Share Option Scheme ('the Executive Scheme'). The details given below relate to the schemes operated by National Grid Transco and the sharesave scheme formerly operated by Lattice. Following the Merger, most Lattice scheme options were converted into 0.375 National Grid Transco plc options. The remaining Lattice scheme options lapsed on 29 April 2003.

In any 10-year period, the maximum number of shares that may be issued or issuable pursuant to the exercise of options under all of the National Grid Transco share option schemes may not exceed the number of shares representing 10% of the issued ordinary share capital of National Grid Transco from time to time.

The sharesave scheme is savings related where, under normal circumstances, share options are exercisable on completion of a three or a five-year save-as-you-earn contract. The exercise price of options granted represents 80% of the market price at the date the option was granted.

The Executive Scheme applies to senior executives, including Executive Directors. Options granted for the 1999/2000 financial year are subject to the achievement of performance targets related to earnings per share growth over a three-year period and have now vested. Options granted for the 2000/01 financial year and thereafter are subject to the achievement of performance targets related to total shareholder returns over a three-year period. The share options are generally exercisable between the third and tenth anniversaries of the date of grant if the relevant performance target is achieved.

National Grid Transco also operates a number of share award schemes under which shares have been awarded to employees or Directors of the Group including a Performance Share Plan (PSP) and a Share Matching Plan.

Under the PSP, awards have been made to Executive Directors and approximately 150 senior employees who have significant influence over the Group's ability to meet its strategic objectives. Under the PSP awards are conditional on National Grid Transco's total shareholder return over a three year period. Awards are delivered in National Grid Transco plc ordinary shares. At 31 March 2005 the number of conditional awards of ordinary share equivalents outstanding under the PSP was 1,012,000 (2004: 513,000). The number of conditional awards during the year ended 31 March 2005 was 558,000 (2004: 513,000) with lapses/forfeits during the year of 58,000 (2004: nil) and exercises of 1,000 (2004: nil).

The Share Matching Plan applies to Executive Directors whereby a predetermined part of each Director's bonus entitlement is automatically deferred into National Grid Transco plc shares and a matching award may be made under the Plan after a three year period provided the Director is still employed by National Grid Transco. At 31 March 2005, the number of conditional awards of ordinary share equivalents outstanding under the Share Matching Plan was 33,000 (2004: 8,000) of which 2,000 (2004: nil) were exercisable. The number of conditional awards during the year ended 31 March 2005 was 25,000 (2004: 4,000) with exercises during the year of nil (2004: nil).

Movements in options to subscribe for ordinary shares under the Group's various options schemes for the two years ended 31 March 2005 are shown below and include those options related to shares issued to employee benefit trusts:

	Sharesave scheme options		Executive share scheme options		Total options
	Weighted average price £	millions	Weighted average price £	millions	millions
At 1 April 2003	3.31	27.0	4.54	0.5	27.5
Granted	3.17	7.1	–	–	7.1
Lapsed – expired	3.52	(3.6)	–	–	(3.6)
Exercised	3.16	(8.2)	–	–	(8.2)
At 31 March 2004	3.23	22.3	4.54	0.5	22.8
Granted	3.83	2.4	–	–	2.4
Lapsed – expired	3.25	(0.9)	4.34	(0.1)	(1.0)
Exercised	3.34	(2.0)	–	–	(2.0)
At 31 March 2005	**3.28**	**21.8**	**4.56**	**0.4**	**22.2**
Exercisable options included above:					
At 31 March 2005	**–**	**–**	**–**	**–**	**–**
At 31 March 2004	–	–	–	–	–

The weighted average share prices at the exercise dates were as follows:

	2005	2004
Sharesave scheme options	**4.49**	3.97
Executive share scheme options	**4.65**	3.99

The weighted average remaining contractual life of options in the employee sharesave scheme at 31 March 2005 was 2 years and 1 month. These options have exercise prices between £3.15 and £3.83.

