

Phoenix Natural Gas Finance Plc

Directors' report and financial statements

Year ended 31 December 2010

Company registration number: NI 600904

Phoenix Natural Gas Finance Plc

Annual Report

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Phoenix Natural Gas Finance Plc

Directors and other information

Directors

P V Dixon
W F M McKinstry
I R Bell
A J Pollock

Secretary

W F M McKinstry

Auditors

KPMG
17/25 College Square East
Belfast
BT1 6DH

Bankers

Northern Bank
Donegall Square West
Belfast
BT1 6JS

Barclays Capital
5 The North Colonnade
Canary Wharf
London
E14 4BB

The Royal Bank of Scotland plc
135 Bishopsgate
London
EC2M 3UR

Registered office

197 Airport Road West
Belfast
BT3 9ED

Company registration number

NI 600904

Phoenix Natural Gas Finance Plc

Directors' report and business review

The directors have pleasure in submitting their Annual Report to the shareholders together with the audited financial statements for the year ended 31 December 2010.

Principal activities and strategy

The company was incorporated on 7 October 2009 as part of a group finance restructuring exercise.

During 2009 the company issued £275m of 5.5% bonds repayable in 2017, guaranteed by immediate parent company, Phoenix Natural Gas Limited, and its intermediate holding company Phoenix Distribution Holdings Limited. These bonds were rated BBB+ by Fitch and Baa2 by Moody's and the proceeds were used to repay existing acquisition debt providers across the Kellen Group, reorganise intercompany arrangements, repay fees and other costs and facilitate the return of any surplus to investors.

Going concern

The global financial crisis, market instability and unprecedented levels of illiquidity have resulted in the company operating in a challenging environment. The principal risks that the company faces, which the directors have considered in the context of continuing as a going concern, are described below and on page 12. The accounts continue to be prepared on a going concern basis, as the directors are satisfied that the company has access to the resources required to continue with existing business.

Business review and outlook

The company does not trade and acts as a financing company for fellow group undertakings. Consequently its performance is measured in terms of meeting interest payments and covenants attached to the bond issuance. The directors have no plans to change the operation of this company.

The loss after taxation for the year ended 31 December 2010 was £396,079 (period ended 31 December 2009: £89,694). Net liabilities at the year end amounted to £485,773 (period end 31 December 2009: £39,694). The directors do not recommend the payment of a dividend.

Accounting policies are disclosed on pages 12 to 14 of these financial statements. These have been applied consistently to all periods presented in these financial statements.

Risk management

The management of the business and the execution of the company's strategy are subject to a number of risks as set out below. Further details can be found in note 14.

Currency risk

All of the company's assets and liabilities, along with interest payments and administration expenses, are in sterling and as such the company is not exposed to currency risk.

Phoenix Natural Gas Finance Plc

Directors' report and business review

Interest rate risk

The company is not exposed to interest rate risk in that its borrowings have a fixed rate coupon.

Liquidity risk

The objective of liquidity management is to ensure the availability at all times, of sufficient funds to ensure all obligations are met. The company achieves this by maintaining sufficient cash balances.

Credit risk

Credit risk is defined as the risk that a customer will be unable or unwilling to meet a commitment that it has entered into and that pledged collateral does not fully cover the company's claims. As the company's receivables relate to fellow group undertakings the directors do not consider credit risk to be significant.

Directors

The directors who held office during the period were:

P V Dixon
W F M McKinstry
I R Bell
A J Pollock

W F M McKinstry is company secretary.

Political and charitable donations

The company made no political or charitable contributions during the period.

Capital Management

The company does not actively manage or review its capital requirements as it is not subject to externally imposed capital requirements. The company deems its capital to consist of 50,000 £1 ordinary shares.

Disclosure of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

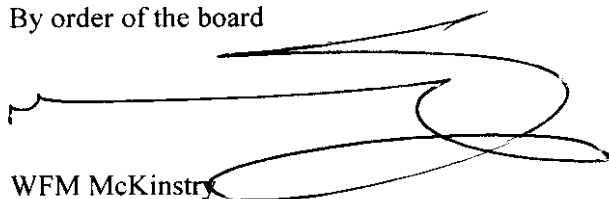
Phoenix Natural Gas Finance Plc

Directors' report and business review

Auditors

Pursuant to Section 487 of the Companies Act 2006, KPMG will be deemed to be reappointed and will therefore continue in office.