5. Payroll costs and employees (continued)

c) Share option and award schemes (continued)

Options outstanding and exercisable and their weighted average exercise prices for the respective ranges of exercise prices and years at 31 March 2005 are as follows:

	Weighted average exercise price of exercisable options £	Number exercisable	Weighted average exercise price of outstanding options £	Number outstanding	Exercise price per share pence	Normal dates of exercise years
Executive scheme	3.76	14,000	3.76	14,000	375.8	2002 – 2009
	4.55	12,000	4.55	12,000	455.2	2003 – 2010
	5.32	39,000	5.32	39,000	531.5	2004 – 2011
	–	–	5.63	34,000	563.0	2005 – 2012
	4.34	24,000	4.40	349,000	434.3 – 481.5	2006 – 2013
	4.35	89,000	4.54	448,000		

Share based payment charges

Under UK GAAP, a charge is made to the profit and loss account based on the fair value of grants in accordance with FRS 20 'Share-based Payment'. All share awards are equity settled. The charge to the profit and loss account for the year ended 31 March 2005 was £7m (2004: £15m).

Awards under share option plans

Average share prices, exercise prices and fair values at the date of options being granted are as follows:

	2005	2004
Where the exercise price is less than the market price at date of grant:		
Average share price at date of grant	**496.0p**	400.0p
Average exercise price at date of grant	**334.8p**	317.0p
Average fair value at date of grant	**92.1p**	67.6p

The fair value of the options granted are estimated using the following principal assumptions:

	2005	2004
Dividend yield (%)	**5.5-5.8**	7.0
Volatility (%)	**15.4**	20.4
Risk-free investment rate (%)	**4.5**	4.6
Average life (years)	**4.0**	3.4

Fair values of awards under the Sharesave scheme have been calculated using the Black Scholes model. This is considered appropriate given the short exercise window of sharesave options.

Volatility has been derived based on the following:

(i) implied volatility in traded options over National Grid Transco's shares;
(ii) historical volatility of National Grid Transco's shares from October 2002 (the date of the merger of National Grid and Lattice); and
(iii) implied volatility of comparator companies where options in their shares are traded.

Volatility is assumed to revert from its current implied level to its long run mean, based on historical volatility under (ii) above.

Awards under other share scheme plans

The average share prices and fair values at the date share awards were granted during each financial year ended 31 March were as follows:

	2005	2004
Average share price	**431.7p**	407.8p
Average fair value	**210.6p**	390.3p

The fair value of the options granted are estimated using the following principal assumptions:

	2005	2004
Dividend yield (%)	**5.3-5.7**	7.0
Volatility (%)	**15.4**	20.4
Risk-free investment rate (%)	**4.5-5.2**	4.6

In 2004 the fair value of awards under the Performance Share Plan were estimated using the share price at the date of grant less an adjustment for dividends not payable in the vesting period. In 2005 fair values have been calculated using a Monte Carlo simulation model, which better reflects the total shareholder return performance conditions of the plan.

For other share scheme awards, where the primary vesting condition is that employees complete a specified number of years service, the fair value has been calculated as the share price at date of grant, adjusted to recognise the extent to which participants do not receive dividends over the vesting period.

Volatility on share awards has been calculated on the same basis as used for share options, described above.

6. Directors' emoluments

The aggregate amount of emoluments paid to Directors in respect of qualifying services for 2005 was £1,570,866 (2004: £1,420,185). The amount paid in respect of compensation for loss of office in 2005 was £nil (2004: £599,011). Directors' emoluments include amounts in respect of accrued bonus which had not yet been approved at the date of these accounts.

Two Directors exercised share options during 2005 (2004: 1 Director).

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 2005, retirement benefits were accruing to 5 Directors under a defined benefit scheme. The aggregate emoluments for the highest paid Director were £494,753 for 2005 (2004: £316,735); and total accrued annual pension at 31 March 2005 for the highest paid Director was £53,000 (2004: £22,800).

Details of Directors' interests in shares are contained on pages 16 and 17.

7. Pensions

Pension cost

Transco Holdings 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:

	2005 £m	2004 £m
Charged against operating profit	**82**	93
Charged within net interest	**11**	26
Total cost	**93**	119

There were no outstanding or prepaid pension contributions at 31 March 2005 (31 March 2004: £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 prior to 31 March 2002. A defined contribution section was added to the scheme from 1 April 2002 for employees joining 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 employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.

The latest full actuarial valuation was carried out 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%; that future real increases in pensionable earnings would be 1.5%; investments held in respect of pensions before they become payable would average 5.05% real annual rate of return; investments held in respect of pensions after they become payable would average 2.7% real 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.

The actuarial valuation carried out at 31 March 2003 showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 23.7% of pensionable earnings (20.7% employers and 3% employees). 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 2004 the rate used for the recovery of administration costs was 1.6% of salary, from 1 April 2005 the rate was 2.6% of salary. Employers are currently, therefore, paying a total contribution rate of 23.3%.

The actuarial valuation revealed that the pre-tax deficit was £879m (£615m net of tax) in the defined benefit section on the basis of the funding assumptions adopted by the actuary. An interim annual assessment of the Lattice Scheme was conducted at 31 March 2004. This assessment showed that the deficit has decreased in the defined benefit section on the basis of the funding 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 this 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 Holdings' share of these payments is £468m (£328m net of tax). Until the 31 March 2007 actuarial valuation has been completed, the National Grid Transco group has arranged for banks to provide the trustees of the Lattice 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 Lattice Group failing to make agreed payments into the fund.

SSAP 24 valuation assumptions

A further valuation of the Scheme was carried out at 31 March 2004, using the attained age method, to calculate the charge in accordance with SSAP 24. The result of this valuation was that the regular cost, as a percentage of salary, was 24.5%. The scheme deficit was £220m.

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 Holdings would have reported in the 12 months ended 31 March 2005 amounted to £139m (2004: £161m) of which £46m (2004: £42m) 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.

8. Net interest

	2005 £m	2004 £m
Bank loans and overdrafts	**18**	9
Other	**440**	396
	458	405
Interest capitalised	**(9)**	(12)
Unwinding of discount on provisions	**2**	6
Interest payable and similar charges net of interest capitalised	**451**	399
Interest receivable and similar income	**(20)**	(2)
	431	397

Interest on the funding attributable to assets in the course of construction was capitalised at a rate of 5.6% (2004: 5.7%).

9. Taxation

	2005 £m	2004 £m
United Kingdom current tax		
– Corporation tax at 30%	**100**	208
– Adjustment in respect of prior years (i)	**(43)**	(14)
Deferred tax		
– Current period	**7**	(14)
– Adjustment in respect of prior years	**27**	(27)
	91	153
Overseas tax	**1**	–
Taxation	**92**	153
Comprising:		
Taxation – excluding exceptional items	**136**	181
Taxation – exceptional items	**(44)**	(28)
	92	153

(i) The UK Corporation tax adjustment in respect of prior years includes a £5m (2004: £nil) charge that relates to exceptional items.

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

% of profit before taxation	2005	2004 (restated)
UK corporation tax rate	**30.0**	30.0
Effect on tax charge of:		
Origination and reversal of timing differences	**(2.7)**	2.0
Permanent differences	**1.9**	1.2
Current tax charge	**29.2**	33.2
Deferred taxation	**1.9**	(2.0)
Effective tax rate before tax adjustments in respect of prior years and exceptional items	**31.1**	31.2
Tax adjustments in respect of prior years	**(4.1)**	(5.8)
Effective tax rate before exceptional items	**27.0**	25.4
Exceptional items	**1.7**	(0.8)
Effective tax rate after exceptional items	**28.7**	24.6

Factors that may affect future tax charges

Transco has brought forward non-trading debits of £39m (2004: £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 £58m (31 March 2004: £46m). At present, it is not envisaged that any tax on amounts rolled over will become payable in the foreseeable future.

10. Dividends

	2005 £m	2004 £m
Ordinary shares:		
Interim dividend	**450**	301
Final dividend (proposed)	**2,000**	–
	2,450	301

Transco Holdings 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 credit rating.