By order of the board

A handwritten signature in black ink, consisting of several loops and a long horizontal stroke, positioned above the printed name.

WFM McKinstry
Director
23rd June 2011

Phoenix Natural Gas Finance Plc

Statement of directors' responsibilities in respect of the directors' report and the financial statements

The directors are responsible for preparing the directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial period. Under that law the directors have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included in the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board



WFM McKinstry
Director
23rd June 2011

Phoenix Natural Gas Finance Plc

Independent auditors' report to the members of Phoenix Natural Gas Finance Plc

We have audited the financial statements of Phoenix Natural Gas Finance Plc for the year ended 31 December 2010 which comprise the statement of comprehensive income, the statement of financial position, the statement of changes in equity, the cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As described in the statement of Directors' responsibilities set out on page 5 the Company's directors are responsible for the preparation of the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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

Scope of the audit

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2010 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Independent auditors' report to the members of Phoenix Natural Gas Finance Plc

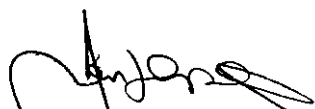
Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the directors' report is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Jon D'Arcy (Senior Statutory Auditor)
for and on behalf of KPMG, Statutory Auditor

Chartered Accountants
Stokes House
17-25 College Square East
Belfast
BT1 6DH

23 June 2011

Phoenix Natural Gas Finance Plc

Statement of comprehensive income

Period ended 31 December 2010

	<i>Notes</i>	2010 £'000	2009 £'000
Net operating expenses	2	(11)	(25)
Operating loss	3	(11)	(25)
Finance income	5	15,413	2,505
Finance expenses	5	(15,952)	(2,605)
Net financing expenses		(539)	(100)
Loss before income tax		(550)	(125)
Taxation	6	154	35
Loss for the period		(396)	(90)
Other comprehensive income		-	-
Total comprehensive loss		(396)	(90)

All of the results of the company derive from continuing operations.

There is no material difference between the company's results as reported and on a historical cost basis. Accordingly, no note of historical cost profits and losses has been reported.

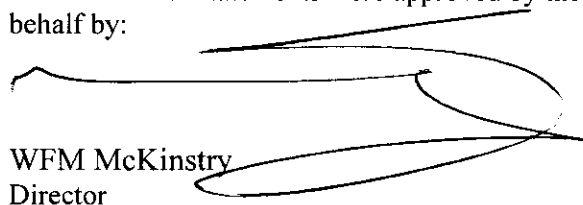
Phoenix Natural Gas Finance Plc

Statement of financial position

At 31 December 2010

	<i>Notes</i>	2010 £'000	2009 £'000
Current assets			
Current taxation		-	-
Trade and other receivables	7	274,797	269,900
Cash and cash equivalents	13	50	50
Total current assets		274,847	269,950
Total assets		274,847	269,950
Non current liabilities			
Interest bearing borrowings	8	(268,261)	(267,200)
Current liabilities			
Trade and other payables	9	(7,022)	(2,790)
Total liabilities		(275,283)	(269,990)
Net liabilities		(436)	(40)
Equity			
Share capital	10	50	50
Retained earnings		(486)	(90)
Total equity		(436)	(40)

These financial statements were approved by the board of directors on 23rd June 2011 and signed on its behalf by:


WFM McKinstry
Director

Company registration number: NI 600904

The notes on pages 12 to 19 form part of these financial statements.