11. 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 2004	76	10,848	159	698	11,781
Additions	6	312	102	43	463
Disposals	–	(20)	–	(4)	(24)
Reclassifications	3	127	(97)	(33)	–
Cost at 31 March 2005	85	11,267	164	704	12,220
Depreciation at 1 April 2004	(23)	(3,458)	–	(424)	(3,905)
Charge for the year	(4)	(321)	–	(79)	(404)
Disposals	–	20	–	4	24
Depreciation at 31 March 2005	(27)	(3,759)	–	(499)	(4,285)
Net book value at 31 March 2005	**58**	**7,508**	**164**	**205**	**7,935**
Net book value at 31 March 2004	53	7,390	159	274	7,876

The net book value of land and buildings comprises:

At 31 March	2005 £m	2004 £m
Freehold	**53**	48
Long leasehold	**1**	1
Short leasehold	**4**	4
	58	53

The cost of tangible fixed assets at 31 March 2005 includes £21m (2004: £12m) 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 £33m (2004: £34m) and £1,065m (2004: £1,000m) respectively.

12. Fixed asset investments
The Company

	Shares in subsidiary undertakings £m
Cost and net book value at 1 April 2004 and 31 March 2005	7,118

The names of the principal Group undertakings are included in note 27.

13. Stocks

The Group

At 31 March	**2005 £m**	2004 £m
Raw materials and consumables	**30**	32

14. Debtors

	Group		Company	
At 31 March	**2005 £m**	2004 £m	**2005 £m**	2004 £m
Amounts falling due within one year				
Trade debtors	**37**	16	**–**	–
Amounts owed by Group undertakings	**–**	–	**8**	–
Amounts owed by fellow subsidiary undertakings	**98**	51	**37**	41
Other debtors	**151**	90	**109**	109
Prepayments and accrued income	**223**	224	**–**	–
	509	381	**154**	150
Amounts falling due after more than one year				
Other debtors	**4**	–	**–**	–
Total debtors	**513**	381	**154**	150

15. Creditors (amounts falling due within one year)

	Group		Company	
At 31 March	**2005 £m**	2004 £m	**2005 £m**	2004 £m
Borrowings (note 17)	**1,764**	988	**126**	173
Trade creditors and accruals	**348**	362	**–**	–
Amounts owed to fellow subsidiary undertakings	**546**	698	**186**	421
Corporation tax	**27**	122	**–**	–
Social security and other taxes	**167**	164	**–**	–
Other creditors	**194**	196	**31**	24
Deferred income	**148**	199	**–**	–
Proposed dividend	**2,000**	–	**2,000**	–
	5,194	2,729	**2,343**	618

Other creditors include interest payable of £168m (2004: £136m).

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

	Group		Company	
At 31 March	**2005 £m**	2004 £m	**2005 £m**	2004 £m
Borrowings (note 17)	**4,780**	5,061	**1,384**	1,425
Amounts owed to Group undertakings	**–**	–	**2,644**	2,544
Deferred income	**1,101**	1,027	**–**	–
	5,881	6,088	**4,028**	3,969

Deferred income mainly comprises contributions to capital projects.

17. Borrowings

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

At 31 March	Group 2005 £m	Group 2004 £m	Company 2005 £m	Company 2004 £m
Amounts falling due within one year:				
Bank loans and overdrafts	**117**	100	**–**	–
Commercial paper	**1,103**	202	**–**	–
Bonds	**262**	494	**20**	–
Borrowings from fellow subsidiary undertakings	**267**	173	**106**	173
Other loans	**15**	19	**–**	–
	1,764	988	**126**	173
Amounts falling due after more than one year:				
Bank loans	**239**	–	**–**	–
Bonds	**4,531**	5,041	**1,384**	1,425
Other loans	**10**	20	**–**	–
	4,780	5,061	**1,384**	1,425
Total borrowings	**6,544**	6,049	**1,510**	1,598
Total borrowings are repayable as follows:				
In one year or less	**1,764**	988	**126**	173
More than one year, but not more than two years	**843**	257	**–**	–
More than two years, but not more than three years	**343**	886	**–**	–
More than three years, but not more than four years	**458**	292	**–**	–
More than four years, but not more than five years	**950**	458	**–**	–
More than five years – other than by instalments	**2,186**	3,168	**1,384**	1,425
	6,544	6,049	**1,510**	1,598

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 £83m (2004: £73m), including accretion of interest to 31 March 2005, in respect of a zero coupon bond due 2021, which had a market value of £299m (2004: £287m).

18. 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 10 and 12.

The Group's counterparty exposure under foreign currency swaps and foreign exchange contracts was £114m (2004: £146m) and interest rate swaps £16m (2004: £32m).

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 2005	**Total £m**	**Variable rate £m**	**Fixed rate £m**	**Weighted average interest rate %**	**Weighted average period for which rate is fixed Years**
Sterling					
Borrowings	**6,544**	**4,664**	**1,880**	**6.6**	**9**
Other financial liabilities	**16**	**16**	**–**	**–**	**–**
	6,560	**4,680**	**1,880**	**6.6**	**9**
At 31 March 2004					
Sterling					
Borrowings	6,049	3,496	2,553	6.2	8
Other financial liabilities	3	3	–	–	–
	6,052	3,499	2,553	6.2	8

18. Financial instruments (continued)

At 31 March 2005 the weighted average interest rate on short-term borrowings of £1,764m (2004: £988m) was 4.3% (2004: 4.6%).

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.

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.

			Fixed rate assets		
At 31 March 2005	**Total £m**	**Non-interest bearing £m**	**Fixed rate £m**	**Weighted average interest rate %**	**Weighted average period for which rate is fixed Years**
Sterling	**12**	**12**	**–**	**–**	**–**
US dollars	**3**	**–**	**3**	**2.8**	**–**
Other currencies	**1**	**–**	**1**	**2.0**	**–**
Cash and investments	**16**	**12**	**4**	**–**	**–**
At 31 March 2004					
Sterling	72	–	72	3.7	–
US dollars	2	–	2	1.1	–
Other currencies	1	–	1	2.0	–
Cash and investments	75	–	75	–	–

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	**2005 £m**	2004 £m
In one year or less	**1,771**	988
More than one year, but not more than two years	**846**	260
More than two years, but not more than three years	**345**	886
More than three years, but not more than four years	**459**	292
More than four years, but not more than five years	**951**	458
More than five years	**2,188**	3,168
	6,560	6,052

Maturity of financial assets at 31 March	**2005 £m**	2004 £m
In one year or less	**16**	75

Fair values of financial instruments at 31 March	**2005**		2004	
	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	**(1,762)**	**(1,769)**	(988)	(950)
Long-term borrowings	**(4,778)**	**(5,449)**	(5,006)	(5,659)
Financial assets	**16**	**16**	75	75
Financial instruments held to manage the interest rate and currency profile:				
Interest rate swaps	**–**	**(48)**	–	23
Forward foreign currency contracts and cross currency swaps	**(4)**	**78**	(58)	90

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.

18. 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 £2,349m (2004: £6,595m) and £1,808m (2004: £3,028m) 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 2004	264	(93)	171	88	(80)	8
(Gains)/losses arising in previous years recognised in the year	(24)	9	(15)	(7)	9	2
Gains/(losses) arising in previous years not recognised in the year	240	(84)	156	81	(71)	10
Gains/(losses) arising in the year	(132)	11	(121)	23	(5)	18
Gains and (losses) on hedges at 31 March 2005	**108**	**(73)**	**35**	**104**	**(76)**	**28**
Of which:						
Gains and (losses) expected to be recognised within one year	1	–	1	12	(13)	(1)
Gains and (losses) expected to be recognised after one year	107	(73)	34	92	(63)	29

Borrowing facilities

At 31 March 2005, the Group had undrawn committed borrowing facilities as shown below:

	2005 £m	2004 £m
In one year or less	**2,320**	758
More than one year, but not more than two years	**–**	575
	2,320	1,333

19. Provisions for liabilities and charges

	Company	Group				
	Deferred Taxation £m	Environmental £m	Restructuring £m	Deferred taxation £m	Other £m	Total £m
At 31 March 2004 (restated)	2	85	36	1,233	–	1,354
Charged to profit and loss account	–	9	174	34	5	222
Transferred to reserves	–	–	–	(2)	–	(2)
Utilised	–	(7)	(119)	–	–	(126)
Unwinding of discount	–	2	–	–	–	2
At 31 March 2005	**2**	**89**	**91**	**1,265**	**5**	**1,450**

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 2005, 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 with some 33% of the spend projected to be spent over the next five years. During the year ended 31 March 2005, a review of the provision was undertaken to take into account the impact of recent changes to the regulations on waste disposal. This review together with related revisions to the expected expenditure profile has resulted in an additional provision being made as an exceptional charge of £9m in the profit and loss account – see note 4.