Phoenix Natural Gas Finance Plc

Statement of changes in equity *Period ended 31 December 2010*

	Share capital £'000	Retained earnings £'000	Total equity £'000
At 1 January 2010	50	(90)	(40)
Total comprehensive loss for the period	-	(396)	(396)
	<hr/>	<hr/>	<hr/>
At 31 December 2010	50	(486)	(436)
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Phoenix Natural Gas Finance Plc

Statement of cash flows Period ended 31 December 2010

	<i>Notes</i>	2010 £'000	2009 £'000
<i>Cash flows from operating activities</i>			
Loss for the year		(396)	(90)
Adjustments for:			
Net finance costs		539	100
Income tax expense		(154)	(35)
		<hr/>	<hr/>
		(11)	(25)
Change in trade and other payables		4,908	373
Change in trade and other receivables		(4,897)	(360)
		<hr/>	<hr/>
Net cash outflow from operating activities		-	(12)
		<hr/>	<hr/>
<i>Cash flows from investing activities</i>			
Loans provided to parent undertaking		-	(267,000)
		<hr/>	<hr/>
Net cash from investing activities		-	(267,000)
		<hr/>	<hr/>
<i>Cash flows from financing activities</i>			
Bond issue receipts		-	267,012
Issue of shares		-	50
		<hr/>	<hr/>
Net cash from financing activities		-	267,062
		<hr/>	<hr/>
Net increase in cash and cash equivalents		-	50
Opening cash and cash equivalents		50	-
		<hr/>	<hr/>
Closing cash and cash equivalents	<i>13</i>	50	50
		<hr/> <hr/>	<hr/> <hr/>

Phoenix Natural Gas Finance Plc

Notes

(forming part of the financial statements)

General information

Phoenix Natural Gas Finance Plc (“the company”) is domiciled in the United Kingdom and its registered office is 197 Airport Road West, Belfast. The company has been set up as a finance vehicle for the restructuring of the group.

1 Accounting policies

Accounting convention

The financial statements have been prepared in accordance with International Financial Reporting Standards and International Accounting Standards (collectively, ‘IFRS’) issued by the International Accounting Standards Board (‘IASB’) as endorsed by the European Union (‘EU’).

The company’s activities are subject to certain risks as set on pages 2 and 3. The global financial crisis, and the deteriorating economic environment have increased the intensity of these risks. The directors have reviewed the company’s business and financial plan for 2010 and considered the critical assumptions underpinning same.

The accounts continue to be prepared on a going concern basis, as the directors are satisfied that the company has access to the resources to continue with existing business. The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Accounting estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of certain assets, liabilities, revenues and expenses and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Since management’s judgement involved making estimates concerning the likelihood of future events, the actual results could differ from those estimates.

Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future period affected. The estimate that has a significant effect on the financial statements and estimate with a significant risk of material adjustment in the next period is the area of impairment of financial assets. A description of the policy in this regard is set out in the accounting policies below.

Income tax, including deferred income tax

Income tax on the profit and loss for the period comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period using tax rates enacted or substantially enacted at the statement of financial position date and any adjustment to tax payable in respect of previous periods.

Deferred income tax is provided, using the statement of financial position liability method, on temporary timing differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax is determined using tax rates based on legislation enacted or substantially enacted at the statement of financial position date and expected to apply when the deferred tax asset is realised or the deferred tax liability is settled. Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences will be utilised.

Phoenix Natural Gas Finance Plc

Notes (continued)

1 Accounting policies

Income tax, including deferred income tax (continued)

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which the profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Trade and other receivables

Trade and other receivables are stated at their cost less impairment losses.

Impairment

The company makes provisions for impairment of financial assets to reflect the losses inherent in those assets at the statement of financial position date.

The carrying values of the company's assets, other than deferred tax and financial assets are revised at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

Share capital

Issued financial instruments, or their components, are classified as equity where there is no contractual obligation to transfer cash or other financial assets to the holder. They confer on the holder a residual interest in the assets of the company.

Cash and cash equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in profit or loss over the period of the borrowings on an effective interest basis.

Finance income and expenses

Financing expenses comprise interest payable on borrowings calculated using the effective interest rate method.

Interest income is recognised in profit or loss as it accrues, using the effective interest method.

Phoenix Natural Gas Finance Plc

Notes (continued)

1 Accounting policies

New standards and interpretations not yet applied

A number of new standards, amendments to standards, and interpretations are not yet effective for the year ended 31 December 2010 and have not been applied in preparing these financial statements. None of these standards will have a material effect on the financial statements.