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 2005 relating to gas site decontamination was £127m (2004: £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).

At 31 March 2005, £16m of the total restructuring provision (2004: £3m) 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.

19. Provisions for liabilities and charges (continued)

Deferred taxation comprises:

	Provided	
At 31 March	**2005 £m**	2004 (restated) £m
Accelerated capital allowances	**1,241**	1,250
Other timing differences	**24**	(17)
	1,265	1,233

20. Share capital

At 31 March	**Number of shares 2005 millions**	Number of shares 2004 millions	**2005 £m**	2004 £m
Authorised				
Ordinary shares of £1 each	**6,491**	6,491	**6,491**	6,491
Allotted and fully paid				
Ordinary shares of £1 each	**147**	147	**147**	147

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

21. Reserves

	Group		Company
	Other reserves £m	Profit and loss account reserve £m	Profit and loss account reserve £m
At 31 March 2004 (restated)	(5,537)	3,583	3,022
Employee share options	–	2	–
Retained loss for the year	–	(2,226)	(2,028)
At 31 March 2005	**(5,537)**	**1,359**	**994**

Transco Holdings 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, £422m (2004: loss of £2m) is attributable to the Company.

22. Reconciliation of movement in equity shareholders' funds

Group	**2005 £m**	2004 (restated) £m
Profit for the year	**224**	469
Dividends	**(2,450)**	(301)
	(2,226)	168
Employee share options	**–**	15
Deferred tax on employee share options	**2**	–
Net (decrease)/increase in equity shareholders' funds	**(2,224)**	183
Equity shareholders' funds (deficit) at the start of the year (restated)	**(1,807)**	(1,990)
Equity shareholders' funds (deficit) at the end of the year	**(4,031)**	(1,807)

23. Group cash flow statement

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

	2005 £m	2004 (restated) £m
Total operating profit	**747**	1,019
Exceptional operating items	**183**	90
Depreciation	**404**	423
Decrease/(increase) in stocks	**2**	(1)
Increase in debtors	**(48)**	(60)
Increase in creditors	**8**	137
Increase in provisions	**5**	–
Share-based payment charges	**–**	15
Cash inflow from operating activities before exceptional items	**1,301**	1,623

23. Group cash flow statement (continued)

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

	2005 £m	2004 £m
Movement in cash and overdrafts	**9**	7
Net cash (inflow)/outflow from the management of liquid resources	**(62)**	68
(Increase)/decrease in borrowings	**(492)**	335
(Increase)/decrease in net debt resulting from cash flows	**(545)**	410
Other non-cash movements	**(9)**	(18)
(Increase)/decrease in net debt in the year	**(554)**	392
Net debt at the start of the year	**(5,974)**	(6,366)
Net debt at the end of the year	**(6,528)**	(5,974)

c) Analysis of changes in net debt

	At 1 Apr 2003 £m	Cash flow £m	Other non-cash 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	(867)	473	(588)	(982)
Borrowings due after one year	(5,493)	(138)	570	(5,061)
		335		
	(6,366)	410	(18)	(5,974)

	At 1 Apr 2004 £m	Cash flow £m	Other non-cash movements £m	**At 31 Mar 2005 £m**
Cash at bank and in hand	–	3	–	**3**
Bank overdrafts	(6)	6	–	**–**
		9		
Current asset investments	75	(62)		**13**
Borrowings due within one year	(982)	(520)	(262)	**(1,764)**
Borrowings due after one year	(5,061)	28	253	**(4,780)**
		(492)		
	(5,974)	(545)	(9)	**(6,528)**

24. Related party transactions

Transco Holdings is a wholly owned subsidiary undertaking of National Grid Transco, which consolidates Transco Holdings within its publicly available financial statements. Transco Holdings is therefore exempt from disclosing transactions with other members of National Grid Transco group. There were no other material related party transactions (2004: £nil).

Amounts owed by other National Grid Transco group undertakings are shown in note 14 and amounts owed to other National Grid Transco group undertakings are shown in notes 15, 16 and 17.

25. Commitments and contingencies

a) Future capital expenditure

As at 31 March 2005, the Group had placed contracts for capital expenditure (tangible fixed assets) amounting to £313m (2004: £76m).

b) Lease commitments

At 31 March 2005, the Group's operating lease commitments for the financial year ending 31 March 2006 amounted to £17m (2004 commitments for 2005: £21m) and are analysed by lease expiry date as follows:

	Land and buildings		Other		Total	
At 31 March	**2005 £m**	2004 £m	**2005 £m**	2004 £m	**2005 £m**	2004 £m
Expiring:						
In one year or less	**–**	1	**–**	2	**–**	3
In more than one year, but not more than five years	**2**	2	**8**	4	**10**	6
In more than five years	**7**	12	**–**	–	**7**	12
	9	15	**8**	6	**17**	21

25. Commitments and contingencies (continued)

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

At 31 March	**2005 £m**	2004 £m
Amounts due:		
In one year or less	**17**	21
In more than one year, but not more than two years	**15**	17
In more than two years, but not more than three years	**11**	15
In more than three years, but not more than four years	**9**	12
In more than four years, but not more than five years	**8**	12
In more than five years	**50**	72
	110	149

c) Third party contingencies

The Group has outstanding BG Group related commitments and contingencies amounting to £13m at 31 March 2005 (2004: £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 2005 amounted to £127m (2004: £69m), including performance guarantees of £5m (2004: £24m) relating to certain property obligations of a National Grid Transco Group undertaking.

e) Parent company loan guarantees on behalf of Group undertakings

Transco, a subsidiary undertaking of Transco Holdings, 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 2005, the sterling equivalent amounted to £961m (2004: £1,222m).

f) Larkhall prosecution

Following a fatal accident at Larkhall, Lanarkshire in December 1999, in which four people died, Transco, a subsidiary undertaking of Transco Holdings, faces charges alleging breaches of sections 3 and 33 of the Health and Safety at Work Act 1974. The case is currently being tried in Edinburgh. The maximum penalty for breach of either of the above sections is an unlimited fine.

g) Cavendish Mill prosecution

Following a fatal accident at Cavendish Mill, Lancashire, in November 2001, in which one person died, Transco, a subsidiary undertaking of Transco Holdings, has been charged with a breach of Section 3 of the Health and Safety at Work Act 1974. The prosecution is ongoing. The maximum penalty for breach of this section is an unlimited fine.

26. Ultimate parent company

Transco Holdings plc's immediate parent company is Lattice Group plc. The ultimate parent company, and controlling party, is National Grid Transco plc, which is registered in England and Wales. Both Lattice Group plc and National Grid Transco plc consolidate the accounts of Transco Holdings plc. Copies of the consolidated accounts of Lattice Group 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.

27. Principal subsidiary undertakings

The principal subsidiary undertakings included in the Group accounts at 31 March 2005 are listed below. These undertakings are wholly-owned.

as at 31 March 2005	Country of operation and incorporation	Principal activity
Transco plc*	UK	Gas transportation
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
Blackwater SC A Limited	UK	Transportation services
Blackwater F Limited	UK	Transportation services
Blackwater 2 Limited	UK	Transportation services
Blackwater G Limited	UK	Transportation services