2 Net operating expenses

	2010 £'000	2009 £'000
Professional fees	11	25

3 Net operating expenses

	2010 £'000	2009 £'000
Included within the loss on ordinary activities before taxation are as follows:		
Auditors' remuneration		
- Audit fees for financial statements	2	5

The auditors' remuneration of £2k for the financial statement audit is borne by a fellow group company.

4 Directors' emoluments

The company had no employees during the period other than the executive directors, whose emoluments were £Nil for the period. The directors of the company are employed and remunerated as employees of Phoenix Natural Gas, a fellow subsidiary of Kellen Investments Limited, in respect of their services to the group as a whole. The directors consider that the amount of time spent in their capacity as directors of Phoenix Natural Gas Finance Plc is not significant.

5 Finance income and expense

	2010 £'000	2009 £'000
Interest income on loans to group undertakings	15,413	2,505
Finance income	15,413	2,505
Interest expense on bonds	(15,952)	(2,605)
Finance expense	(15,952)	(2,605)
Net finance expense recognised in profit or loss	(539)	(100)

Phoenix Natural Gas Finance Plc

Notes *(continued)*

6 Taxation

Recognised in the income statement

	2010	2009
	£'000	£'000
<i>Current tax</i>		
UK corporation tax on loss for the period	(154)	(35)
Adjustment in respect of prior periods	-	-
	<hr/>	<hr/>
	(154)	(35)
	<hr/>	<hr/>
<i>Deferred tax</i>		
Origination and reversal of temporary differences	-	-
	<hr/>	<hr/>
	-	-
	<hr/>	<hr/>
Total credit in income statement	(154)	(35)
	<hr/> <hr/>	<hr/> <hr/>

Effective tax rate

The tax for the period is the same as the standard average rate of corporation tax in the UK (28%) as analysed below:

	2010	2009
	£'000	£'000
Loss before tax	(550)	(125)
	<hr/>	<hr/>
Corporation tax in the UK of 28% (2009: 28%)	(154)	(35)
Effects of:		
Difference between current tax rate and deferred tax rate on timing differences	-	-
Adjustment in respect of prior periods	-	-
	<hr/>	<hr/>
Total tax credit for the period	(154)	(35)
	<hr/> <hr/>	<hr/> <hr/>

Phoenix Natural Gas Finance Plc

Notes (continued)

7	Current trade and other receivables	2010	2009
		£'000	£'000
	Amounts due from group undertakings	274,797	269,900
		<hr/>	<hr/>
		274,797	269,900
		<hr/> <hr/>	<hr/> <hr/>
8	Interest bearing borrowings	2010	2009
		£'000	£'000
	<i>Current liabilities</i>		
	Bank loans	-	-
		<hr/>	<hr/>
		-	-
		<hr/> <hr/>	<hr/> <hr/>
	<i>Non-current liabilities</i>		
	Bond	275,000	275,000
	Less: transaction costs	(8,000)	(8,000)
	Add: amortisation of loan issue costs	1,261	200
		<hr/>	<hr/>
		268,261	267,200
		<hr/> <hr/>	<hr/> <hr/>

Terms and debt repayment schedule

The group had the following bond in issue at year end:

London, regulated market ISIN XS0462854687

The terms and conditions of outstanding loans were as follows:

	Currency	Nominal interest rate	Year of maturity	Face value £'000	Carrying amount £'000
Bond	GBP	5.5%	2017	275,000	268,261
				<hr/>	<hr/>
Total interest-bearing Borrowings				275,000	268,261
				<hr/> <hr/>	<hr/> <hr/>

The bond is guaranteed by Phoenix Natural Gas Limited (PNG) and Phoenix Distribution Holdings Limited (PDHL). Security is held over PDHL's assets, principally shares in PNG.

Phoenix Natural Gas Finance Plc

Notes (continued)

9 Trade and other payables

	2010 £'000	2009 £'000
Accruals	7,022	2,790

10 Share capital

	2010 £'000	2009 £'000
<i>Authorised, allotted, called up and fully paid</i> 50,000 ordinary shares of £1 each	50	50

50,000 ordinary shares of £1 each were issued on incorporation.