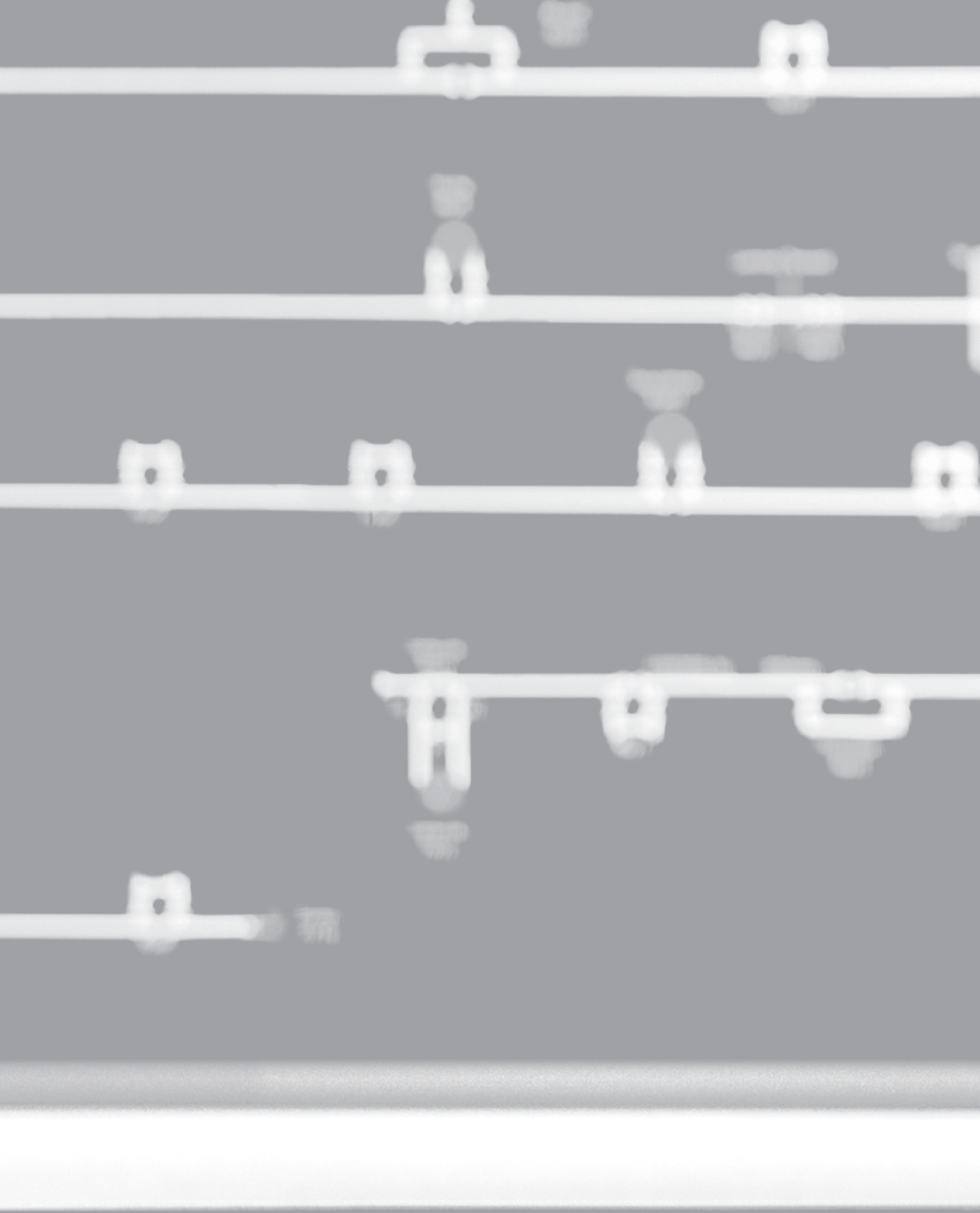
*Shares are directly held by the Company where marked with an asterisk; others are held by subsidiary undertakings.

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.

28. Subsequent events

On 1 June, the Group completed the sale of four of its regional gas distribution networks for £5.8 billion cash. The sales process has included the adoption of a new regulatory regime from Ofgem, the transfer of the networks into four new subsidiary companies on 1 May 2005 and obtaining separate gas transporter licences for each network. Ofgem gave unconditional approval to the sales on 25 May 2005, and the sales completed on 1 June 2005.

On 25 May 2005, Blackwater SC A Limited, Blackwater F Limited, Blackwater 2 Limited and Blackwater G Limited declared dividends totalling £22 million payable to Transco plc.



Transco Holdings plc

1-3 Strand, London WC2N 5EH, United Kingdom

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