11 Commitments

There were no outstanding capital commitments at 31 December 2010.

12 Related party transactions

Transactions, arrangements and agreements involving directors and others

Key management personnel are those persons considered to have the authority and responsibility for planning, directing and controlling the activities of the company, directly or indirectly. Management consider that the only key management personnel are the directors, who take advice from the finance function within Phoenix Natural Gas Limited.

All directors' emoluments and key management personnel salaries are paid by Phoenix Natural Gas Limited directly and are not recharged to the company as the amount is not deemed to be significant. As a result, the company has not been required to disclose compensation paid to key management personnel.

Parent and group undertakings

The table below provides the balances that the company has with its parent and other group undertakings along with the transactions included in the income statement:

	Parent company £'000	2010 Group undertakings £'000
Statement of comprehensive income		
Interest receivable	15,413	-
Statement of financial position		
Amounts due from parent undertakings	274,797	-

Phoenix Natural Gas Finance Plc

Notes (continued)

13 Cash and cash equivalents

	2010 £'000	2009 £'000
Bank balances	50	50
Cash and cash equivalents	50	50

14 Financial instruments

The fair values of the financial assets and liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

	2010 Carrying Amount £'000	Fair value £'000
Assets		
Trade and other receivables	274,797	274,797
Cash and cash equivalents	50	50
Liabilities		
Trade and other payables	(7,022)	(7,022)
Loans and borrowings	(268,261)	(275,000)

Trade and other receivables

The fair value of trade and other receivables was estimated using discounted cash flows applying either market rates, where practicable, or rates currently offered by other financial institutions for placings with similar characteristics.

Cash and cash equivalents

Cash and cash equivalents consist of bank balances with the parent company with their carrying value being equal to their fair value.

Trade and other payables

The fair value of all trade and other payables is estimated using discounted cash flows applying either market rates, where applicable, or interest rates currently offered by the group.

Loans and borrowings

The fair value of loans and borrowings is estimated using discounted cash flows applying interest rates implicit in the underlying financial instrument.

Phoenix Natural Gas Finance Plc

Notes (continued)

14 Financial instruments (continued)

Liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments:

31 December 2010	Carrying amount	Contractual cash flows	6mths or less	6-12 mths	1-2 years	2-5 years	More than 5 years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Secured bank loans	268,261	380,875	7,562	7,563	15,125	45,375	305,250
Trade and other payables	7,022	7,022	7,022	-	-	-	-
	<u>275,283</u>	<u>388,015</u>	<u>15,780</u>	<u>7,563</u>	<u>15,125</u>	<u>45,375</u>	<u>305,250</u>
	=====	=====	=====	=====	=====	=====	=====
31 December 2009	Carrying amount	Contractual cash flows	6mths or less	6-12 mths	1-2 years	2-5 years	More than 5 years
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Secured bank loans	267,200	380,875	7,562	7,563	15,125	45,375	305,250
Trade and other payables	2,790	2,790	2,790	-	-	-	-
	<u>269,990</u>	<u>383,665</u>	<u>10,352</u>	<u>7,563</u>	<u>15,125</u>	<u>45,375</u>	<u>305,250</u>
	=====	=====	=====	=====	=====	=====	=====

Interest rate risk

At the reporting date the interest profile of the company's interest bearing financial instruments was:

	Carrying amount £'000
Fixed rate instruments	
Financial liabilities	(268,261)
Financial assets	274,797
Liabilities	
Trade and other payables	(7,022)

Fair value sensitivity analysis for fixed rate instruments

The company does not account for any fixed rate financial assets and liabilities at fair value through the profit and loss account, and the company does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit.

15 Parent company

The immediate parent company and controlling party is Phoenix Natural Gas Limited, a company registered in Northern Ireland. The smallest and largest group in which the financial statements of the company are consolidated is Kellen Investments Limited, a company registered in the United Kingdom. The accounts for Kellen Investments Limited are available from Companies House, Cardiff.